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CHAPARRAL RESOURCES INC
Form 10-Q
November 19, 2001

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, 2001

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.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

84-0630863

(State or Other Jurisdiction of
Incorporation or Organization)

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

16945 Northchase Drive, Suite 1620
Houston, Texas 77060

(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

As of November 19, 2001 the Registrant had 14,283,801 shares of its common
stock, par value \$0.0001 per share, issued and outstanding.

Part I - Summarized Financial Information

Item 1 - Financial Statements

Chaparral Resources, Inc.

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Consolidated Balance Sheets
(In Thousands)

	September 30, 2001 (Unaudited) -----	December 31, 2000 (Audited) -----
Assets		
Current assets:		
Cash and cash equivalents	\$ 29	\$ 604
Accounts receivable	--	30
Receivable from affiliate	--	265
Prepaid expenses	241	202
	-----	-----
Total current assets	270	1,101
Investment in KKM and other oil and gas property costs - full cost method Republic of Kazakhstan:	68,360	64,902
Furniture, fixtures and equipment	109	91
Less: accumulated depreciation	(58)	(41)
	-----	-----
	51	50
	-----	-----
Other assets		
Hedge agreement	392	3,518
Other	484	585
	-----	-----
Total other assets	876	4,103
	-----	-----
Total assets	\$ 69,557 =====	\$ 70,156 =====

See accompanying notes.

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

	September 30, 2001 (Unaudited) -----	Decem 2000 (Au -----
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable	\$ 563	\$
Accrued liabilities:		
Accrued compensation	415	
Accrued interest and other	200	
Shell Capital loan, current portion net of discount	32,328	
	-----	-----
Total current liabilities	33,506	

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Shell Capital loan, net of discount	--	
Redeemable preferred stock- cumulative, convertible, Series A 75,000 designated, 50,000 issued and outstanding, At stated value, \$5.00 cumulative annual Dividend, \$5,937,000 redemption value	5,813	
Stockholders' equity:		
Common stock - authorized, 100,000,000 shares of \$0.0001 par value; issued and outstanding, 14,283,801 and 14,283,634 shares as of September 30, 2001 and December 31, 2000, respectively	1	
Capital in excess of par value	94,061	
Preferred stock - 1,000,000 shares authorized, 925,000 shares undesignated. Issued and outstanding - none	--	
Accumulated deficit	(63,824)	
Total stockholders' equity	30,238	
Total liabilities and stockholders' equity	\$ 69,557	\$

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 September 30, 2001	September 30, 2000	For t Septembe 2001
Revenue	\$ --	\$ --	\$
Costs and expenses:			
Depreciation and depletion	250	116	
General and administrative	940	1,054	
	1,190	1,170	
Loss from operations	(1,190)	(1,170)	(
Other income (expense):			
Interest income	371	2	
Interest expense	(6,312)	(22,597)	(1
Equity in income from investment	1,208	736	
Hedge gains/(losses)	158	--	
Other	--	3	
	(4,575)	(21,856)	(
Loss before cumulative effect of change in accounting principle	(5,765)	(23,026)	(
Cumulative effect of change in accounting principle	--	--	(
Net loss	\$ (5,765)	\$ (23,026)	\$ (1

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	=====	=====	=====
Cumulative annual dividend accrued			
Series A Redeemable Preferred Stock	(63)	(63)	
Discount accretion			
Series A Redeemable Preferred Stock	(25)	(25)	
	-----	-----	-----
Net loss available to common stockholders	\$ (5,853)	\$ (23,114)	\$ (1,000)
	=====	=====	=====
Basic and diluted earnings per share:			
Loss per share before cumulative			
effect of change in accounting principle	\$ (0.41)	\$ (10.88)	\$ (10.88)
Cumulative effect of change in			
accounting principle	\$ --	\$ --	\$ --
Net loss per share	\$ (0.41)	\$ (10.88)	\$ (10.88)
Weighted average number of shares			
outstanding (basic and diluted)	14,283,801	2,124,083	14,283,801

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,	September 30,
	2001	2000
	-----	-----
Cash flows from operating activities		
Net loss	\$ (11,426)	\$ (26,000)
Adjustments to reconcile net loss to		
Net cash used in operating activities:		
Equity income from investment	(4,213)	(1,000)
Depreciation, depletion, and amortization	694	
Gain on the sale of oil and gas properties	--	
Loss on disposition of furniture and fixtures	--	
Cumulative effect of change in		
accounting principal	2,519	
Hedge losses	607	
Stock options issued for services and bonuses	--	
Interest expense attributable to beneficial		
conversion	--	20,000
Interest expense converted into capital	--	
Interest expense from transfer of net profits		
interest	4,369	
Amortization of debt issuance cost	540	
Amortization of note discount	--	
Changes in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	295	
Prepaid expenses	(39)	
Accrued interest income on advances to KKM	(1,185)	
Interest payments from KKM	3,913	
Hedge agreement	--	(4,000)
Other	--	

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Increase (decrease) in:		
Accounts payable and accrued liabilities	376	(2)
Interest expense reclassified as principal on the Shell Capital loan	4,260	2
	-----	-----
Net cash provided (used) in operating activities	710	(10)
	-----	-----
Cash flows from investing activities		
Additions to furniture, fixtures and equipment	\$ (18)	\$
Investment in and advances to KKM and other oil and gas property costs	(6,917)	(19)
Proceeds from sale of interest in oil and gas properties - domestic	--	
	-----	-----
Net cash used in investing activities	(6,935)	(19)
	-----	-----

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

	For the Nine Months Ended September 30, 2001	September 30, 2000
	-----	-----
Cash flows from financing activities		
Net proceeds from Shell Capital loan	\$ 5,650	\$ 2
Net proceeds from note conversion	--	1
Debt issuance cost	--	
Restricted cash	--	
	-----	-----
Net cash provided by financing activities	5,650	3
	-----	-----
Net (decrease) increase in cash and cash equivalents	(575)	
Cash and cash equivalents at beginning of period	604	
	-----	-----
Cash and cash equivalents at end of period	\$ 29	\$
	=====	=====
Supplemental cash flow disclosure		
Interest paid	\$ 669	\$
Supplemental schedule of non-cash investing and financing activities		
Stock warrant issued to Shell Capital	--	
Notes payable converted to common stock	--	2

See accompanying notes.

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Chaparral Resources, Inc.
Notes to Consolidated Financial Statements (continued)
(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 oilfield 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 100% owned subsidiaries, Central Asian Petroleum (Guernsey) Limited ("CAP-G"), 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 through CAP-D. As discussed in Note 7, Shell Capital Incorporated ("Shell Capital") owns a 40% interest in the distributable profits of CAP-G. Hereinafter, Chaparral and its subsidiaries are collectively referred to as the "Company." All significant intercompany transactions have been eliminated.

CAP-G owns a 50% interest in Closed Type JSC Karakudukmunay ("KKM"), a Kazakhstan joint stock company, which holds the rights for the exploration, development and production of oil in the Karakuduk Field in Western Kazakhstan. KKM is owned jointly by CAP-G (50%), KazakhOil JSC ("KazakhOil") (40%) and a private Kazakhstan joint stock company (10%). KazakhOil, the national petroleum company of Kazakhstan, is owned by the government of the Republic of Kazakhstan. The Company shares control of KKM through participation on KKM's board of directors.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. Reference should be made to the notes to the financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.

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 to a 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.

2. New Accounting Standards

In June 1998, the FASB issued SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities. This standard provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. This statement, as amended by SFAS No. 137 and 138, is effective for years beginning after June 15, 2000. On January 1, 2001, the Company adopted SFAS No. 133.

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

2. New Accounting Standards (continued)

As a result of adoption of SFAS 133, the Company recognizes all derivative financial instruments in the consolidated 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 stockholders' 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. The Company's put contracts entered into as part of its loan agreement (the "Loan") with Shell Capital Incorporated ("Shell Capital"), do not qualify for hedge accounting under SFAS 133. Therefore, effective January 1, 2001, the Company adjusted the carrying value of the contracts to their fair value of \$999,000, recognizing a loss from the cumulative effect of adoption of approximately \$2.52 million.

During 2001, the FASB has issued the following pronouncements, which have potential future accounting implications for the Company:

SFAS 141, Accounting for Business Combinations, requires the use of the purchase method of accounting for all business combinations and provides new criteria to determine whether an acquired intangible asset should be recognized. SFAS 141 applies to all business combinations initiated after June 30, 2001 and to all business combinations accounted for by the purchase method that are completed after June 30, 2001.

SFAS 142, Accounting for Goodwill and Intangible Assets, requires that goodwill as well as other intangible assets with indefinite lives be tested annually for impairment. SFAS 142 is effective for fiscal years beginning after December 15, 2001.

SFAS 143, Accounting for Asset Retirement Obligations, 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. SFAS 143 is effective for fiscal years beginning after June 15, 2002.

SFAS 141 and 142 will not apply to the Company unless it enters into a future business combination. The Company is currently assessing the impact of SFAS 143 on its financial condition and results of operations.

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 incurred recurring operating losses in previous years and has a working capital deficiency as of September 30, 2001. In addition, the Company is in default under the Loan with Shell Capital, which could result in the loss of the Company's investment in the Karakuduk Field (see Note 7). These conditions raise substantial doubt about the

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Company's 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.

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

3. Going Concern (continued)

The Company is seeking to alleviate these conditions by restructuring the terms of the Loan with Shell Capital, including obtaining a waiver of all existing events of default, obtaining additional sources of equity or debt financing, and increasing cash flows available from the sale of crude oil production from the Karakuduk Field. No assurances can be provided, however, that the Company will be able to restructure the Loan or successfully generate enough liquidity to meet the working capital requirements necessary to conduct ongoing operations. Shell Capital has reserved its right to exercise all remedies available under the Loan, including calling the Loan immediately due and payable, seizing the Company's investment in the Karakuduk Field, or retaining future proceeds from oil sales currently being utilized by the Company to fund operations. The Company requires Shell Capital's approval before it can raise any additional equity or debt financing from other sources, which may hinder the Company's attempts to raise the necessary working capital to continue operations if the Company's negotiations with Shell Capital are unsuccessful. If the Company is unable to re-negotiate the Loan with Shell Capital, the Company's investment in the Karakuduk Field may be lost.

4. Restatement of Quarter and Nine Months Ended September 30, 2000

The Company's net loss available to common stockholders for the quarter ended September 30, 2000 has been restated from \$23.13 million to \$23.11 million, or by \$0.01 per share of common stock. The adjustment is due to KKM's restatement of proved oil reserves as of December 31, 1999 to reflect the SEC's definition of proved undeveloped reserves versus the definition as accepted by the Society of Petroleum Engineers. Specifically, the restated amounts represent proved undeveloped reserves from "drilling units offsetting productive units that are reasonably certain of production when drilled" or from "other undrilled units...where it can be demonstrated with certainty that there is a continuity of production from the existing productive formation." As a result of the restatement, the Company's equity income from investment for the quarter ended September 30, 2000 was increased by \$88,000 to reflect adjustments to KKM's net income for the period (see Note 9). The Company recognized an additional \$77,000 in depreciation and depletion expense for the quarter ended September 30, 2000 due to the resulting increase in the effective depletion rate attributable to the Company's acquisition costs of its equity interest in KKM. Equity income from investment for the quarter ended September 30, 2000 also reflects the elimination of \$442,000 in interest income from KKM to eliminate 100% of intercompany transactions due to the application of EITF 99-10, Percentage Used to Determine the Amount of Equity Method Losses. The reclassification of interest income did not impact the Company's net loss for the period.

The Company's net loss available to common stockholders for the nine months

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ended September 30, 2000 was restated from \$26.85 million to \$26.63 million, or by \$0.17 per share of common stock, based on KKM's restatement of proved oil reserves as of December 31, 1999 discussed above. The Company's equity income from investment for the nine months ended September 30, 2000 was increased by \$377,000 to reflect adjustments to KKM's net income for the period (see Note 9). The Company recognized an additional \$149,000 in depreciation and depletion expense due to the resulting increase in the effective depletion rate attributable to the Company's acquisition costs of its equity interest in KKM. Equity income from investment for the nine months ended September 30, 2000, as adjusted, also reflects the elimination of \$1.17 million in interest income from KKM to eliminate 100% of intercompany transactions due to the application of EITF 99-10, Percentage Used to Determine the Amount of Equity Method Losses. The reclassification of interest income did not impact the Company's net loss for the period.

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

5. Hedge Agreement

As a condition of the Loan, the Company paid \$4 million for put contracts to sell 1,562,250 barrels of North Sea Brent crude (the "Hedge Agreement") to hedge price risk of future sales of oil production from the Karakuduk Field. The exercise prices of the various put contracts in the Hedge Agreement range from \$22.35 to \$17.25 per barrel, with monthly expiration dates beginning in October 2000 and ending in December 2002. The contracts are evenly spread between October 2000 to December 2001 (62,750 barrels per month) and between January 2002 to December 2002 (51,750 barrels per month). Beginning in October 2000, the Company amortized the Hedge Agreement ratably over the period the underlying contracts expired, recognizing \$482,000 in hedge losses as of December 31, 2000.

As discussed in Note 2, the Company adopted SFAS 133 effective January 1, 2001, which requires derivative financial instruments be recorded at their fair value. Accordingly, the Company recognized a \$2.52 million loss from the cumulative effect of change in accounting principle upon adoption. In addition, the Company recognized \$607,000 in losses for the nine months ended September 30, 2001 to record the Hedge Agreement at its fair value as of that date in accordance with SFAS 133.

6. Other Assets

In March 2000, the Company paid \$750,000 to Shell Capital for a beneficial interest in Shell Capital's policy for transportation risk insurance, covering certain circumstances whereby KKM would be unable to export crude oil production outside of the Republic of Kazakhstan through the existing pipeline routes currently available. In the event coverage under Shell Capital's policy is triggered, proceeds from the policy would go to the benefit of the Company for use in making principal and interest payments required under the Loan. The Company is amortizing the transportation risk insurance over the life of the Loan. The Company has recognized cumulative amortization expense of \$271,000 on the transportation risk policy, of which \$101,000 was incurred during the nine months ended September 30, 2001.

7. Shell Capital Loan

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In November 1999, the Company entered into the Loan with Shell Capital, to provide up to \$24 million of financing for the development of the Karakuduk Field. CAP-D, CAP-G, and KKM also signed the Loan as co-obligors. As of September 30, 2001, the Company had drawn down the entire \$24 million principal balance available under the Loan.

The Loan accrues interest at an annual rate of the London Interbank Offered Rate ("LIBOR") plus 17.75%, compounding quarterly prior to project completion ("Project Completion"). Prior to Project Completion, an interest amount, equal to annual rate of LIBOR plus .50%, is payable quarterly to Shell Capital. The annual interest rate is reduced to LIBOR plus 12.75% after Project Completion. The remaining unpaid interest is added to the Loan balance at the end of each quarter. After Project Completion, all quarterly interest on the outstanding Loan is fully due and payable by the Company at the end of each calendar quarter.

Per the terms of the Loan, Project Completion occurs when various conditions are met by the Company and KKM, including, but not limited to: (i) receipt by Shell Capital of an independent engineer's reserve report evidencing proved developed reserves of at least 30 million barrels in the Karakuduk Field, (ii) sustaining average gross production of 13,000 barrels of oil per day from the Karakuduk Field for a period of 45 consecutive days, (iii) sustaining water injection at an average rate of 15,000 barrels per day over 45 consecutive days, (iv) injection of lift gas into one well over a 24 hour period, and (v) various other financial and technical milestones.

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

7. Shell Capital Loan (continued)

In May 2001, the Loan was amended to provide the Company with up to \$8.0 million in uncommitted working capital, which could be drawn down in increments of \$250,000 through August 31, 2001, at the sole discretion of Shell Capital (the "Bridge Loan"). The Company borrowed a total of \$3.15 million under the Bridge Loan through August 31, 2001. The principal borrowed under the Bridge Loan accrues interest at LIBOR plus 17.75% and is subject to an arrangement fee of 2%. Interest payments in the amount of LIBOR plus .50% are due at the end of each month the Bridge Loan is outstanding. All unpaid interest is added to the outstanding principal balance on each repayment date. The outstanding principal of the Bridge Loan, plus all accrued interest, was due on or before September 30, 2001.

As an incentive for the Company to repay the Bridge Loan or refinance the entire Loan (including the Bridge Loan), Chaparral's board of directors approved CAP-G's issuance of Series A Preferred shares to Shell Capital. Per the terms of the amendment, if the Company failed to repay or refinance the Bridge Loan on or before September 30, 2001, the Series A Preferred shares automatically convert and entitle Shell Capital to 40% of the distributable profits of CAP-G.

As of September 30, 2001, the Company was in default of the Loan for failure to pay outstanding principal and interest due on the Bridge Loan totaling \$3.34 million on or before September 30, 2001, failure to make an interest payment

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totaling \$189,280 due September 28, 2001, failure to achieve Project Completion by September 30, 2001, failure to settle certain accounts payable within 90 days, KKM's failure to obtain Shell Capital's approval prior to entering a short-term debt arrangement, and failure to maintain listing of the Company's common stock on one of the major stock exchanges (i.e. Nasdaq, NYSE, or AMEX). The Company had previously obtained a waiver from Shell Capital regarding the delisting of its common stock from the Nasdaq SmallCap Market, subject to the Company not incurring another event of default under the Loan. Shell Capital terminated the waiver due to the other events of default discussed above. The Company subsequently repaid all outstanding default interest due on both the Loan and Bridge Loan and KKM repaid the short-term indebtedness obtained without Shell Capital's approval.

As a result of the Company's failure to timely repay the Bridge Loan, Shell Capital's Series A Preferred shares in CAP-G converted as of October 1, 2001, entitling Shell Capital to 40% of the distributable profits of CAP-G. The Company recorded an additional loan discount of \$4.37 million, equal to 40% of the Company's unamortized costs of acquiring its equity interest in CAP-G, which is estimated to approximate the fair value of the net profits interest transferred to Shell Capital. The discount was fully recognized as interest expense on September 30, 2001, the maturity date of the Bridge Loan.

The Company and Shell Capital are in active negotiations to restructure the Loan and Shell Capital has not exercised any of its remedies available under the Loan, except for charging a default interest rate of LIBOR plus 19.75% on the outstanding principal balance of the Bridge Loan. The Company is attempting to restructure the Loan, including obtaining a waiver of all existing events of default and re-acquiring Shell Capital's 40% interest in the distributable profits of CAP-G. However, there can be no assurances that the Company will be able to re-negotiate the Loan on acceptable terms, if at all. If not, Shell Capital could exercise its remedies available under the Loan, including calling the entire Loan immediately due and payable.

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

7. Shell Capital Loan (continued)

The Loan subjects the Company to a significant number of restrictions, including various representations and warranties, positive and negative covenants, and events of default, which are more fully described in the Company's Form 10-K for the year ended December 31, 2000. In general, the Company has pledged substantially all of its assets to Shell Capital as collateral for the Loan and has committed to not engage in any other business activity besides the development of the Karakuduk Field without Shell Capital's approval.

As of September 30, 2001, the outstanding Loan balance (including the Bridge Loan) of \$32.33 million is comprised of \$27.15 million in cash borrowings plus \$7.74 million of interest added to the balance as additional principal, net of \$2.56 million in unamortized discount. Interest expense for the nine months ended September 30, 2001 totaled \$10.01 million, including \$5.13 million of interest on outstanding principal and \$4.88 million in discount amortization. Due to the fact the Loan is currently in default, the Company recorded the

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entire outstanding principal balance of the Loan as a current liability in the Company's financial statements.

8. Common Stock

On August 9, 2001, the Company's common stock was delisted from the Nasdaq SmallCap Market for failure to comply with Nasdaq Marketplace Rules 4350(i)(1)(A), 4350(i)(1)(B) and 4350(i)(1)(D)(ii), which required the Company to obtain stockholder approval prior to the conversion of its 8% Non-Negotiable Subordinated Convertible Promissory Notes into 11,690,259 shares of its common stock on September 21, 2000 and the issuance of 1,612,903 shares of common stock on October 30, 2000. Nasdaq also cited a violation of its annual meeting requirement. The Nasdaq Listing Qualifications Panel did not, however, cite any public interest concerns as a basis for its determination. The Company's common stock is being traded on the OTC Bulletin Board. The Company's failure to maintain listing of its common stock on one of the major stock exchanges (i.e. NASDAQ, NYSE, or AMEX), is an event of default under the Loan (see Note 7).

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

9. Investments

The results from operations of the Company's equity-based investment in KKM are summarized below:

Closed Type JSC Karakudukmunay
Statement of Expenses and Accumulated Deficit
For the Periods Ended September 30, 2001 and 2000
(Amounts in Thousand US Dollars)
(Unaudited)

	For The Three Months Ended		For Th
	September 30, 2001	September 30, 2000(2)	Septembe 2001
Revenues:			
Oil Sales(1)	\$ 6,916	\$ 4,341	\$ 24,9
Costs and expenses:			
Transportation expenses	1,234	714	5,0
Operating expenses	812	1,521	3,3
Depreciation and depletion	1,828	884	5,8
Management service fee	144	173	4
General and administrative	711	615	2,7
Total cost and expenses	4,729	3,907	17,3

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Income from operations	2,187	434	7,5
Other income (expense):			
Interest income	\$ 3	\$ 14	\$
Interest expense from affiliates	(514)	(596)	(1,4
Other	1	--	(
	-----	-----	-----
Net income (loss)	\$ 1,677	\$ (148)	\$ 6,0
Accumulated deficit, beginning of period	(6,223)	(12,591)	(10,6
	-----	-----	-----
Accumulated deficit, end of period	\$ (4,546)	\$ (12,739)	\$ (4,5
	=====	=====	=====

- (1) Revenue is presented gross of transportation expenses in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs.
- (2) As discussed in Note 4, KKM's net loss for the quarter ended September 30, 2000 has been restated from \$236,000 to \$148,000 to reflect additional interest capitalization of \$287,000 and additional depreciation and depletion expense of \$199,000 during the period.
- (3) As discussed in Note 4, KKM's net loss for the nine months ended September 30, 2000 has been restated from \$1,109,000 to \$732,000 to reflect additional interest capitalization of \$806,000 and additional depreciation and depletion expense of \$429,000 during the period.

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

9. Investments (continued)

During the quarter ended September 30, 2001, KKM sold approximately 385,000 barrels of crude oil for \$6.92 million in revenue. Export sales for the period were approximately 345,000 barrels of crude oil for approximately \$6.57 million. To fulfill government requirements, KKM also sold approximately 40,000 barrels on the local market for approximately \$350,000. Approximately 226,000 barrels of crude oil were held in crude oil inventory as of September 30, 2001.

During the nine months ended September 30, 2001, KKM sold approximately 1.36 million barrels of crude oil for approximately \$24.91 million in revenue. Export sales for the period were approximately 1.06 million barrels of crude oil for approximately \$22.21 million. To fulfill government requirements, KKM also sold approximately 295,000 barrels on the local market for approximately \$2.70 million.

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The Company's equity income or loss from investment in KKM represents its share of KKM's net income or loss for the respective period after applying EITF 99-10, adjusted for the elimination of the Company's proportional share of inter-company interest charged by the Company to KKM during the period.

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

1. Liquidity and Capital Resources

General Liquidity Considerations.

Going Concern

Our financial statements have been presented on the basis Chaparral is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. We are responsible for providing 100% of the funding for the development of the Karakuduk Field not provided from oil sales or third party sources. We have recognized recurring operating losses and have a working capital deficiency as of September 30, 2001. In addition, Chaparral is in default under its loan with Shell Capital, which could result in the loss of our investment in the Karakuduk Field.

We are seeking to alleviate these conditions by restructuring the terms of the loan with Shell Capital, including obtaining a waiver of all outstanding defaults, obtaining additional sources of equity or debt financing, and increasing cash flows available from the sale of crude oil production from the Karakuduk Field. No assurances can be provided, however, that we will be able to restructure the loan or successfully generate enough liquidity to meet the working capital requirements necessary to conduct ongoing operations. Shell Capital has reserved the right to exercise all remedies available under the loan, including calling the loan immediately due and payable, seizing our investment in the Karakuduk Field, or retaining future proceeds from oil sales currently being utilized by Chaparral and KKM to fund operations. We require Shell Capital's approval before we can raise any additional equity or debt financing from other sources, which may hinder our ability to raise the necessary working capital to continue operations if our negotiations with Shell Capital are unsuccessful. If we are unable to re-negotiate our loan with Shell Capital, our investment in the Karakuduk Field may be lost.

Liquidity and Capital Resources

We are presently engaged in the development of the Karakuduk Field, which requires substantial cash expenditures for drilling costs, well completions, workovers, oil storage and processing facilities, pipelines, gathering systems, plant & equipment (generators, pumps, communications, etc.) and other field facilities. We have invested approximately \$59 million in the development of the Karakuduk Field and have drilled or re-completed 35 productive wells, including 16 wells subsequent to December 31, 2000. Total capital expenditures for 2001 are estimated to be approximately \$22.5 million in comparison to total capital expenditures of \$23.6 million incurred in 2000. Capital expenditures are estimated to be at least \$60.0 to \$80.0 million for the period from 2002 through 2005, including drilling approximately 28 more well locations through this time

period.

We expect to finance the continued development of the Karakuduk Field primarily through cash flows from the sale of crude oil. During the nine months ended September 30, 2001, KKM sold approximately 1.36 million barrels of crude oil for \$19.90 million, net of transportation costs. As of November 19, 2001, daily production, net of royalty, is approximately 8,300 barrels per day from 22 of the 35 productive wells in the Field. The remaining 13 wells are shut-in for various reasons, including installation of additional gathering lines and well equipment (4 wells) and additional workover and well stimulation operations to bring wells on to primary production (8 wells). Another shut-in well is being considered for future use as an injection well for a pilot waterflood project. KKM's maximum daily production is also restrained by certain field facility constraints, including the lack of adequate storage capacity at the export pipeline pumping station. KKM is presently installing a larger tank battery, which is expected to alleviate this problem during the first quarter of 2002. In the short-term, we expect to increase and maintain net daily production of approximately 8,500 barrels of oil per day through the first quarter of 2002 as these various restrictions are addressed. No assurances may be provided, however, that production constraints will be alleviated as expected, due to potential factors such as delays in obtaining necessary regulatory approvals, inaccessibility of contractors and materials needed for construction, and adequate working capital to timely fund field operations.

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Our highest operational priority in the short-term is to alleviate production constraints to obtain a level of operational cash flow sufficient to fund our cash requirements. We anticipate up to \$5 million in additional working capital will be necessary to achieve this objective. Chaparral and KKM have also initiated cost reduction measures to avoid incurring any unnecessary overhead or operating expenses. Primarily, KKM has suspended drilling operations as of October 2001 to allow the ongoing facilities development program to catch up to current and future productive capacity and allow further analysis of available geological data to most efficiently complete the development of the Karakuduk Field. Subject to restructuring the loan with Shell Capital (see below), we expect drilling operations to resume during 2002.

Our short and long-term operational liquidity is also impacted by local oil sales obligations, imposed by the government of Kazakhstan on oil and gas producers to supply local energy needs. Under the terms of its agreement with the government, KKM has a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. Through November 19, 2001, however, KKM was required by the government to sell approximately 18.5% of its crude oil on the domestic market. The domestic market does not permit world market prices to be obtained, resulting in approximately \$6.0 to \$8.0 less cash flow per barrel on 2001 local oil sales. We are taking steps to reduce our local market obligations, including petitioning the government to enforce our rights under KKM's agreement and seeking an exemption from all local market obligations during the early stages of development of the Karakuduk Field. While management believes we will be successful in reducing KKM's local sales requirements, some level of future local market obligation is expected for all oil and gas producers in Kazakhstan, including KKM. If we are unsuccessful in reducing or eliminating our future local sales obligations, we may be required to initiate legal proceedings within Kazakhstan or make a claim under our political risk insurance policy for the breach of our agreement by the government of Kazakhstan. We can provide no assurances that legal proceedings within Kazakhstan would be successful, or that any potential insurance proceeds available under our political risk policy would fully offset losses incurred due

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to additional local sales requirements. The initiation of formal legal proceedings could lead to more material restrictions of our contractual rights, including our right to develop the Karakuduk Field or sell any of our crude oil production on the export market whatsoever.

Shell Capital loan.

As of November 19, 2001, our most significant outstanding indebtedness is our loan with Shell Capital. We entered into the loan on November 1, 1999, to provide up to \$24 million of financing for the development of the Karakuduk Field, drawing down a total of \$21.5 million of the facility as of December 31, 2000 and the remaining \$2.5 million as of May 2001.

The loan accrues interest at an annual rate of LIBOR plus 17.75%, compounding quarterly prior to project completion. Prior to project completion, an interest amount, equal to annual rate of LIBOR plus .50%, is payable quarterly to Shell Capital. The annual interest rate is reduced to LIBOR plus 12.75% after project completion. The remaining unpaid interest is added to the loan balance at the end of each quarter. After project completion, all quarterly interest on the outstanding loan is fully due and payable at the end of each calendar quarter.

Per the terms of the loan, project completion occurs when various conditions are met by us and KKM, including, but not limited to: (i) receipt by Shell Capital of an independent engineer's reserve report evidencing proved developed reserves of at least 30 million barrels in the Karakuduk Field, (ii) sustaining average gross production of 13,000 barrels of oil per day from the Karakuduk Field for a period of 45 consecutive days, (iii) sustaining water injection at an average rate of 15,000 barrels per day over 45 consecutive days, (iv) injection of lift gas into one well over a 24-hour period, and (v) various other financial and technical milestones.

In May 2001, the loan was amended to provide Chaparral with up to \$8.0 million in uncommitted working capital as a bridge loan, which could be drawn down in increments of \$250,000 through August 31, 2001, at the sole discretion of Shell Capital. We borrowed a total of \$3.15 million under the bridge loan through August 31, 2001. The principal borrowed under the bridge loan accrues interest at LIBOR plus 17.75% and is subject to an arrangement fee of 2%. Interest payments in the amount of LIBOR plus .50% are due at the end of each month the bridge loan is outstanding. All unpaid interest is added to the outstanding principal balance on each repayment date. The outstanding principal of the bridge loan, plus all accrued interest, was due on or before September 30, 2001.

As an incentive for Chaparral to repay the bridge loan or refinance the entire loan (including the bridge loan), Chaparral's board of directors approved CAP-G's issuance of Series A Preferred shares to Shell Capital. Per the terms of the amendment, if Chaparral failed to repay or refinance the bridge loan on or

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before September 30, 2001, the Series A Preferred shares automatically convert and entitle Shell Capital to 40% of the distributable profits of CAP-G.

As of September 30, 2001, Chaparral was in default of the loan for failure to pay outstanding principal and interest due on the bridge loan totaling \$3.34 million on or before September 30, 2001, failure to make an interest payment totaling \$189,280 due September 28, 2001, failure to achieve project completion by September 30, 2001, failure to settle certain accounts payable within 90 days, KKM's failure to obtain Shell Capital's approval prior to entering a short-term debt arrangement, and failure to maintain listing of Chaparral's

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common stock on one of the major stock exchanges (i.e. Nasdaq, NYSE, or AMEX). We had previously obtained a waiver from Shell Capital regarding the delisting of our common stock from the Nasdaq SmallCap Market, subject to not incurring another event of default under the loan. Shell Capital terminated the waiver due to the other events of default discussed above. Chaparral subsequently repaid all outstanding default interest due under the loan and bridge loan, and KKM repaid the short-term indebtedness obtained without Shell Capital's approval.

As a result of our failure to timely repay the bridge loan, Shell Capital's Series A Preferred shares in CAP-G converted as of October 1, 2001, entitling Shell Capital to 40% of the distributable profits of CAP-G. We have recorded an additional loan discount of \$4.37 million, equal to 40% of Chaparral's unamortized costs of acquiring its equity interest in CAP-G, which is estimated to approximate the fair value of the net profits interest transferred to Shell Capital. The discount was fully recognized as interest expense on September 30, 2001, the maturity date of the bridge loan.

We are in active negotiations to restructure the loan with Shell Capital, which has not exercised any of its remedies available under the loan, except for charging a default interest rate of LIBOR plus 19.75% on the outstanding principal balance of the bridge loan. We are attempting to restructure the loan, including obtaining a waiver of all existing events of default and re-acquiring Shell Capital's 40% interest in the distributable profits of CAP-G. However, there can be no assurances that we will be able to re-negotiate the loan on acceptable terms, if at all. If not, Shell Capital could exercise its remedies available under the loan, including calling the entire loan immediately due and payable.

The loan subjects us to a significant number of restrictions, including various representations and warranties, positive and negative covenants, and events of default. These restrictions include, but are not limited to, the following:

- o Pledge of Assets. We pledged substantially all of our assets to Shell Capital, including our interest in the Karakuduk Field. If an event of default occurs under the loan and is not timely cured, Shell Capital is entitled to remedies, including the right to accelerate repayment of the loan and obtain our rights to the Karakuduk Field.
- o Business Alteration. We cannot engage in any other business except the ownership of KKM and the operation of the Karakuduk Field without the prior consent of Shell Capital.
- o Change in Control. We cannot enter into any transaction where a "group" as defined in the Securities Exchange Act of 1934 acquires or otherwise gains control of 20% or more of our outstanding shares of voting stock. Some transactions are exempt from this restriction, including the conversion of our outstanding Series A Preferred Stock, the exercise of the Shell warrant, and a grant of non-statutory or statutory options to purchase up to 15% of our outstanding common stock to our officers, directors, employees, and consultants (subject to anti-dilution provisions). Furthermore, it is an event of default under the loan if Allen & Company and Whittier Ventures let their ownership in us fall below 20%, unless otherwise agreed with Shell Capital.
- o Charged Accounts. We must retain all cash receipts from oil sales, proceeds from the loan, and any other funds raised through approved equity or debt offerings in pledged bank accounts (the "Charged Accounts"). The Charged Accounts are controlled by Shell Capital. We retain title to the Charged Accounts, but Shell Capital directs all cash movements at our request. On a monthly basis, we request transfers of funds from the Charged Accounts into specific operating

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accounts controlled directly by us or by KKM, respectively.

- o Cash Expenditures. We must expend funds in accordance with capital and operating budgets approved by Shell Capital on an annual basis, unless otherwise approved by Shell Capital.

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- o Project Completion. KKM was required to reach project completion on or before September 30, 2001. Failure to reach project completion is an existing event of default under the loan.
- o Share Capital. We cannot purchase, issue, or redeem any of our share capital without the prior approval of Shell Capital.
- o Future Indebtedness. We cannot borrow money, other than trade debt, without the approval of Shell Capital.
- o Sale of Significant Assets. We cannot dispose of any significant assets, including capital stock in our subsidiaries, without the approval of Shell Capital.
- o Leases. Without Shell Capital's approval, KKM cannot enter into any lease or license arrangement with annual payments in excess of \$1.0 million and Chaparral will not enter into any lease or license arrangement with annual payments in excess of \$200,000.
- o Dividends. KKM cannot pay dividends prior to project completion, and then only subject to Shell Capital's approval. We cannot pay any dividends without Shell Capital's consent.
- o OPIC Insurance. We must maintain political risk insurance with the Overseas Private Investment Company ("OPIC") throughout the duration of the loan.
- o Hedge Agreement. We will not cancel or terminate the hedging contracts entered into as part of the loan or enter into any other hedging transaction without Shell Capital's consent.
- o Market Listing. Chaparral is required to list its common stock on either the Nasdaq Stock Market, American Stock Exchange or the New York Stock Exchange. The delisting of Chaparral's common stock from the Nasdaq SmallCap Market in August 2001 is an event of default under the loan.

As of September 30, 2001, the outstanding loan balance (including the bridge loan) of \$32.33 million is comprised of \$27.15 million in cash borrowings plus \$7.74 million of interest added to the balance as additional principal, net of \$2.56 million in unamortized discount. Interest expense for the nine months ended September 30, 2001 totaled \$10.01 million, including \$5.13 million of interest on outstanding principal and \$4.88 million in discount amortization. As the loan is in default, the entire outstanding principal balance is recorded as a current liability.

The terms and conditions and related financing costs of the loan are significant. We estimate approximately \$42 to \$51 million of future cash flows will be necessary to fully repay the loan and all accrued interest and fees thereon, depending upon the amount of excess cash flows available from operations, if any, to repay the loan prior to scheduled repayments. Future cash

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flows from operations required for debt service will not be available for other purposes. Our ability to obtain additional debt or equity financing in the future for working capital, capital expenditures, or acquisitions is also restricted, as well as our ability to acquire or dispose of significant assets or investments. These restrictions may make us more vulnerable and less able to react to adverse economic conditions. The failure of Chaparral to restructure the loan, including the waiver of all existing defaults and to re-acquire Shell Capital's 40% interest in CAP-G, could result in the loss or significant impairment of our investment in the Karakuduk Field.

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Capital Commitments and Other Contingencies

Our operations may be subject to other regulations 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 drilling permits and production rates. Drilling permits could become difficult to obtain or prohibitively expensive. Production rates could be set so low that they would make production unprofitable. These regulations may substantially increase the costs of doing business and may prevent or delay the starting or continuation of any given exploration or development project.

All regulations are subject to future changes by legislative and administrative action and by judicial decisions. Such changes could adversely affect the petroleum industry in general, and us in particular. It is 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, 2001 Compared to the Three Months Ended September 30, 2000.

We account for our investment in KKM using the equity method.

Our operations for the quarter ended September 30, 2001 resulted in a net loss of \$5.77 million, compared to a net loss of \$23.03 million for the quarter ended September 30, 2000. The \$17.26 million decrease primarily relates to interest expense from non-recurring transactions in our attempts to finance the development of the Karakuduk Field. Alternatively, we recognized \$1.21 million in net equity income from our investment in KKM, reflecting KKM's increase in the production and sale of crude oil during the quarter.

Interest expense decreased from \$22.60 million for the quarter ended September 30, 2000 to \$6.31 million for the quarter ended September 30, 2001. Interest expense for the current period reflects additional loan discount of \$4.37 million recorded and fully amortized as of September 30, 2001 due to the transfer of a 40% interest in the distributable profits of CAP-G to Shell Capital for our failure to repay a \$3.15 million bridge loan to Shell Capital on or before September 30, 2001. See Note 7 of the consolidated financial statements. Interest expense for the quarter ended September 30, 2000 reflects a non-recurring, non-cash interest charge of \$20.34 million recognized upon conversion of our notes with an aggregate principal amount of \$20.85 million into 11,690,259 shares of Chaparral's common stock. The notes' conversion feature, at \$1.86 per share, was a "beneficial conversion feature" as addressed in EITF 98-5. EITF 98-5 required the recognition of additional interest expense

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equal to the face value of the notes, net of original discount of \$506,000, upon conversion of the notes.

Interest income increased \$369,000 to \$372,000 for the three months ended September 30, 2001, due to the impact of EITF 99-10, Percentage Used to Determine the Amount of Equity Method Losses, on the equity method income or losses recognized by Chaparral. We eliminate inter-company interest income from KKM based upon the proportion of equity income or losses recognized from KKM for the respective period. During the three months ended September 30, 2000, we recognized 100% of KKM's equity method income and, therefore, eliminated 100% of our interest income from KKM. As of December 31, 2000, we had recaptured all non-proportional EITF 99-10 losses and currently recognize income from KKM based on our proportional 50% interest. Therefore, 50% of our interest income from KKM was eliminated against equity method income for the quarter ended September 30, 2001.

General and administrative costs decreased from \$1.05 million for the three months ended September 30, 2000 to \$940,000 for the three months ended September 30, 2001, primarily due to a reduction in professional fees during the current period.

Depreciation and depletion expense increased by \$134,000 to \$250,000 for the three months ended September 30, 2001, due to the increase in oil production from the Karakuduk Field. Our depreciation and depletion expense was \$116,000 for the three months ended September 30, 2000.

Our equity income from investment was \$1.21 million for the three months ended September 30, 2001, compared to \$736,000 for the three months ended September 30, 2000. During the three months ended September 30, 2001, KKM sold approximately 385,000 barrels of crude oil, recognizing \$6.92 million in revenue, or \$17.96 per barrel. Associated operating costs were \$812,000, or \$2.11 per barrel, and associated transportation costs were \$1.23 million, or \$3.21 per barrel. During the three months ended September 30, 2000, KKM sold approximately 183,000 barrels of crude oil, recognizing \$4.34 million in revenue, or \$23.72 per barrel. Associated operating costs were \$1.52 million, or \$8.31 per barrel, and associated transportation costs were \$714,000, or \$3.90 per barrel. Our equity income or loss from investment also reflects the elimination of \$370,000 and \$907,000 of inter-company interest income on our loan to KKM for the three months ended September 30, 2001 and 2000, respectively.

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Results of Operations for the Nine Months Ended September 30, 2001 Compared to the Nine Months Ended September 30, 2000.

We account for our investment in KKM using the equity method.

Our operations for the nine months ended September 30, 2001 resulted in a net loss of \$11.43 million, compared to a net loss of \$26.36 million as of September 30, 2000. The \$14.93 million net decrease in our loss from operations primarily relates to interest expense from non-recurring transactions in our attempts to finance the development of the Karakuduk Field and the impact of the adoption of SFAS 133, Accounting for Derivative Instruments and Hedging Activities as of January 1, 2001. Alternatively, equity income from our investment in KKM increased by \$2.61 million due to KKM's significant increase in the production and sale of crude oil during the period.

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Interest expense decreased from \$25.29 million for the nine months ended September 30, 2000 to \$10.01 million for the nine months ended September 30, 2001. Interest expense for the current period reflects additional loan discount of \$4.37 million recorded and fully amortized as of September 30, 2001, due to the transfer of a 40% interest in the distributable profits of CAP-G to Shell Capital for failure to repay a \$3.15 million bridge loan to Shell Capital on or before September 30, 2001. See Note 7 of the consolidated financial statements. Interest expense for the quarter ended September 30, 2000 reflects a non-recurring, non-cash interest charge of \$20.34 million recognized upon conversion of our notes with an aggregate principal amount of \$20.85 million into 11,690,259 shares of Chaparral's common stock. The notes' conversion feature, at \$1.86 per share, was a "beneficial conversion feature" as addressed in EITF 98-5. EITF 98-5 required the recognition of additional interest expense equal to the face value of the notes, net of original discount of \$506,000, upon conversion of the notes.

As a result of the adoption of SFAS 133, we recognized a loss of \$2.52 million as a cumulative effect of change in accounting principal and an additional loss of \$607,000 for the nine months ended September 30, 2001 to record the derivatives at their fair value as of the end of the period. See Note 2 to our consolidated financial statements.

Interest income increased \$1.18 million from \$10,000 for the nine months ended September 30, 2000 to \$1.19 million for the nine months ended September 30, 2001. The increase was due to additional financing of KKM's operations in Kazakhstan and the impact of EITF 99-10, Percentage Used to Determine the Amount of Equity Method Losses, on the equity method income or losses recognized by Chaparral. We eliminate inter-company interest income from KKM based upon the proportion of equity income or losses recognized from KKM for the respective period. During the nine months ended September 30, 2000, we recognized 100% of KKM's equity method losses and, therefore, eliminated 100% of our interest income from KKM. As of December 31, 2000, we have recaptured all non-proportional EITF 99-10 losses and recognize income from KKM based on our proportional 50% interest. Therefore, 50% of our interest income from KKM was eliminated against equity method income for the nine months ended September 30, 2001.

General and administrative costs increased from \$2.52 million for the nine months ended September 30, 2000 to \$3.10 million for the nine months ended September 30, 2001. The \$579,000 increase was due to approximately \$262,000 in additional insurance expense for premiums on our OPIC political risk insurance policy required by Shell Capital as part of the loan and a \$271,000 increase in professional fees associated with the development of the Karakuduk Field.

Depreciation and depletion expense increased by \$363,000 to \$593,000 for the nine months ended September 30, 2001, due to the increase in oil production from the Karakuduk Field. Our depreciation and depletion expense was \$230,000 for the nine months ended September 30, 2000.

Our equity income from investment was \$4.21 million for the nine months ended September 30, 2001, compared to \$1.60 million for the nine months ended September 30, 2000. During the nine months ended September 30, 2001, KKM sold approximately 1.36 million barrels of crude oil, recognizing \$24.91 million in revenue, or \$18.34 per barrel. Associated operating costs were \$3.31 million, or \$2.44 per barrel, and associated transportation costs were \$5.02 million, or \$3.69 per barrel. During the nine months ended September 30, 2000, KKM sold approximately 409,000 barrels of crude oil, recognizing \$8.89 million in revenue, or \$21.75 per barrel. Associated operating costs were \$2.32 million or \$5.66 per barrel, and associated transportation costs were \$1.78 million, or \$4.36 per barrel. Our equity income or loss from investment also reflects the elimination of \$1.19 million and \$2.35 million of inter-company interest income on our loan to KKM for the nine months ended September 30, 2001 and 2000,

respectively.

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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 effectively maintain oil prices through 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. Recent events regarding the ongoing military efforts and terrorist activities in Afghanistan and abroad, combined with the significant prospect of a global economic recession, may adversely impact crude oil prices obtainable by KKM for the sale of its crude oil production on both the export and local markets.

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 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 its cash and cash equivalents in U.S. dollars in an offshore bank account outside of 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. As of September 30, 2001, the exchange rate was 147.7 tenge per U.S. dollar.

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. 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 and in our Form 10-K for the year ended December 31, 2000, which is incorporated by reference as part of this report. These factors may cause our actual results to differ materially from any forward-looking statement.

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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 to conform these statements to actual results.

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Item 3 - Quantitative and Qualitative Disclosures About Market Risks

We are subject to various market risks, including interest rate risk and commodity price risk.

Our loan is subject to a variable quarterly interest rate based upon LIBOR plus 17.75%. As of September 30, 2001, the outstanding loan balance subject to interest was approximately \$34.89 million. During the nine months ended September 30, 2001, the high, low, and average interest rates applicable against the loan were 24.27%, 21.41%, and 22.58%, respectively. The terms of the loan are more fully described in Note 7 of our consolidated financial statements. An increase in applicable interest rates will result in a corresponding increase in the interest costs associated with the loan.

Under the original terms of the loan, we must begin repaying the principal balance of the loan on December 31, 2001. The loan stipulates the minimum principal repayments required, but also requires all excess cash flows available from crude oil sales be utilized to repay the loan as quickly as possible. Earlier repayment of the loan results in significantly less interest expense charged on the loan. KKM's ability to generate excess cash flows is dependent upon many factors, including production rates, access to export markets to sell our crude oil production, and the available commodity price of crude oil. Lower crude oil prices could significantly reduce cash flows earned by KKM, which would otherwise be used to prepay the loan. We estimate approximately \$42 million to \$51 million of net cash flows from oil sales will be required to repay the loan depending upon excess cash flows available to repay principal earlier than scheduled.

To hedge the risk of a drop in commodity prices, we entered into the hedge agreement as part of the loan, paying \$4 million for put contracts to sell a total of 1,562,250 barrels of North Sea Brent crude. The exercise prices of the various put contracts range from \$22.35 to \$17.25 per barrel, with monthly expiration dates beginning in October 2000 and ending in December 2002. The contracts are evenly spread between October 2000 to December 2001 (62,750 barrels per month) and between January 2002 to December 2002 (51,750 barrels per month). During the nine months ended September 30, 2001, the high, low, and average price of the hedge agreement was \$999,000, \$234,000, and \$617,000, respectively. As of September 30, 2001, the put contracts had a fair market value of \$392,000. If oil prices drop below the exercise prices of the put contracts, we will generate some income from the hedge contracts. We cannot sell the contracts under the terms of the loan, however, without Shell Capital's approval.

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Item 3 - Defaults Upon Senior Securities

Chaparral has incurred various material defaults on its loan with Shell Capital, including the failure to pay outstanding principal and interest due on the bridge loan totaling \$3.34 million on or before September 30, 2001, failure to make an interest payment totaling \$189,280 due September 28, 2001, failure to achieve project completion by September 30, 2001, failure to settle certain accounts payable within 90 days, KKM's failure to obtain Shell Capital's approval prior to entering a short-term debt arrangement, and failure to maintain the listing of Chaparral's common stock on one of the major stock exchanges (i.e. Nasdaq, NYSE, or AMEX). We had previously obtained a waiver from Shell Capital regarding the delisting of our common stock from the Nasdaq SmallCap Market, subject to not incurring another event of default under the loan. Shell Capital terminated the waiver due to the other events of default discussed above. Chaparral subsequently repaid all outstanding interest due under the loan and bridge loan, and KKM repaid the short-term indebtedness obtained without Shell Capital's approval. Default principal and interest in arrears as of November 19, 2001, totaled approximately \$3.32 million. See Note 7 to our consolidated financial statements.

We are attempting to restructure the loan with Shell Capital, including obtaining a waiver of all existing events of default and reacquiring Shell Capital's 40% interest in the distributable profits of CAP-G. However, there can be no assurances that we will be able to re-negotiate the loan on acceptable terms, if at all. If not, Shell Capital could exercise its remedies available under the loan, including calling the entire loan immediately due and payable. If we are unable to restructure the loan with Shell Capital, our investment in the Karakuduk Field may be lost.

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Item 6 - Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K

We filed a Current Report on Form 8-K, dated August 16, 2001 to report delisting of Chaparral's common stock by the Nasdaq SmallCap Market as of August 9, 2001, and the subsequent waiver of the delisting as an event of default under Chaparral's loan agreement with Shell Capital on August 13, 2001.

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.

Dated: November 19, 2001

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Chaparral Resources, Inc.

By: /s/ Michael B. Young

Michael B. Young, Treasurer, Controller
and Principal Accounting Officer