CHAPARRAL RESOURCES INC
Form 10-K
March 23, 2006

FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the fiscal year ended December 31, 2005.

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.) |

2 Gannett Drive, Suite 418
White Plains, New York 10604
(Address of Principal Executive Offices)

Registrant's telephone number, including area code: (866) 559-3822

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value $.0001 Per Share
(Title of Class)

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 (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES |X| NO |_|

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. |_|

Indicate by check mark whether the registrant is an accelerated filer.

YES |_| NO |X|

As of June 30, 2005, the aggregate market value of registrant's voting common stock, par value $.0001 per share, held by non-affiliates was $39,737,883.

As of March 17, 2006, registrant had 38,209,502 shares of its common stock, par value $.0001 per share, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: Form 8-K filed with the Securities and Exchange Commission on March 14, 2006 is incorporated by reference in Items 1 and 15.

TABLE OF CONTENTS

PART IV



PART I

ITEM 1. BUSINESS

Our Business

Chaparral Resources, Inc. is an independent oil and gas development and production company. Our strategy is to maximize stockholder returns from existing assets. Through intermediate holding companies, Central Asian Petroleum (Guernsey) Ltd., a Guernsey company ("CAP-G"), Korporatsiya Mangistau Terra International Limited ("MTI"), a Kazakhstan company, and Central Asian Petroleum, Inc., a Delaware company ("CAP-D"), we own a 60% interest in ZAO Karakudukmunay ("KKM"), a Kazakh limited liability company that holds a governmental license to develop the Karakuduk Oil Field. All references to "Chaparral," "we," "us," and "our" refer to Chaparral Resources, Inc., and Chaparral's greater than 50% owned subsidiaries, unless indicated otherwise.

Since 1995, the business of Chaparral has been the development of the Karakuduk Field, a 16,900-acre oil field in the Republic of Kazakhstan. The U.S. based oil and gas assets of Chaparral were divested during 1996 and 1997 to help fund the development of the Karakuduk Field. The Government of the former Soviet Union discovered the Karakuduk Field in 1972 and drilled 22 exploratory and development wells, none of which produced commercially. KKM began to aggressively develop the Karakuduk Field in early 2000, re-establishing oil production from a majority of the existing wells and drilling a total of 23 new wells through to September 2001. In February 2003, KKM commenced a new drilling campaign to further develop and commercially produce the oil reserves in the Karakuduk Field. By the end of 2005 the well stock had risen to 61 producing wells, 9 water injection wells and 9 wells that were temporarily shut in, plus one well awaiting completion at year end.

In December 2004 KazMunayGaz JSC ("KMG"), the state owned national petroleum and transportation company of the Republic of Kazakhstan, which owned a 40% interest in KKM, sold its entire interest in KKM to Nelson Resources Limited ("Nelson"). Since May 2004, Nelson has owned approximately 60% of the outstanding common stock of Chaparral. On October 14, 2005 LUKOIL Overseas Holding Limited ("LUKOIL Overseas"), a wholly owned subsidiary of OAO LUKOIL ("LUKOIL") acquired a 65% interest in Nelson. On December 5, 2005 LUKOIL Overseas acquired the remaining shares of Nelson. On the same date Nelson was amalgamated with Caspian Investments Resources Limited ("Caspian") and Nelson ceased to exist.

Currently, the Karakuduk Field is our only oil field. We have no other significant subsidiaries other than CAP-G, MTI and CAP-D.

Merger

On March 13, 2006 Chaparral announced that it had entered into an agreement with LUKOIL Overseas to effect a merger into a wholly owned subsidiary of Lukoil. On the effective date of this merger, all issued and outstanding common stock of Chaparral will be exchanged for $5.80 per share in cash. The transaction is subject to the approval of a meeting of stockholders expected to be held in May

2006 and certain other conditions including the receipt of all regulatory approvals and consents. Further details are contained within the form 8-K filed by the Company with the SEC on March 14, 2006, which is incorporated herein by reference.

On March 14, 2006, a lawsuit was filed in the Court of Chancery in the State of Delaware in and for New Castle County by Robert Kelly against Chaparral, LUKOIL Overseas and the directors of Chaparral requesting among other things, that the suit be designated a class action in favor of stockholders, that the merger be declared unlawful and unenforceable because it was entered into in breach of the individual defendants' fiduciary duties and that the merger be enjoined. This summary and description of the Robert Kelly complaint is qualified in its entirety by reference to the complaint, which has been filed as Exhibit 99.2 to this Form 10-K.

## Available Information

Chaparral files Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and registration statements and other items with the Securities and Exchange Commission (SEC). Chaparral provides access free of charge to all of these SEC filings, as soon as reasonably practicable after



filing, on its Internet site located at www.chaparralresources.com. Chaparral will also make available to any stockholder, for a nominal fee, copies of its Annual Report on Form 10-K as filed with the SEC. For copies of this, or any other filing, please contact: Chaparral Resources, Inc., 2 Gannett Drive, Suite 418, White Plains, New York 10604 or call (866) 559-3822.

In addition, the public may read and copy any materials Chaparral files with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site (www.sec.gov) that contains reports, proxy and information statements and other information regarding issuers, like Chaparral, that file electronically with the SEC.

## Crude Oil Sales

We derive substantially all of our revenue through the production and sale of crude oil from the Karakuduk Field. We are continuing to develop the Karakuduk Field from which we began generating revenue from the sale of crude oil during 2000. KKM recognized $150.58 million in revenue in 2005 from the sale of approximately 3.30 million barrels of crude oil, net of royalty. In 2004, KKM recorded $78.45 million in revenue based upon sales of approximately 2.76 million barrels of crude oil, net of royalty.

KKM sells the majority of its crude oil on the "far" abroad export market. Sales at world market prices were responsible for approximately 98% of KKM's oil sales revenue in 2005. Currently, KKM has a five year crude oil sales agreement in place with Vitol Central Asia S.A. ("Vitol") for the sale of KKM's oil production quota for the export market. This agreement was signed in June 2005. KKM is responsible for obtaining export quotas and all other permissions from Kazakhstan, Russia, or other relevant jurisdictions necessary to transport and deliver KKM's oil production to the off-taker, which is currently FOB Odessa on the Black Sea. The off-taker is responsible for nominating and coordinating oil tankers, if necessary, and arranging for the lifting of the crude oil purchased.

In 2005 and 2004, all of KKM's crude oil export sales were to Vitol.

Transportation routes for our crude oil exports, and hence off-take points, are constrained by the Ministry of Energy's quota allocations. The majority of our crude oil is transported via the Kaztransoil and Transneft pipeline systems to the port of Odessa in Ukraine. The other export point is the port of Primosk on the Baltic Sea. Sales prices at the port locations are based on the average quoted Urals crude oil price from Platt's Crude Oil Marketwire for the three days following the bill of lading date. The actual price is net of deductions that include freight charges and, if applicable, the cost associated with the "detention time" of the tankers transiting the Turkish Straits in and out of the Black Sea. Throughout 2005, all export sales have been made to Vitol, who have a major share of oil exports from Odessa which has enabled them to become the most competitive off-taker, capable of combining export parcels from different crude oil suppliers to make cost efficient cargoes of up to 80,000 tons in one lifting. Under the contract terms with Vitol, payment is made within 30 days of receipt of the bill of lading and KKM's sales invoice, unless otherwise agreed by both parties.

Under the terms of KKM's Agreement with the Ministry of Energy and Natural Resources for Exploration, Development and Production of Oil in the Karakuduk Oil Field (the "Agreement"), we have a right to export, and receive export quota for, 100% of the production from the Karakuduk Field. However, oil producers within Kazakhstan are required to supply a portion of their crude oil production to the local market to meet domestic energy needs. The domestic market does not permit world market prices to be obtained, resulting in, on average, approximately $28 to $29 lower cash flow per barrel in 2005 compared with $15 to $16 in 2004. Furthermore, the Government of Kazakhstan 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 the export market. The Company has determined that it is no longer in the best interests of the Company to pursue arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan, instead we intend to resolve this matter amicably. See Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.



## Risks of Oil and Gas Activities

The current market for oil is characterized by instability. This instability has caused fluctuations in world oil prices in recent years and there is no assurance of any price stability in the future. The production and sale of oil from the Karakuduk Field may not be commercially feasible under market conditions prevailing in the future. The price we receive for our oil may not be sufficient to generate revenues in excess of our costs of production or provide sufficient cash flow to meet our investment and working capital requirements.

We make no assurance that we will be able to sell oil that we produce nor about the price at which such sales will be made. Our estimated future net revenue from oil sales is dependent on the price of oil, as well as the quantity of oil produced. The volatility of the energy market makes it difficult to estimate future prices of oil. Various factors beyond our control affect these prices. These factors include:

- domestic and worldwide supplies of oil;
- the ability of the members of the Organization of Petroleum Exporting Countries (OPEC) to agree to and maintain oil price and production controls;

- political instability or armed conflict in oil-producing regions;
- the price of foreign imports;
- the level of consumer demand;
- the price and availability of alternative fuels;
- the availability of pipeline capacity and;
- changes in existing federal regulation and price controls.

It is likely that oil prices will continue to fluctuate as they have in the past. Current oil prices may not be representative of oil prices in either the near- or long-term. We do not expect oil prices to maintain current price levels and do not base our capital spending decisions on current market prices.

No assurances can be given that we will be able to successfully develop, produce, and market the oil reserves underlying the Karakuduk Field. The development of oil reserves inherently involves a high degree of risk, even though the reserves are proved. Our risks are increased because our activities are concentrated in areas where political or other unknown circumstances could adversely affect commercial development of the reserves. Costs necessary to acquire, explore, and develop oil reserves are substantial. No assurances can be given that we will recover the costs incurred to acquire and develop the Karakuduk Field.

Development of oil reserves is a high risk endeavor and is frequently marked by unprofitable efforts, such as:

- drilling unproductive wells;
- drilling productive wells which do not produce commercial quantities and;
- production of developed oil reserves which cannot be marketed or achieve an adequate market price.

There are many additional risks associated with drilling for and producing oil and gas. These risks include blowouts, cratering, fires, equipment failure and accidents. Any of these events could result in personal injury, loss of life and environmental and/or property damage. If such an event does occur, we may be held liable and we are not fully insured against all of these risks. In fact, many of these risks cannot be insured against. The occurrence of such events that are not fully covered by insurance may require us to pay damages, which would reduce our profits. As of March 1, 2006, we have not experienced any material losses due to these events.

## Risks of Foreign Operations

Our ability to develop the Karakuduk Field is dependent on fundamental contracts with governmental agencies in Kazakhstan, including the Agreement and KKM's petroleum license with the Government allowing KKM to operate and develop the Karakuduk Field. Kazakhstan is a relatively new country and, as is inherent in such developing markets, there is some uncertainty as to the interpretation and application of Kazakh law and the stability of the region.



The laws of the Republic of Kazakhstan govern our operations and a number of our significant agreements. As a result, we may be subject to arbitration in Kazakhstan or to the jurisdiction of the Kazakh courts. Even if we seek relief in foreign territories such as the courts of the United States or Switzerland, we may not be successful in subjecting foreign persons to the jurisdiction of those courts.

The export of oil from Kazakhstan depends on access to transportation routes, particularly the Russian pipeline system. Transportation routes are limited in number, and access to them is regulated and restricted. If any of our agreements relating to oil transportation or marketing are breached, or if we are unable to renew such agreements upon their expiration, we may be unable to transport or market our oil. Also, a breakdown of the Kazakhstan or Russian pipeline systems could delay or even halt our ability to sell oil. Any such event would result in reduced revenues.

Obtaining the necessary quotas and permissions to export production through the Russian pipeline system can be extremely difficult, if not impossible in some circumstances. Our agreements with the Government of the Republic of Kazakhstan grant us the right to export, and to receive export quota. We cannot, however, provide any assurances that we will receive export quota or any other approvals required to export and deliver our production in the future.

## Environmental Regulations

We must comply with laws of the Republic of Kazakhstan and international requirements that regulate the discharge of materials into the environment. Environmental protection and pollution control could, in the future, become so restrictive as to make production unprofitable. Furthermore, we may be exposed to claims and lawsuits involving such environmental matters as soil and water contamination and air pollution. We are currently in compliance with all local and international environmental requirements and are closely monitored by the environmental authorities of the Republic of Kazakhstan. During 2004, KKM completed the construction of a waste "polygon" as required by the State Environmental Authorities. This is an area where KKM can safely dispose of waste drilling fluids and cuttings and other harmful or toxic waste. During 2005 KKM also completed the construction of a 28 km gas pipeline from the central processing facility at the field to the oil pipeline booster pumping station. This pipeline represents part of KKM's gas utilization project. The gas will be used to fuel the oil heaters at the booster station, which presently use diesel. Total expenditure on these projects during the year was approximately $1 million. In 2006 KKM is planning to complete construction and start-up operations for gas utilization infrastructure including gas drying and compression to fill in gas-main pipeline. In January 2004, KKM, as part of its obligations under the Agreement, commenced payments into an escrow account controlled by KKM and the Government of the Republic of Kazakhstan. The purpose of the payments is to provide a cash fund to use for future site restoration costs at the Field when operations cease. Monthly payments of $14,000 will be made until the fund reaches $3 million. In January 2004, an extra amount of $168,000 was paid for amounts due in 2003. As of December 31, 2005 overall payments to the fund totaled $504,000.

## Competition

We compete in all areas of the development and production segment of the oil and gas industry with a number of other companies. These companies include large multinational oil and gas companies and other independent operators, many of which possess greater financial resources and more experience than Chaparral. We do not hold a significant competitive position in the oil industry given that we compete both with major oil and gas companies and with independent producers for, among other things, rights to develop oil and gas properties, access to limited pipeline capacity, procurement of available materials and resources, and hiring qualified local and international personnel.

## Employees

As of March 1, 2006, Chaparral had no full-time employees and KKM had 248 employees. Both Chaparral and KKM retain independent consultants on an as needed basis. We believe that our relationship with our employees and consultants is good.



## Sale by KMG of Minority Interest in KKM to Nelson

In November 2004 the Company entered into an agreement with its majority stockholder, Nelson, which provided that in the event Chaparral, through CAP-G and/or MTI, received notice from KMG that KMG desired to sell its 40% equity interest in KKM, then the Company would, if requested by Nelson, exercise its right of first refusal under the Agreement to purchase such interest at the price and on the terms specified in such notice. In December 2004, pursuant to this agreement, the Company, through CAP-G, exercised its right of first refusal to purchase from KMG the remaining 40% equity interest in KKM. The Company entered into definitive sale and purchase agreements with both KMG and Nelson, which provided that upon completion of the acquisition by CAP-G, ownership of the newly acquired 40% interest in KKM would be transferred to Nelson. The transfer of the 40% interest from KMG to CAP-G occurred in December 2004, and the transfer from CAP-G to Nelson was completed in January 2005. The purchase price of $34.6 million paid by CAP-G to KMG was determined on an open tender, and the funds for this were made available to CAP-G by Nelson. In addition, Nelson paid the Company a fee of $1.0 million, recorded as part of Other Income in 2004, as well as all documentation and transaction costs relating to the acquisition.

## Corporate Information

Chaparral was incorporated under the laws of the State of Colorado in 1972. In 1999, Chaparral reincorporated under the laws of the State of Delaware.

Our address is 2 Gannett Drive, Suite 418, White Plains, New York 10604, and our telephone number is (866) 559-3822.

## Special Note Regarding Forward-Looking Statements

Some of the statements in this Annual Report on Form 10-K 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 in "Risks of Oil and Gas Activities" and "Risks of Foreign Operations." 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 Annual Report on Form 10-K to conform these statements to actual results.

ITEM 2. PROPERTIES

Properties
----------

The Karakuduk Field is located in the Mangistau Region of the Republic of Kazakhstan. The license to develop the Karakuduk Field covers an area of approximately 16,900 acres and is effective for a 25-year period, which may be extended upon mutual consent of KKM and the Government of the Republic of Kazakhstan. In 1995, KKM entered into the Agreement with Kazakhstan's Ministry of Energy and Natural Resources to develop the Karakuduk Field.

The Karakuduk Field is located approximately 227 miles northeast of the regional capital city of Aktau, on the Ust-Yurt Plateau. The closest settlement is the Say-Utes railway station approximately 51 miles southeast of the field. The ground elevation varies between 590 and 656 feet above sea level. The region has a dry, continental climate, with fewer than 10 inches of rainfall per year. Mean temperatures range from minus 25 degrees Fahrenheit in January to 100 degrees Fahrenheit in July. The operating environment is similar to that found in northern Arizona and New Mexico in the United States.



The Karakuduk Field structure is an asymmetrical anticline located on the Aristan Uplift in the North Ust-Yurt Basin. Oil was discovered in the structure in 1972, when Kazakhstan was a republic of the former Soviet Union, from Jurassic age sediments between 8,500 and 10,000 feet. The former Soviet Union drilled 22 exploratory and development wells to delineate the Karakuduk Field, discovering the presence of recoverable oil reserves. The productive area of the Karakuduk Field is estimated to contain a minimum of 8 separate productive horizons present in the Jurassic formation. None of the original wells were ever placed on commercial production prior to KKM obtaining the rights to the Karakuduk Field.

The Karakuduk Field is approximately 18 miles north of the main utility corridor, which includes the Makat-Mangishlak railroad, the Mangishlak-Astrakhan water pipeline, the Beyneu-Uzen high voltage utility lines, and the Uzen-Atrau-Samara oil and gas pipelines. KKM, according to its agreements with the Republic of Kazakhstan, has a right to use the existing oil export pipeline and related utilities. KKM also has a contract with CJSC Kaztransoil ("KTO"), a 100% subsidiary of KMG, granting KKM the right to use the export pipeline for transportation of crude oil to local and export markets, subject to transit quota restrictions, and as a temporary storage facility until the produced hydrocarbons are sold by KKM.

As of December 31 2005, KKM had 61 active productive wells in the Karakuduk Field out of a total well fund of 80 wells. Of these, 67 were drilled by KKM and 13 are re-completions of exploration and delineation wells drilled during the Soviet period. Current production exceeds an average of 12,000 barrels of oil per day (11,000 barrels per day net of royalties), compared to an average for 2005 of 10,565 barrels per day (9,682 barrels per day net of royalties). The remaining wells include 9 that are temporarily shut in, one new drill requiring completion and 9 water injection wells. KKM implemented an aggressive drilling program during 2000, drilling a total of 12 development wells and re-completing four delineation wells, using a combination of two drilling rigs and a workover rig. KKM drilled an additional exploration well and performed two re-completions prior to 2000. During 2003, KKM drilled and completed 13 wells, 12 producers and one injector. Two water supply wells were also drilled and two redundant producing wells were converted to injectors as part of KKM's reservoir pressure maintenance program. The drilling program continued into 2004 during which a total of 16 wells were drilled, 12 as producers, three awaiting completion at year end and one water injector. In addition, a well being drilled over the end of 2003 was completed in 2004 as a water injector. During 2005 an additional 14 wells were drilled and 6 kv power transmission lines were laid to wells transferred from natural flow to mechanical extraction. We constructed access lanes for drilling rigs and carried out certain landfill operations.

In the past, KKM's daily oil production has been limited due to various facility constraints and lack of working capital to fund field operations. KKM remains committed to improving efficiency of field facilities through continued expansion of its oil storage capacity, installation of additional gathering and processing facilities, and the full implementation of the central processing facility.

In June 2002, KKM commissioned an 18-mile crude oil pipeline from the Karakuduk Field currently capable of transporting up to 13,000 barrels of oil per day to the transfer pumping station where KKM's crude oil is transferred to the State owned Kaztransoil pipeline system. During 2004, KKM completed installation of the booster pump station mid way along this pipeline which will allow throughput of up to 18,000 barrels of oil per day. KKM still transports oil from some wells by truck to the nearest field gathering station or to the central processing facility at the field. These are either new wells which have yet to be tied in to the field gathering system, or naturally flowing wells that do not have sufficient wellhead pressure to overcome the back pressure in the field flow line system. In 2005 we installed three new submersible pumps to enhance the wells production performance.

As part of a program to maximize sales revenue, a decision has been taken to construct a railroad rack to transport Karakuduk crude oil to the port of Aktau to discharge at oil terminals in the Caspian Sea. This will ensure that the quality crude oil from Karakuduk is not mixed with lower quality, high sulfur oil in the current pipeline systems. This project will involve construction of a two-way rack with simultaneous filling of up to 30 tank wagons and reservoir facilities of two 5,000 cubic meter and two 2,000 cubic meter tanks. The total capital cost of the project will amount to over $13 million. This project is due for completion in the fourth quarter of 2006.

In 2003, KKM further expanded the central processing unit in order to improve its produced water processing capability in the field, to enable reservoir pressure maintenance through water injection. KKM continued to expand and



upgrade all field production facilities in 2004 and 2005. Additions to the field processing facilities, gathering stations and export infrastructure were made to enable increased production and higher fluid throughput anticipated from the ongoing drilling, well artificial lift plans and hydraulic fracturing.

During 2005 KKM used one drilling rig provided by the Oil and Gas Exploration Krakow company. As of January 16, 2006 this drilling contract expired. Currently KKM is not undertaking any drilling activity. KKM plan to operate two drilling rigs from July 1, 2006 and plan to drill 12 more wells by the end of 2006. Tendering procedures for drilling rigs have commenced. Two workover rigs will be operating at the field to complete new drills, transfer wells and the set-up of pumping units. During 2005 21 wells were converted to artificial lift.

During 2004, the reserves of the Karakuduk Field were re-estimated as required by the State Reserves Committee of the Republic of Kazakhstan. Development of the field has shown that the original State reserves were underestimated by more than 20% and therefore KKM commissioned NIPINeftegas, a local research institute, to prepare a reserves estimate in accordance with Kazakh reporting standards. As a result of this, it is now estimated that more wells will be required to develop the field than previously expected, an increase from 110 to between 140 and 150 wells. Drilling is therefore likely to continue at Karakuduk for several more years.

Full-scale water injection commenced at Karakuduk in April 2004. KKM is injecting into nine wells at the field. Daily injection volume at the field is approximately 15,000 barrels of water per day.

## Reserves

As of December 31, 2005, the Karakuduk Field has total estimated proved reserves of approximately 45.33 million barrels (compared with 40.59 million barrels for prior year), net of government royalty, of which our proportional interest is approximately 27.20 million barrels, based upon our 60% interest in KKM. The reserve disclosure is based on a reserve study of the Karakuduk Field conducted by McDaniel and Associates Consultants Limited ("McDaniel"), including data available subsequent to December 31, 2005, in which total estimated proved reserves were calculated in accordance with SEC Regulation SX Rule 4-10.

## Net Quantities of Oil and Gas Produced

The following table summarizes sales volumes, sales prices and production cost information for our oil and gas production for each of the three years ended December 31, 2005:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2003 | 2004 | 2005 |
| Net production volumes | | | |
| Oil (bbls) | 2,694,000 | 2,835,000 | 3,534,000 |
| Gas (mcf) | - | - | - |
| Net sales volumes | | | |
| Oil (bbls) | 2,694,000 | 2,758,000 | 3,297,000 |
| Gas (mcf) | - | - | - |
| Average sales price | | | |
| Oil ($ per bbl) | 21.39 | 28.44 | 45.67 |
| Gas ($ per mcf) | - | - | - |
| Average production cost ($ per bbl produced) | 2.20 | 2.93 | 4.48 |

The average sales revenue, net of transportation costs, was approximately $40.53 and $23.35 per barrel sold for the years ended December 31, 2005 and 2004, respectively. For the same periods, the average transportation costs per barrel sold were approximately $5.14 and $5.09, respectively.

Under the Agreement with the Government of the Republic of Kazakhstan we are entitled to receive 65% of KKM's cash flow from oil sales, net of royalty, on a quarterly basis until our loan to KKM has been fully repaid. The remaining 35%



of net cash flows is used by KKM to meet capital and operating expenditures. We may waive temporarily receipt of quarterly loan repayments, in whole or in part, to provide KKM with additional working capital. A further restriction in the BNP / KBC credit facility limits the annual cash flow received by Chaparral from KKM to a maximum of $4 million.

## Productive Wells and Acreage

As of December 31, 2005, we had an interest in 70 gross producing oil wells and no gas wells. KKM produces oil from the J1, J2, J4, J6, J7 and J8 reservoirs. In some wells, production is commingled from the J1 and J2 reservoirs (13 wells) and the J8 and J9 reservoirs (five wells). Production is from 13,800 gross acres with the developed acreage being 5,700 acres.

## Undeveloped Acreage

As of December 31, 2005, 8,100 acres in the Karakuduk Field production area are undeveloped.

## Drilling Activity

During the three years ended December 31, 2005, our net interests in exploratory and development wells drilled were as follows:

| | Exploratory Wells, Net | | Development Wells, Net | |
|---|---|---|---|---|
| Year Ended December 31, | Productive | Dry | Productive | Dry |
| 2003 | - | - | 7.8 | - |
| 2004 | - | - | 10.2 | - |
| 2005 | - | - | 8.4 | - |

All wells are located in the Republic of Kazakhstan.

## Present Activities

The workover of well 115 was completed on January 8, 2006 and it is now producing. Drilling of well 155 was completed on January 11, 2006 and production started after workover on February 8, 2006.

## ITEM 3. LEGAL PROCEEDINGS

The Company is not conducting any significant legal proceedings, other than as described under "Merger" in Item 1. BUSINESS.

## ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

On November 10, 2005, Chaparral held its Annual Meeting of Stockholders. Our stockholders elected the following five persons as directors, each to serve until the next Annual Meeting of Stockholders or until his successor is elected or appointed: R. Frederick Hodder, Nicholas P. Greene, Peter G. Dilling, Alan D. Berlin, and Simon K. Gill. Chaparral's stockholders also voted to ratify selection by the board of directors of Ernst & Young as Chaparral's independent auditors for the fiscal year ended December 31, 2005.

The number of shares voted and withheld with respect to each director was as follows:

| Election of Directors | For | Withheld |
|---|---|---|
| R. Frederick Hodder | 30,577,203 | 826,617 |
| Nicholas P. Greene | 30,576,571 | 827,249 |
| Peter G. Dilling | 30,993,596 | 410,224 |
| Alan D. Berlin | 30,614,585 | 789,235 |

| | | |
|---|---|---|
| Simon K. Gill | 30,573,576 | 830,244 |



The number of shares voted with respect to the approval of Ernst & Young as Chaparral's independent auditors was as follows:

| For | Against | Abstained |
|---|---|---|
| 31,337,444 | 35,990 | 30,386 |

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is currently quoted on the OTC Bulletin Board under the symbol "CHAR". As of March 1, 2006, we have 1,282 stockholders of record of our common stock. No dividend has been paid on our common stock, and there are no plans to pay dividends in the foreseeable future.

The following table shows the range of high and low bid prices for each quarter during our last two calendar years ended December 31, 2005 and 2004, as reported by the National Association of Securities Dealers, Inc:

| | Price Range ($ per common share) | |
|---|---|---|
| Fiscal Quarter Ended | High | Low |
| March 31, 2004 | 2.00 | 1.00 |
| June 30, 2004 | 1.43 | 1.08 |
| September 30, 2004 | 1.40 | 1.05 |
| December 31, 2004 | 1.75 | 1.21 |
| March 31, 2005 | 2.50 | 1.50 |
| June 30, 2005 | 2.85 | 1.80 |
| September 30, 2005 | 7.24 | 2.75 |
| December 31, 2005 | 5.57 | 3.25 |

In August 2001, our 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 Chaparral 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.

1998 Incentive and Non-statutory Stock Option Plan

On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to 50,000 options to acquire Chaparral's common stock may be granted to officers, directors, employees, or consultants of Chaparral and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or non-statutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. Chaparral has not granted any options under the 1998 Plan as of December 31, 2005.

2001 Stock Incentive Plan

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees, and consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2005.

We did not sell any securities since October 1, 2001, which were not registered under the Securities Act of 1933, as amended.



ITEM 6. SELECTED FINANCIAL DATA

| | As of or for the Year Ended December 31, $000 (except where stated) | | | |
|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2002 (1) |
| Oil and gas sales | 150,584 | 78,451 | 57,615 | 45,133 |
| Total revenues | 150,584 | 78,451 | 57,615 | 45,133 |
| Equity in income from investment | - | - | - | - |
| Net income / (loss) | 30,817 | 8,522 | 2,061 | 4,117 |
| Net income / (loss) per common share ($) | 0.81 | 0.22 | 0.05 | 0.14 |
| Working capital surplus / (deficit) | 11,358 | (23,474) | (12,487) | (2,366) |
| Total assets | 168,792 | 123,703 | 98,668 | 87,308 |
| Long-term obligations and redeemable preferred stock | 43,578 | 28,888 | 30,470 | 29,542 |
| Stockholders' equity | 85,509 | 54,692 | 46,170 | 44,109 |
| Other Data | | | | |
| Present value of proved reserves (2) | 555,002 | 204,585 | 167,182 | 128,739 |
| Minority interest present value of proved reserves | 222,001 | 81,834 | 66,873 | 51,496 |
| Proved oil reserves (bbls) | 45,331 | 40,594 | 25,616 | 21,855 |
| Minority interest of proved oil reserves (bbls) | 18,132 | 16,238 | 10,246 | 8,742 |
| Proved gas reserves (mcf) | - | - | - | - |

(1) In 2002, Chaparral obtained a controlling interest in KKM. Consequently, our financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. Chaparral accounted for its 50% investment in KKM using the equity method of accounting, which is reflected in our selected financial data for periods prior to 2002.

(2) Present value of proved reserves for the years prior to 2002 represent our 50% equity interest in KKM. Present value of proved reserves for the years 2002

and after are presented at 100%. Discount rate applied was 10%.



ITEM 7. 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 that the Company is a going concern, which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. Chaparral has experienced limitations in obtaining 100% export quota for the sale of our hydrocarbons and has had a working capital deficit in four of the last five years. Previously these conditions raised substantial doubt about our ability to continue as a going concern. Due to the refinancing of the Company's debt during 2005 (see below) we now expect to be able to meet all expenditure and cash flow requirements through the next twelve months.

Chaparral has continued to manage the ratio of export sales to local market deliveries during 2005 with approximately 3,108,000 barrels, or 94% of current year sales of 3,297,000 barrels sold at world market prices and 189,000 at domestic prices. This compares with total sales of approximately 2,758,000 barrels in 2004, of which approximately 2,544,000 barrels, or 92% (2003: 2,591,000 barrels, 96%), was sold at world market prices and 214,000 barrels, or 8% (2003: 103,000 barrels, 4%), at domestic market prices.

On March 24, 2005, KKM signed a $40 million Structured Crude Oil Pre-export Credit Facility Agreement with BNP Paribas (Suisse) SA and others (the "BNP / KBC Credit Facility"). The funds from this facility are available for use to cover any short-term working capital deficiencies and were used to pay down the previous loan with Kazkommertsbank. Amounts borrowed under the BNP / KBC Credit Facility are repayable in 36 equal monthly installments commencing December 31, 2005. The interest rate is LIBOR plus 3.25% for the first 12 months and LIBOR plus 4.00% thereafter. The lenders also require that KKM implement a crude oil price hedging program, in a form satisfactory to the lenders. In addition, on March 22, 2005, Chaparral and CAP-G signed a Promissory Note Amendment Agreement with Nelson (the "Amended Note"). This provided for a prepayment of $1million of the $4 million due to be repaid to Nelson on May 10, 2005 under the previous $4 million loan note and the replacement of that loan note with a new loan note for $3 million on substantially similar terms, but with an increase in the interest rate from 12% to 14% from May 10, 2005 and an extension of the maturity date of one year to May 10, 2006. The debt refinancing, coupled with current production and price levels, will enable the Company to meet all current financial obligations and continue with field development.

Liquidity and Capital Resources

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, water injection facilities, plant and equipment (pumps, transformer sub-stations etc.) and gas utilization. We have invested approximately $207 million in the development of the Karakuduk Field and have drilled or re-completed 70 productive wells by the end of 2005. Total capital expenditures for 2005 were approximately $31 million compared to $30 million incurred in 2004. Capital expenditures are estimated to be at least $100 million from 2006 through 2010, including the drilling of approximately 60 more wells over this period. We anticipate 2006 capital expenditures of approximately $46 million.

We expect to finance the continued development of the Karakuduk Field primarily through cash flows from the sale of crude oil. During 2005, KKM sold approximately 3.3 million barrels of crude oil for $151 million. As of January 24, 2006, daily oil production was in excess of 12,000 barrels per day (11,000 barrels per day net of royalties) from 59 of the 71 productive wells in the field. The ability of KKM to pay dividends in the immediate future is restricted by the needs of its capital investment program.

In 2006, KKM expects to increase production by drilling new wells, converting at least 16 more wells to artificial lift, converting four more wells to water injection wells, adding four new water injection wells to the injection fund and



by continuing with hydraulic fracturing work in selected wells. Management expects production from the Karakuduk Field to increase to over 16,000 barrels of oil per day (14,650 barrels per day net of royalties) by year-end 2006.

In addition, 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, on average, approximately $28 to $29 lower cash flow per barrel in 2005. 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 the export market. The Company has determined that it is no longer in the best interests of the Company to pursue arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan, instead we intend to seek an amicable resolution of this matter. If the matter cannot be resolved in a satisfactory manner, we have, however, reserved our right to commence formal arbitration proceedings pursuant to our contractual arrangements with the Government.

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

## Obligations and Commitments

The following table is a summary of Chaparral's future payments on obligations as of December 31, 2005:

Obligations by Period

| | $000 | | | | |
|---|---|---|---|---|---|
| | 1 Year | 2 - 3 Years | 4 - 5 Years | Later Years | Total |
| Debt | 24,667 | 7,333 | -- | -- | 32,000 |
| Interest on debt | 1,033 | 188 | -- | -- | 1,221 |
| Contracts with suppliers | 3,666 | -- | -- | -- | 3,666 |

In May 2002, Chaparral received a total equity and debt capital infusion of $45 million. Chaparral received a total investment of $12 million from Central Asian Industrial Holdings, N.V. ("CAIH"), including $8 million in exchange for 22,925,701 shares, or 60%, of Chaparral's outstanding common stock, and $4 million in exchange for a three year note (the "Note") bearing interest at 12% per annum (of which $2 million was repaid during 2002 but re-borrowed in 2004). These shares and the Note were sold to Nelson in May 2004. Additionally, Kazkommertsbank provided KKM with a credit facility totaling $33 million bearing interest at 14% per annum. On March 24, 2005 a further credit facility for $40 million was agreed with BNP Paribas (Suisse) SA ("BNP") and KBC Bank N.V. ("KBC"), the BNP / KBC facility. On June 30, 2005 $32 million was drawn down from this facility and utilized to repay the Kazkommertsbank loan in full. As of December 31, 2005 the outstanding principal balance on the BNP / KBC Credit Facility was $29 million. A repayment of $12 million was made in January 2006 from current cash resources. The terms and conditions of the Note and the BNP / KBC Credit Facility are more fully described in Note 12 of our consolidated financial statements for the year ended December 31, 2005.

The financing costs of the BNP / KBC Credit Facility and the Note represent significant future cash flow requirements. A substantial portion of our future cash flow from operations will be required for debt service and may not be available for other purposes. We expect up to $33.3 million of our future available net cash flows from the Karakuduk Field will be utilized to service these loans, depending upon excess cash flows available from operations, if any, to repay the loan prior to its stated maturity date. The availability of future cash flows is contingent upon many factors beyond our control, including successful development of the underlying oil reserves from the Karakuduk Field,

12

production rates, production and development costs, oil prices, access to oil transportation routes, and political stability in the region. In addition under the BNP / KBC Credit Facility, 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 meet the terms of the BNP / KBC Credit Facility could result in an event of default. If such a default is not waived by the lenders, they can require KKM to immediately repay the full amount outstanding under the facility and may enforce the Nelson guarantee and their step-in rights under the Offtake agreement. We are currently in compliance with all the terms of the BNP / KBC Credit Facility. We had made all principal and interest payments due under the BNP / KBC Credit Facility and the Note as of December 31, 2005.

## Related Party Transactions

KKM has a contract to transport 100% of its oil sales through the pipeline owned and operated by KTO, a wholly owned subsidiary of KMG, which was, until December 2004, the 40% minority shareholder in KKM. The rates for transportation are in accordance with those approved by the Government of the Republic of Kazakhstan. Currently, the use of the KTO pipeline system is the only viable method of exporting KKM's production. As KTO notifies KKM of the export sales allocated to KKM on a monthly basis, KTO controls both the volume and transportation cost of export sales. As described above, KKM are constructing a railroad rack to allow alternate routes for shipping of the crude oil from the Karakuduk field.

KKM makes a prepayment for crude transportation based upon the allocation of export sales received from KTO. This prepayment includes pipeline costs charged by the operators of the Russian and Ukrainian pipeline systems which are dependent upon the point of sale of KKM's exports. The following table summarizes KKM's payments to, and balances with, KTO:

| | $000 | |
|---|---|---|
| | 2005 | 2004 |
| KKM's payments to KTO during the year | 16,494 | 13,348 |
| of which transportation costs for the year | 16,252 | 13,144 |
| Prepayment balance with KTO at December 31 | 1,787 | 1,162 |
| Charges for pipeline storage, sales commission, export sales customs fees and Volga pipeline water | 242 | 204 |
| of which outstanding at December 31 | 14 | 8 |

KKM had a drilling contract with KMGD, an affiliate of KMG, for one development drilling rig operating in the Karakuduk Field. The contract expired on December 31, 2004.

As previously mentioned, on March 24, 2005, Chaparral and CAP-G signed a Promissory Note Amendment Agreement with Nelson (the "Amended Note"). This provided for a prepayment of $1 million of the $4 million due to be repaid to Nelson on May 10, 2005 under the existing $4 million loan note and the replacement of the existing loan note with a new loan note for $3 million on substantially similar terms, but with an increase in the interest rate from 12% to 14% from May 10, 2005 and an extension of the maturity date of one year to May 10, 2006.

All other related party transactions are disclosed in the notes to our consolidated financial statements for December 31, 2005. The loans with Kazkommertsbank and Nelson are disclosed in Note 12 and the drilling contract with KMGD is described in Notes 18 and 19, prepaid transportation to KTO in Note 3 and an insurance policy with Kazkommerts Policy in Note 19.

## Legal Proceedings

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for $9.1 million (the "Tax Claim") relating to taxes and penalties covering the three years from 1999 to 2001. KKM appealed the claim



through the courts in Kazakhstan, which eventually ruled in favor of KKM with the exception of $255,000 which was upheld. As a result, during 2003 KKM reversed $899,000 for income taxes accrued during 2002 for the Tax Claim net of the $255,000 which was settled January 2004.

The Ministry of State Revenues of the Republic of Kazakhstan had been considering penalties with respect to the Tax Claim in the amount of $970,000. In March 2004, a court hearing was conducted which resulted in a reduction of these penalties to $53,000. This amount was paid in full during 2004.

## 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 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 may have on our operations.

## 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 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.

## Exchange Rates and 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. A 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, but KKM's statutory tax basis for 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. During 2004 and 2005, however, the Tenge has remained relatively stable against the U.S. Dollar. There remains no guarantee that this stability is sustainable for the foreseeable future. As of December 31, 2005, the exchange rate was 133.77 Tenge per U.S. Dollar compared to 130.00 as of December 31, 2004. It should be noted that 94% of our crude oil sales by volume in 2005 were denominated in U.S. Dollars, while the majority of our capital expenditures, operating costs and general and administrative expenses are denominated in Tenge.

## Critical Accounting Policies

Application of generally accepted accounting principles 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, alternative methods can exist to meet various accounting principles. 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 KKM's development 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). Chaparral follows the full cost 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. Effective with the adoption of Statement of Financial Accounting Standards ("SFAS") No. 143 in 2003, the carrying amount of oil and gas properties also includes estimated asset retirement costs recorded based on the fair value of the asset retirement obligation when incurred. The application of the full cost method of accounting for oil and gas properties generally results in higher capitalized costs and higher DD&A rates compared to the successful efforts method of accounting for oil and gas properties.

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized using the unit-of-production method based on 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. Abandonment of properties is 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. Chaparral excludes these costs on a country-by-country basis 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 or a charge is made against earnings for those international operations where a reserve base has not yet been established. 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 relinquishment of drilling rights.

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. Financial Accounting Standards Board ("FASB") Interpretation No. 33 ("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 depreciation, depletion and amortization ("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 Chaparral 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 McDaniel 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 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. A material change in the estimated volumes of reserves could have an impact on the DD&A rate calculation and the financial statements.

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 related hedged items. 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.

Accounting for Asset Retirement Obligations. 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. 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. As a result of the adoption of SFAS 143, Chaparral has increased its assets and liabilities by $516,000 as of January 1, 2003 to reflect the net present value of its retirement obligations. See Note 11 to our consolidated financial statements for the year ended December 31, 2004 for results of the adoption of SFAS 143.

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.

Income Taxes. As part of the process of preparing our consolidated financial statements, we are required to estimate our taxes in each of the jurisdictions of operation. This process involves management estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheets. We then must assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent recovery is not likely, we must establish a valuation allowance. Future taxable income depends on the ability to generate income in excess of allowable deductions. To the extent we establish a valuation allowance or increase this allowance in a period, an expense is recorded within the tax provision in the consolidated statement of operations. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to establish a valuation allowance that could materially impact our financial condition and results of operations.

Change in Estimates. Chaparral has not materially changed the use of its methodology for the estimates described above for the years presented and actual results compared to estimates made have not had a material effect on Chaparral's financial condition and results of operations. There are currently no known trends, demands, commitments, events or uncertainties that are reasonably likely to occur that could materially affect the methodology or assumptions described above.



## Recent Accounting Pronouncements

In April 2003, the FASB issued SFAS No. 149, Amendment of Statement 133 on 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 our consolidated 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 our consolidated financial statements.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an interpretation of ARB 51. The primary objectives of this interpretation are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities") and how to determine which business enterprise (the "primary beneficiary") should consolidate the variable interest entity and when. This new model for consolidation applies to an entity in which either (i) the equity investors (if any) do not have a controlling financial interest; or (ii) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN 46 requires that the primary beneficiary, as well as all other enterprises with a significant variable interest in a variable interest entity, make additional disclosures. Certain disclosure requirements of FIN 46 were effective for financial statements issued after January 31, 2003.

In December 2003, the FASB issued FIN No. 46 (revised December 2003), Consolidation of Variable Interest Entities ("FIN 46-R") to address certain FIN 46 implementation issues. The effective dates and impact of FIN 46 and FIN 46-R are as follows:

(i) Special purpose entities ("SPEs") created prior to February 1, 2003. Chaparral must apply either the provisions of FIN 46 or early adopt the provisions of FIN 46-R at the end of the first interim or annual reporting period ending after December 15, 2003.

(ii) Non-SPEs created prior to February 1, 2003. Chaparral is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

(iii) All entities, regardless of whether a SPE, that were created subsequent to January 31, 2003. The provisions of FIN 46 were applicable for variable interests in entities obtained after January 31, 2003. Chaparral is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

The adoption of the provisions applicable to SPEs and all other variable interests obtained after January 31, 2003 did not have a material impact on Chaparral's financial statements. FIN 46-R applicable to Non-SPEs created prior to February 1, 2003 does not impact on Chaparral's results of operations, financial position and cash flows.

In June 2001, the FASB issued 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. Chaparral adopted SFAS 143 on January 1, 2003. See Note 11 to our consolidated financial statements for the year ended December 31, 2004 for results of the adoption of SFAS 143.



In November 2004, the FASB issued SFAS 151, Inventory Costs, an Amendment of APB Opinion No. 43, Chapter 4. SFAS 151 clarifies the accounting treatment for various inventory costs and overhead allocations and is effective for inventory costs incurred after July 1, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In December 2004, the FASB issued SFAS 153, Exchanges of Non-monetary Assets, an Amendment of APB Opinion No. 29. SFAS 153 specifies the criteria required to record a non-monetary asset exchange using carryover basis and is effective for non-monetary asset exchanges occurring after July 1, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In December 2004, the FASB issued SFAS 123 (revised 2004) ("SFAS 123R"), Share Based Payments. SFAS 123R requires that the cost from all share-based payment transactions, including stock options, be recognized in the financial statements at fair value and is effective for public companies in the first interim period after June 15, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections. SFAS 154 changes the accounting for and reporting of a change of accounting principle. It requires retrospective application of a change of accounting principal unless impracticable. SFAS 154 is effective for fiscal years beginning after December 15, 2005 and is not expected to have a material impact on the company's financial statements when adopted.

## 2. Results of Operations

### Results of Operations for the Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Net income for the year ended December 31, 2005 amounted to $30.82 million compared to $8.52 million for the year ended December 31, 2004. The increase of $22.30 million is principally due to higher oil prices and increased sales partially offset by excess profit taxes payable in Kazakhstan and higher minority interest and taxes as a result of the higher profits.

Revenue. Revenues for the year ended December 31, 2005 amounted to $150.58 million compared to $78.45 million in the year ended December 31, 2004. The increase of $72.13 million is the result of higher oil prices and increased sales volumes. In 2005 we sold 3,297,000 barrels compared to 2,758,000 barrels in 2004, an increase of 19.5%. The average price per barrel of crude oil recognized in 2005 was $45.67 compared to $28.44 per barrel in 2004. This increase of $17.23 per barrel is reflective of the increase in the average spot price of Brent crude over the same period.

Transportation and Operating Expenses. Transportation costs for the year ended December 31, 2005 were $16.95 million or $5.14 per barrel sold, and operating expenses were $15.83 million or $4.48 per net barrel of crude oil produced. In comparison transportation costs for the year ended December 31, 2004 were $14.05 million, or $5.09 per barrel sold, and operating costs associated with sales were $8.32 million, or $2.93 per barrel produced. The increase in operating costs is due to higher production volumes in the year ended December 31, 2005 and higher labor costs, higher equipment, materials and supplies expenses and increased rental costs.

Excess Profits Tax. Under KKM's Agreement with the Ministry of Energy and Natural Resources for the Exploration, Development and Production of Oil in the Karakuduk Field a charge for Excess Profits Tax becomes payable when the total cumulative return on cash flows at the field exceeds certain levels. This charge is levied at various rates. During 2005 the cumulative rate of return at the Karakuduk field reached a level where this charge has become payable. A charge of $3.22 million has been estimated for the year ended December 31, 2005. There was no corresponding charge for Excess Profits Tax in the year ended December 31, 2004.

Depreciation and Depletion. Depreciation and depletion expense was $25.38 million for the year ended December 31, 2005 compared to $18.18 million for the year ended December 31, 2004. The increase of $7.20 million is principally due to higher sales volumes. The depletion expense for 2005 amounted to $24.54 million or $6.94 per barrel produced compared with $17.55 million or $6.19 per barrel in 2004.



Interest Expense. Interest expense for the year ended December 31, 2005 decreased to $4.68 million from $5.55 million in 2004. This decrease of $0.87 million is mainly due to reductions in the net loan balances outstanding of an average of approximately $10 million. This has been partially offset as the company did not capitalize any interest during the year ended December 31, 2005. The corresponding amount capitalized in 2004 amounted to $0.45 million.

General and Administrative Expenses. General and administrative expenses in the year ended December 31, 2005 decreased by $1.30 million to $7.09 million compared to $8.39 million in 2004. The main reason for the higher expenditure in 2004 was severance payments to former executives of the Company of $0.78 million. In addition to this, further economies were made due to the relocation of the offices of the Company to accommodation shared with Nelson Resources Limited.

Management fee. The management fee increased by $0.23 million to $0.68 million in the year ended December 31, 2005 from $0.45 million in the prior year. This increase is due to the inclusion of twelve months management fees in 2005 compared to seven months fees in 2004.

Marketing fee. The increase of the marketing fee from $0.27 million in the year ended December 31, 2004 to $0.55 million in the year ended December 31, 2005 is due to the inclusion of a full year of the contract in 2005 compared to seven months in 2004 and also an increase in production levels.

Hedge losses. The hedge losses in 2005 relate to certain contracts for oil sales taken out as part of the hedging strategy connected with the BNP / KBC loan facility. Under these agreements, KKM had the option each month, from April 2005 to December 2005, to require BNP to pay it an amount per barrel of specified monthly amounts of crude oil equivalent to the excess of $33.00 per barrel over the monthly average for that month of dated Brent. The crude oil amounts specified are 75,000 barrels per calendar month during the second quarter of 2005, 160,000 barrels per calendar month during the third quarter of 2005 and 170,000 barrels per calendar month during the last quarter of 2005. The Company paid $267,300 as consideration for these contracts, equivalent to $0.22 per barrel. There are no open hedge arrangements at December 31, 2005.

Other Income / (Expense). Other income for the year ended December 31, 2004 includes $1 million received from Nelson as a fee for the Company exercising its pre-emption rights regarding the sale in December 2004 by KMG of its 40% share of KKM, which was then transferred to Nelson, who funded the purchase price. There was no similar transaction in 2005.

Income Taxes. The income tax expense increased by $15.78 million to $22.90 million in the year ended December 31, 2005 from $7.12 million in the year ended December 31, 2004. This increase is due to higher taxable revenues at the KKM level in respect of the year ended December 31, 2005. In 2005 the pre-tax profit at the KKM level was $78.06 million compared to $25.80 million in 2004. All income taxes provided for relate to our operations in Kazakhstan. Chaparral currently has no U.S. income tax liability due to Chaparral's estimated USA domestic tax loss carryforwards of $25.7 million as of December 31, 2005. These carryforwards will expire at various times between 2006 and 2022. See Note 14 to our consolidated financial statements for the year ended December 31, 2005.

## Results of Operations for the Year Ended December 31, 2004 Compared to the Year Ended December 31, 2003

Our operations for the year ended December 31, 2004 resulted in a net income of $8.52 million compared to a net income of $2.06 million for the year ended December 31, 2003. The $6.46 million increase in our net income is primarily due to (i) higher oil prices, (ii) increased sales and (iii) the receipt of pre-emption fee income, partially offset by (i) higher minority interest and taxes as a result of higher profits at KKM, (ii) higher transportation tariffs, (iii) higher workover costs, (iv) increased interest charges and (v) the beneficial effect in 2003 of a change in accounting principle.

Revenue. Revenues were $78.45 million for the year ended December 31, 2004 compared with $57.61 million for the year ended December 31, 2003. The $20.84 million increase is the result of higher volumes sold and higher oil prices received during the year ended December 31, 2004. The increase in volumes sold



during 2004 was the result of increased production and sales quotas obtained for the year. During 2004 we sold approximately 2,758,000 barrels of crude oil, recognizing $78.45 million, or $28.44 per barrel, in revenue. In comparison, we sold approximately 2,694,000 barrels of crude oil, recognizing $57.61 million in revenue, or $21.39 per barrel, for the year ended December 31, 2003.

Transportation and Operating Expenses. Transportation costs for the year ended December 31, 2004 were $14.05 million, or $4.96 per barrel produced, and operating costs associated with sales were $8.32 million, or $2.93 per barrel. In comparison, transportation costs for the year ended December 31, 2003 were $11.47 million, or $4.26 per barrel, and operating costs associated with sales were $5.92 million, or $2.20 per barrel. The increase in transportation costs per barrel is mainly due to higher tariffs imposed on the Company and a 160,000 barrel sale to the local market in 2003 that carried no transportation cost. The increase in operating cost per barrel is mainly due to higher work-over costs.

Depreciation and Depletion. Depreciation and depletion expense was $18.18 million for the year ended December 31, 2004 compared to $18.04 million for the year ended December 31, 2003. The $0.14 million increase is the result of higher sales volumes, offset by a slightly lower effective depletion rate. During the year 2004, Chaparral recognized a total depletion expense of $17.55 million or $6.19 per barrel, compared with $17.30 million or $6.42 per barrel in depletion expense for the year 2003. The decrease in the effective depletion rate of $0.23 per barrel is due to additions to the Company's estimated proved reserves, partially offset by increased estimated capital expenditures for the development of the field for future years.

Interest Expense. Interest expense for the year ended December 31, 2004, increased by $1.02 million from $4.53 million in 2003 to $5.55 million in 2004. This increase is mainly due to $0.46 million of interest payable in 2004 by KKM on advanced sales receipts, $0.21 million increase in discount on the Note, higher interest on the Note of $0.18 million due to the re-borrowing of $2 million in March 2004, and a lower amount of capitalized interest of $0.45 million, offset by lower interest payable of $0.39 million on the KKM Credit Facility.

General and Administrative Expense. General and administrative costs for the year ended December 31, 2004, increased by $0.63 million from $7.76 million for the year 2003 to $8.39 million for the year 2004. The increase is largely due to $0.78 million of severance payments to former executives of the Company, partially offset by reduced costs as a result of economies in consultancy services and salaries and wages.

Other Income. Other income for the year ended December 31, 2004 includes $1 million received from Nelson as a fee for the Company exercising its pre-emption rights regarding the sale in December 2004 by KMG of its 40% share of KKM, which was then transferred to Nelson, who funded the purchase price. See Item 1 for a fuller description of the transaction.

Income Taxes. Income tax expense for the year ended December 31, 2004, increased by $3.00 million from $4.12 million for the year 2003 to $7.12 million for the year 2004. The $3.00 million increase is due to KKM generating higher taxable income in the Republic of Kazakhstan. Net income at the KKM level for the year ended December 31, 2004 was $18.66 million compared with $10.76 million for the year ended December 31, 2003. All income taxes provided for relate to our operations in Kazakhstan. Chaparral had no U.S. income tax liability due to Chaparral's estimated USA domestic tax loss carryforwards of $24.8 million as of December 31, 2004. These carryforwards expire at various times between 2005 and 2022. See Note 14 to our consolidated financial statements for the year ended December 31, 2004.

Cumulative Effect of Change in Accounting Principle. As a result of the adoption of SFAS 143, Chaparral recognized a gain of $1.02 million as a cumulative effect of change in accounting principle for the year ended December 31, 2003. In addition, Chaparral recognized $73,000 in accretion expense to account for changes in the ARO liability. There were no such items recorded in 2004. See Note 11 to our consolidated financial statements for the year ended December 31, 2004.

20

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency
----------------

Chaparral's 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 in 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 (133.77 and 130.00 Kazakh Tenge per U.S. Dollar as of December 31, 2005 and 2004, 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.

A 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. During 2005, the Tenge has depreciated against the U.S. Dollar by approximately 3%. Since December 31, 2003, however, the Tenge has appreciated against the U.S. Dollar by approximately 7%. There remains no guarantee that this appreciation is either sustainable or permanent in the foreseeable future. KKM retains the majority of cash and cash equivalents in U.S. Dollars in bank accounts within Kazakhstan, but KKM's statutory tax basis for 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. It should be noted that 94% of our crude oil sales in 2005 were denominated in U.S. Dollars, while the majority of our capital expenditures, operating costs and general and administrative expenses are denominated in Tenge.

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 that Chaparral could realize or settle these assets and liabilities in U.S. Dollars.

We had $1.79 million of net monetary liabilities denominated in Tenge as of December 31, 2005 compared to $8.25 million at December 31, 2004.

## Commodity Prices for Oil

During 2005 we sold approximately 3,297,000 barrels of crude oil, recognizing $150.58 million, or $45.67 per barrel, in revenue. In comparison, we sold approximately 2,758,000 barrels of crude oil, recognizing $78.45 million in revenue, or $28.44 per barrel, for the year ended December 31, 2004.

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, on average, approximately $28 to $29 lower cash flow per barrel in 2005. 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 the export market. The Company has determined that it is no longer in the best interests of the Company to pursue arbitration proceedings in Switzerland for the breach of the Agreement by the Government of Kazakhstan, instead we intend to seek an amicable resolution of this matter.

During 2004 and 2005 Chaparral has been successful in maintaining the export sales/local market deliveries ratio which had significantly improved from 2002 to 2003. For the year ended December 31, 2005, Chaparral sold approximately 3,297,000 barrels of its current year production, of which approximately 3,108,000 barrels, or 94%, have been sold at world market prices and 189,000 barrels, or 6%, have been sold at domestic market prices compared to 92% at world market prices and 8% at domestic market prices in 2004.



## Customer credit concentration

During 2005 we sold all of our crude oil for export to Vitol Central Asia S.A. ("Vitol"). This accounted for approximately 98% of the Company's revenues during the year. KKM has a five year crude oil sales agreement in place with Vitol. Under this agreement the price for each month's delivery of crude oil is agreed in advance between the off-taker and KKM. KKM has the absolute right, at its own discretion, to sell its oil to a third party if a price cannot be agreed. Crude oil is a fungible product and, as such, a ready market is available subject to the discussion above concerning commodity price risk. All sales to Vitol are covered by an irrevocable letter of credit issued by an international bank having a long term credit rating of no less than 'A'.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Item 15(a) for a list of the Financial Statements and the supplementary financial information included in this report following the signature page.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

## ITEM 9A. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed in the periodic reports we file with the SEC is recorded, processed, summarized and reported within the time periods specified in the rules of the SEC. The Company carried out an evaluation as of December 31, 2005, under the supervision and the participation of our management, including our chief executive officer and chief financial officer, of the design and operation of these disclosure controls and procedures pursuant to Rules 13a-15(e) under the Securities Exchange Act of 1934. Based upon that evaluation, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures are effective in timely alerting them to material information required to be included in our periodic SEC filings.

### Changes in Internal Controls over Financial Reporting

As a result of the evaluation referred to in the preceding paragraph, there were no changes during the quarter ended December 31, 2005 that materially affected or are reasonably likely to affect our internal control over financial reporting. There have been no significant changes in internal controls over financial reporting or other factors subsequent to December 31, 2005.



PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

As of March 17, 2006, the following table sets forth the names and ages of our directors and executive officers of Chaparral, the principal offices and positions with Chaparral held by each person and the date such person became a director or executive officer. The executive officers are elected annually by the board of directors. Executive officers serve terms of one year or until their death, resignation or removal by the board of directors. The present term of office of each director will expire at the next annual meeting of stockholders. Each director will hold office until his successor is duly elected and qualified, until his resignation or until he is removed in the manner provided by our bylaws.

| Name of Director or Officer and Position in Chaparral | Since | Age | Principal Occupation During the Last 5 Years |
|---|---|---|---|
| Dmitri Timoshenko<br>Director | 2005 | 33 | Mr Timoshenko graduated from the Moscow State Academy in 1994 and joined LUKOIL in 1996. He Vice-President and General Counsel for LUKOIL Holding Limited. |
| Oktay Movsumov*<br>Director | 2005 | 49 | Mr Movsumov graduated in 1978 from the Azerbi and Construction Institute and has a PhD in E has worked for JSC OAO LUKOIL since 1996 and Vice-President Finance and Chief Treasurer of Overseas Holding Limited. |
| Peter G. Dilling*<br>Director | 2002 | 56 | From 1995 to 1997, Mr. Dilling held various p Chaparral, including Vice Chairman of the Boa 2002 as Director. Mr. Dilling served as Presi Chief Executive Officer of Trinidad Explorati Development, Ltd., an oil and gas exploration from 1999 to 2003 and as President and Chief Officer of Anglo-African Energy, Inc., from 1 Dilling also serves as Chairman and Director SPV Ltd and Holland Park SPV Ltd, both real e investment and development companies, since 2 |
| Boris Zilbermints<br>Director and Chief Executive Officer | 2005 | 37 | Since 2001 Mr Zilbermints has worked for LUKO Service Limited, initially as Head of the Str Planning division and as Regional Director fo since November 2002. Mr Zilbermints serves as Director for the Karachaganak Operating Compa Petroleum and the joint venture company devel LUKOIL's interests in the Caspian. He is a me Society of Petroleum Engineers, the Internati Association for Energy Economics and the Asso |

International Petroleum Negotiators.



| Name of Director or Officer and Position in Chaparral | Since | Age | Principal Occupation During the Last 5 Years |
|---|---|---|---|
| Alan D. Berlin* Director and Corporate Secretary | 2002 | 66 | Since 1995, Mr. Berlin has been a partner of Aitken Irvin Berlin & Vrooman, LLP. He was en private practice of law for over five years p joining Aitken Irvin. Mr. Berlin served as a Chaparral in 1997 and was the Secretary of Ch January 1996 to August 1997. Since June 1998, served Chaparral in the same position. From 1 Mr. Berlin was the President of the Internati of Belco Petroleum Corp. and held various oth with Belco Petroleum Corp. and Belco Oil and from 1977 to 2001. Mr. Berlin has been appoin Honorary Associate of the Centre for Petroleu Law and Policy at the University of Dundee, S is a member of the Association of Internation Negotiators. |
| Charles Talbot VP-Finance and Chief Financial Officer | 2005 | 37 | Mr. Talbot was appointed Vice President-Finan Financial Officer of the Company in October 2 Group Financial Controller of Caspian Investm Resources Limited. He was Group Financial Con Black & Veatch, Europe, a global engineering 2001 to 2005. He was admitted to membership o Institute of Chartered Accountants in England 1993. |

* Audit Committee member.

Audit Committee Financial Expert

The board of directors has determined that all audit committee members are financially literate under the current listing standards of the New York Stock Exchange. The board also determined that Peter G. Dilling qualifies as an "audit committee financial expert" as defined by the SEC rules adopted pursuant to the Sarbanes-Oxley Act of 2002.

Code of Ethics

Chaparral has adopted a code of ethics that applies to all of its directors, officers (including its chief executive officer, chief financial officer, chief accounting officer, controller and any person performing similar functions) and its employees. Chaparral has filed a copy of this Code of Ethics as Exhibit 14 to this form 10-K.

Shareholder Nomination Procedures

There had been no material changes during the fourth fiscal quarter to the procedures disclosed in the Proxy statement filed on February 16, 2006 with the SEC.

Committees of the Board of Directors and Meeting Attendance

During the fiscal year 2005, Chaparral held seven board meetings. The board had three committees, namely the Compensation Committee, the Audit Committee and the Corporate Governance Committee.

24

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon a review of Forms 3 and 4 and any amendments furnished to Chaparral during our fiscal year ended December 31, 2005, and Form 5 and any amendments furnished to Chaparral with respect to the same fiscal year, we believe that our current directors, officers, and greater than 10% beneficial owners complied with all applicable Section 16 filing requirements.

ITEM 11. EXECUTIVE COMPENSATION

The following table shows the compensation paid by Chaparral for services rendered during the year by Mr. Gill as former Chief Executive Officer of Chaparral, and his predecessor Mr. Klinchev, and by Mr. Penney as former Vice President - Finance and Chief Financial Officer of Chaparral, and his predecessors, Messrs. Soto, Wood and Moore. There were no other executive officers of Chaparral whose annual salary and bonus exceeded $100,000 during the fiscal year 2005.

Summary Compensation Table.

| | | Annual Compensation | | | Long-Ter | |
|---|---|---|---|---|---|---|
| | | | | | Awards | |
| Name and Principal Position | Year | Salary | Bonus | Other Annual Compensation | Restricted Stock Awards ($) | Securiti Underlyi Options SARs (# |
| Simon K. Gill<br>Former Chief<br>Executive Officer<br>(05/04 to 12/05) | 2005<br>2004 | $170,986(1)<br>$115,500(2) | -<br>- | -<br>- | -<br>- | |
| Nikolai D. Klinchev<br>Former Chief<br>Executive Officer<br>(11/02 to 05/04) | 2005<br>2004 | -<br>$106,887 | -<br>$250,000 | -<br>- | -<br>- | |
| Nigel F. Penney<br>Former VP-Finance<br>and Chief<br>Financial Officer<br>(08/04 to 09/05) | 2005<br>2004 | $214,238<br>$101,500 | -<br>- | -<br>- | -<br>- | |
| Miguel C. Soto<br>Former VP-Finance<br>and Chief<br>Financial Officer | 2005<br>2004 | -<br>$112,126 | -<br>$50,000 | -<br>- | -<br>- | |

| | | | | | |
|---|---|---|---|---|---|
| (05/04 to 08/04) | | | | | |
| Jonathan P. Wood<br>Former VP-Finance<br>and Chief<br>Financial Officer<br>(01/04 to 05/04) | 2005<br>2004 | -<br>$100,646 | -<br>$82,000 | -<br>- | -<br>- |
| Richard J. Moore<br>Former VP-Finance<br>and Chief<br>Financial Officer<br>(08/04 to 09/05) | 2005<br>2004 | -<br>- | -<br>- | -<br>- | -<br>- |

25

(1) Includes $137,436 paid to Nelson for the services of Mr Gill for the period January to December 2005.

(2) Paid to Nelson for the services of Mr. Gill for the period June to December 2004.

(3) Represents $282,000 severance pay and $29,323 paid by Chaparral for the education of Mr. Klinchev's daughter.

(4) Severance pay.

Options/SAR Grants.

For the fiscal years ended December 31, 2005 and 2004, we did not grant any options.

Aggregated Option/SAR Exercises and Year-End Option/SAR Value.

As of December 31, 2005, there were no unexercised options/SARs and additionally, no options were exercised in fiscal year 2005.

Director Interlocks.

Mr. Greene was Chief Financial Officer of Nelson until December 2, 2005. Mr. Hodder was an employee of Nelson until December 2, 2005. Mr. Gill was an employee of Nelson until October 21, 2005. Mr. Timoshenko is Vice President and Chief Legal Counsel, Mr. Movsumov is Vice President Finance and Chief Treasurer and Mr Zilbermints is an employee of LUKOIL Overseas.

Compensation of Directors.

During the fiscal year ended December 31, 2002, Chaparral implemented a standard compensation arrangement for its directors, including providing (i) $700 in compensation to each director for each board or committee meeting attended via teleconference, (ii) $1,000 in compensation to each director for each board or committee meeting attended in person, (iii) $2,000 in compensation per day while traveling on Chaparral related business, including board meetings, and (iv) $2,500 in quarterly compensation for serving on Chaparral's board. During 2005, a Special Committee of independent Directors was formed to monitor and protect the interests of all shareholders, equally, in response to the takeover of Nelson. The fees for this committee were approved at $25,000 for each member of the special committee.

Stock Performance Graph.



Comparison of Five Year Cumulative Total Return

The following table compares the total returns (assuming reinvestment of dividends) of common stock, the Nasdaq Market Index and the SIC Code Index for the five year period ending December 31, 2005

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 |
|---|---|---|---|---|---|---|
| Chaparral Resources, Inc. | 100.00 | 41.66 | 27.59 | 27.86 | 48.27 | 140.12 |
| SIC Code Index | 100.00 | 89.03 | 87.04 | 126.73 | 167.72 | 248.97 |
| NASDAQ Market Index | 100.00 | 79.21 | 54.46 | 82.12 | 89.65 | 91.59 |



Board Compensation Committee Report on Executive Compensation

Insider Participation in Compensation Decisions and Compensation Committee Report on Executive Compensation

The Compensation Committee of our board of directors determines the compensation of the executive officers named in the Summary Compensation Table included as part of "Item 11 - Executive Compensation." The Compensation Committee will furnish the following report on executive compensation in connection with the Annual Meeting:

Compensation Philosophy
-----------------------

As members of the Compensation Committee, it is our duty to administer the executive compensation program for Chaparral. The Compensation Committee is responsible for establishing appropriate compensation goals for the executive officers of Chaparral, evaluating the performance of such executive officers in meeting such goals and making recommendations to the board with regard to executive compensation. Chaparral's compensation philosophy is to ensure that executive compensation be directly linked to continuous improvements in corporate performance, achievement of specific operational, financial and strategic objectives, and increases in shareholder value. The Compensation Committee regularly reviews the compensation packages of Chaparral's executive officers, taking into account factors which it considers relevant, such as business conditions within and outside the industry, Chaparral's financial performance, the market composition for executives of similar background and experience, and the performance of the executive officer under consideration. The particular elements of Chaparral's compensation programs for executive officers are described below.

## Compensation Structure

The base compensation for the executive officers of Chaparral named in the Summary Compensation Table is intended to be competitive with that paid in comparable situated industries, taking into account the scope of responsibilities. The goals of the Compensation Committee in establishing Chaparral's executive compensation program are:

- to compensate the executive officers of Chaparral fairly for their contributions to Chaparral's short, medium and long-term performance; and

- to allow Chaparral to attract, motivate and retain the management personnel necessary to Chaparral's success by providing an executive compensation program comparable to that offered by companies with which Chaparral competes for management personnel.

The elements of Chaparral's executive compensation program are annual base salaries, annual bonuses and equity incentives. The Compensation Committee bases its decisions on the scope of the executive's responsibilities, a subjective evaluation of the executive's performance and the length of time the executive has been in the position.

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees, and consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2005.

## Compensation of the Chief Executive Officer

During fiscal year 2005, Mr. Gill served as Chief Executive Officer of Chaparral until December 2005 when he resigned. In establishing his base salary, the Compensation Committee considered the factors set forth above, including the level of CEO compensation in other publicly owned/similar sized development and production companies in the oil and gas industry and their level of involvement in the day-to-day operations of Chaparral.

## Executive Compensation Deductibility

Chaparral intends that amounts paid under Chaparral's compensation plans generally will be deductible compensation expenses. The Compensation Committee does not currently anticipate that the amount of compensation paid to executive officers will exceed the amounts specified as deductible according to Section

162(m) of the Internal Revenue Code of 1986.



## Compensation Committee Interlocks and Insider Participation

No executive officer or director of Chaparral serves as an executive officer, director, or member of a compensation committee of any other entity, for which an executive officer, director, or member of such entity is a member of the board or the Compensation Committee of the board. There are no other interlocks.

Compensation Committee of the Board of Directors,
O. Movsumov, Chairman
B. Zilbermints
P. G. Dilling

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The following table sets forth information as of March 10, 2006, with respect to our directors, named executive officers and each person who is known by us to own beneficially more than 5% of our common stock, and with respect to shares owned beneficially by all of our directors and executive officers as a group. The address for all of our directors and executive officers of Chaparral is 2 Gannett Drive, Suite 418, White Plains, New York 10604.

| Name of Beneficial Owner | Position | Amount and Nature of Beneficial Ownership (1) | Percen St |
|---|---|---|---|
| Open Joint Stock Company "Oil" Company "LUKOIL" 11, Sretensky Boulevard Moscow Russia, 101000 | - | 26,002,624 | |
| Allen & Company Incorporated 711 Fifth Avenue New York, New York 10022 | - | 3,813,854 | |
| Peter G. Dilling | Director | - | |
| Alan D. Berlin | Director | 167 | |
| Dimitri Timoshenko | Director | - | |
| Oktay Movsumov | Director | - | |
| Boris Zilbermints | Director and Chief Executive Officer | - | |
| R Frederick Hodder | Former Chairman of the Board | - | |
| Simon K. Gill | Former Director and Chief Executive Officer | - | |
| Nicholas P. Greene | Former Director | - | |

| Name of Beneficial Owner | Position | Amount and Nature of Beneficial Ownership (1) | Percen St |
|---|---|---|---|
| Nikolai D. Klinchev | Former Director and Chief Executive Officer | 84 | |
| Charles I. Talbot | VP-Finance and Chief Financial Officer | - | |
| Nigel F. Penney | Former VP-Finance and Chief Financial Officer | - | |
| Jonathan S. Wood | Former VP-Finance and Chief Financial Officer | - | |
| Miguel C. Soto | Former VP-Finance and Chief Financial Officer | - | |
| All current directors, nominees, executive officers as a group (six persons) | | 167 | |

* Represents less than 1% of the shares of Common Stock outstanding.

(1) Beneficial ownership of Common Stock has been determined for this purpose in accordance with Rule 13d-3 under the Exchange Act, under which a person is deemed to be the beneficial owner of securities if such person has or shares voting power or investment power with respect to such securities, has the right to acquire beneficial ownership within 60 days or acquires such securities with the purpose or effect of changing or influencing the control of Chaparral.

(2) In accordance with Rule 13d-3(d)(1)(i)(A), includes 3,076,923 shares underlying warrants to purchase shares of Common Stock. Does not include shares owned directly by officers and stockholders of LUKOIL with respect to which LUKOIL disclaim beneficial ownership. Officers and stockholders of LUKOIL may be deemed to beneficially own shares of the Common Stock reported to be beneficially owned directly by LUKOIL.

(3) Does not include shares owned directly by officers and stockholders of Allen Holding and Allen & Company with respect to which Allen Holding and Allen & Company disclaim beneficial ownership. Officers and stockholders of Allen Holding and Allen & Company may be deemed to beneficially own shares of the Common Stock reported to be beneficially owned directly by Allen Holding and Allen & Company.

1998 Incentive and Non-statutory Stock Option Plan

On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to 50,000 options to acquire Chaparral's common stock may be granted to officers, directors, employees or consultants of Chaparral and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or non-statutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. Chaparral has not granted any options under the 1998 Plan as of December 31, 2005.

2001 Stock Incentive Plan

In June 2001, Chaparral's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of Chaparral's common stock for issuance to Chaparral's officers, directors, employees and consultants. Chaparral has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2005.



ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In May 2002, Chaparral received a total equity and debt capital infusion of $45 million, which was partially utilized to repay a substantial portion of Chaparral's loan agreement with Shell Capital. Chaparral received a total investment of $12 million from CAIH, including $8 million in exchange for 22,925,701 shares, or 60%, of Chaparral's outstanding common stock, and $4 million in exchange for a three year note bearing interest at 12% per annum (the "Note"). Along with the Note, CAIH received a warrant to purchase 3,076,923 shares of Chaparral's common stock at $1.30 per share (the "Warrant"). These shares, the Note and the Warrant were purchased by Nelson in May 2004. Nelson was amalgamated with Caspian in December 2005.

Additionally, Kazkommertsbank, an affiliate of CAIH, provided KKM with a credit facility totaling $33 million, consisting of $28 million that was used to repay a portion of the Shell Capital Loan and $5 million that was made available for KKM's working capital requirements. Chaparral paid CAIH $1.79 million as a related restructuring fee. This loan was repaid in full on July 1, 2005. See Note 12 to our consolidated financial statements for the year ended December 31, 2005 for additional disclosure on loans with affiliates.

In 2003, Chaparral approved a one-year agreement with OJSC Kazkommerts Securities ("KKS"), an affiliate of Kazkommertsbank. The agreement was effective as of January 7, 2003 and provided for KKS to assist Chaparral's senior management with financial advisory and investment banking services. In consideration for the services, KKS received a monthly fee of $25,000 (the "Advisory Fee"). This agreement was extended until April 2004 when it was cancelled.

In August 2004, the Company approved a two-year agreement with Nelson to provide corporate administrative services and financial advisory services (the "Service Agreement") to support its business activities. The Service Agreement is effective as of June 1, 2004 and can be terminated upon 30 days written notice by either party. In consideration for these services Nelson will receive a fixed monthly fee of $20,000 for administrative services and $25,000 for financial advisory services (the "Management Fee"). As part of the Service Agreement, Nelson is also required to provide personnel to cover Chaparral's executive and managerial needs. The cost of executive and managerial personnel will be allocated on the basis of the cost of personnel involved and on the percentage of time actually spent by such personnel on matters related to Chaparral, as mutually agreed by the parties from time to time. In addition, Nelson would use its greater buying power to obtain more favorable rates for goods and services, including insurance coverage, for Chaparral. These expenditures will be passed to Chaparral at cost with a ten percent mark-up. The total amount charged for the Management Fee, the executive and managerial cost, insurance coverage and the mark-up under the Service Agreement during the year ended December 31, 2005 amounted to $677,000 and $682,000 during the year ended December 31, 2004.

On June 3, 2004, KKM entered into a three year agency agreement with Nelson (the "Marketing Agreement"), whereby Nelson becomes the duly authorized, exclusive agent for the purpose of marketing crude oil, and is empowered to represent the interests of KKM in relations with governmental authorities and commercial organizations and also enter into contracts and agreements and any other documents necessary for and related to the marketing of crude oil. The Marketing Agreement is effective as of June 1, 2004 and can be terminated upon 90 days written notice by either party. As consideration for the services provided under the Marketing Agreement, KKM shall pay Nelson a fixed fee of $20,000 per month and a variable fee of five US cents per barrel of total production in a reporting calendar month, if the amount of supplies to the local market in that month is more than 10% of the total amount of production, or eight US cents per barrel of total production in a reporting calendar month, if the amount of supplies to the local market in that month is less than 10% of the total amount of production (the "Marketing Fee"). In 2005 a total of $548,000 was charged under the marketing agreement compared to $274,000 during 2004.



ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

The following table shows the fees paid or accrued by Chaparral for the audit and other services provided by Ernst & Young and affiliated entities for the years ended December 31, 2005 and 2004.

| Description | 2005 | 2004 |
|---|---|---|
| | $000 | $000 |
| Audit Fees | 272 | 219 |
| Tax Fees | 11 | 21 |
| Audit Related Fees | - | - |
| All other fees | 3 | - |
| Total | 286 | 240 |

The Audit Committee must pre-approve audit-related and non-audit services not prohibited by law to be performed by Chaparral's independent auditors. The Audit Committee pre-approved all audit-related and non-audit services in 2005.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) Financial Statements

Table of Contents

Chaparral Resources, Inc.



(a)(2) Financial Statement Schedules

All schedules for which a provision is made in the applicable accounting regulations of the SEC that are not required under the related instructions or are inapplicable have been omitted.

(b) Exhibits.

| Exhibit No. | Description and Method of Filing |
|---|---|
| *2.1 | Stock Acquisition Agreement and Plan of Reorganization dated April 12, 1995 between Chaparral Resources, Inc., and the Shareholders of Central Asian Petroleum, Inc. |
| *2.2 | Escrow Agreement dated April 12, 1995 between Chaparral Resources, Inc., the Shareholders of Central Asian Petroleum, Inc. and Barry W. Spector. |
| *2.3 | Amendment to Stock Acquisition Agreement and Plan of Reorganization dated March 10, 1996 between Chaparral Resources, Inc., and the Shareholders of Central Asian Petroleum, Inc. |
| 3.1 | Certificate of Incorporation, dated April 21, 1999, incorporated by reference to Chaparral Resources, Inc.'s Notice and Definitive Schedule 14A dated April 21, 1999. |

| | |
|---|---|
| 3.2 | Bylaws, dated April 21, 1999, incorporated by reference to Annex IV to our Notice and Definitive Schedule 14A dated April 21, 1999. |
| 4.1 | Written Resolutions of the Shareholders of Central Asian Petroleum (Guernsey) Limited dated May 30, 2001, authorizing the issuance of Series A Preferred Shares in Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit 4.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2001, filed with SEC on August 14, 2001. |



| Exhibit No. | Description and Method of Filing |
|---|---|
| *10.1 | Agreement dated August 30, 1995 for Exploration, Development and Production of Oil in Karakuduk Oil Field in Mangistau Oblast of the Republic of Kazakhstan between Ministry of Oil and Gas Industries of the Republic of Kazakhstan for and on Behalf of the Government of the Republic of Kazakhstan and Joint Stock Company of Closed Type Karakuduk Munay Joint Venture. |
| *10.2 | License for the Right to Use the Subsurface in the Republic of Kazakhstan. |
| *10.3 | Amendment dated September 11, 1997, to License for the Right to Use the Subsurface in the Republic of Kazakhstan. |
| *10.4 | Amendment to License for the Right to Use the Subsurface in the Republic of Kazakhstan, dated December 31, 1998. |
| 10.5 | Letter from the Agency of the Republic of Kazakhstan on Investments to Central Asian Petroleum (Guernsey) Limited dated July 28, 1999 regarding License for the Right to Use the Subsurface in the Republic of Kazakhstan, incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1999, filed with the SEC on March 30, 2000. |
| *10.6 | 1998 Incentive and Non-statutory Stock Option Plan. |
| 10.7 | CRI-CAP(G) Loan Agreement, dated February 7, 2000, between Chaparral Resources, Inc. and Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit 10.13 to Chaparral Resources, Inc.'s Current Report on 8-K dated February 14, 2000, filed with the SEC on March 22, 2000. |
| 10.8 | CAP(G)-KKM Loan Agreement, dated February 7, 2000, between Closed Type JSC Karakudukmunay and Central Asian Petroleum (Guernsey) Limited, incorporated by reference to Exhibit 10.16 to Chaparral Resources, |

| | |
|---|---|
| | Inc.'s Current Report on 8-K dated February 14, 2000, filed with the SEC on March 22, 2000. |
| 10.9 | 2001 Stock Incentive Plan approved by the stockholders of Chaparral Resources, Inc. on June 21, 2001, incorporated by reference to Exhibit 10.43 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2001, filed with the SEC on April 15, 2002. |
| 10.10 | Master Agreement, dated May 9, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |
| 10.11 | Mutual Release Agreement, dated May 7, 2002, among Chaparral Resources, Inc., Central Asian Petroleum (Guernsey) Limited, Central Asian Petroleum, Inc. and Closed Type JSC Karakudukmunay, and Shell Capital Inc., Shell Capital Services Limited and Shell Capital Limited, incorporated by reference to Exhibit 10.2 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |
| 10.12 | Promissory Note, dated May 10, 2002, jointly and severally between Chaparral Resources, Inc. and Central Asian Petroleum (Guernsey) Limited and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.3 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |



| Exhibit No. | Description and Method of Filing |
|---|---|
| 10.13 | Stock Purchase Warrant, dated May 10, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.4 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |
| 10.14 | Registration Agreement, dated May 10, 2002, between Chaparral Resources, Inc. and Central Asian Industrial Holdings, N.V., incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |
| 10.15 | Agreement, dated May 8, 2002, between Chaparral Resources, Inc. and Exeter Finance Group, Inc., incorporated by reference to Exhibit 10.6 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |

| | |
|---|---|
| 10.16 | Stock Purchase Agreement, dated May 9, 2002, between Chaparral Resources, Inc. and Dardana Limited, incorporated by reference to Exhibit 10.7 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended March 31, 2002, filed with the SEC on May 20, 2002. |
| 10.17 | Loan Agreement #250, dated May 6, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.18 | Additional Agreement, dated May 6, 2002, to Loan Agreement #250, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.2 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.19 | Additional Agreement, dated June 6, 2002, to Loan Agreement #250, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.3 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.20 | Accessorial Agreement #5382A, dated May 6, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.4 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.21 | Additional Agreement, dated May 7, 2002, to Accessorial Agreement #5382A, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.5 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.22 | Accessorial Agreement #5896A, dated July 31, 2002, among Closed Joint Stock Company Karakudukmunai and Open Joint Stock Company Kazkommertsbank, incorporated by reference to Exhibit 10.6 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |

| Exhibit No. | Description and Method of Filing |
|---|---|
| 10.23 | Open Joint Stock Company Kazkommertsbank letter dated August 16, 2002, to Closed Joint Stock Company Karakudukmunai, incorporated by reference to Exhibit 10.7 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the quarter ended June 30, 2002, filed with the SEC on August 19, 2002. |
| 10.24 | Amendment to License dated December 11, 2002, to provide for the stabilization of taxes and clarification on tax laws applicable to KKM, incorporated by reference to Exhibit 10.58 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2002, filed with the SEC on March 31, 2003. |
| 10.25 | Service Agreement, dated January 7, 2003, between Chaparral Resources, Inc. and OJSC Kazkommerts Securities, incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2003, filed with the SEC on August 14, 2003. |
| 10.26 | Agency Agreement, dated June 3, 2004, between Nelson Resources Limited and Closed Type JSC Karakudukmunay incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the SEC on August 13, 2004. |
| 10.27 | Corporate Administrative and Financial Advisory Service Agreement, effective June 1, 2004, between Chaparral Resources, Inc. and Nelson Resources Limited, incorporated by reference to Exhibit 10.2 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the SEC on August 13, 2004. |
| 10.28 | Additional agreement to Accessorial agreement # 5382/A, dated July 28, 2004, between Kazkommertsbank OJSC and Closed Type JSC Karakudukmunay, incorporated by reference to Exhibit 10.3 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the SEC on August 13, 2004. |
| 10.29 | Accessorial agreement # 615/A, dated June 14, 2004, between Kazkommertsbank OJSC and Closed Type JSC Karakudukmunay, incorporated by reference to Exhibit 10.4 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2004, filed with the SEC on August 13, 2004. |
| 10.30 | Letter agreement between Chaparral Resources, Inc. and Nelson Resources Limited dated November 24, 2004, incorporated by reference to Exhibit 1.01 to Chaparral Resources, Inc.'s Report on Form 8-K dated November 24, 2004, filed with the SEC on November 29, 2004. |

| | |
|---|---|
| 10.31 | Promissory Note Amendment Agreement by and among Chaparral Resources, Inc. and Central Asian Petroleum (Guernsey) Limited and NRL Acquisition Corp. dated March 22, 2005, incorporated by reference to Exhibit 99.1 to Chaparral Resources, Inc's Annual Report on Form 10-K for the year ended December 31, 2004, filed with the SEC on March 31, 2005. |
| 10.32 | Guarantee between Closed Type JSC Karakudukmunay and Nelson Resources Limited dated April 19, 2005, incorporated by reference to Exhibit 10.1 to Chaparral Resources, Inc.'s Quarterly Report on Form 10-Q for the period ended June 30, 2005, filed with the SEC on August 12, 2005. |
| 14 | Chaparral's Code of Ethics, incorporated by reference to Exhibit 99.2 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2003, filed with the SEC on March 29, 2004. |

36

| Exhibit No. | Description and Method of Filing |
|---|---|
| 21 | Subsidiaries of the Registrant, incorporated by reference to Exhibit 21 to Chaparral Resources, Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1997, filed with the SEC on April 6, 1998. |
| **31.2 | Certification Pursuant to Item 601(b)(31) of Regulation S-K, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| **32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K). |
| **32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished pursuant to Item 601(b)(32) of Regulation S-K). |
| **99.1 | Form 8-K filed with the Securities and Exchange Commission on March 14, 2006 is incorporated by reference. |
| **99.2 | Complaint filed in the Court of Chancery in the State of Delaware in and for New Castle County, captioned Robert Kelly, individually and on behalf of all others similarly situated, v. Dmitry Timoshenko, Oktay Movsumov, Boris Zilbermints, Peter G. Dilling, Alan D. Berlin, LUKOIL Overseas Holding, Ltd. and Chaparral Resources, Inc., Civil Action No. 2001-N, filed March 14, 2006. |

* These exhibits, previously incorporated by reference to Chaparral's reports under file number 0-7261, have now been on file with the Commission for more than 5 years and are not filed with this Annual Report. We agree to furnish these documents to the Commission upon request.

** Filed herewith.



SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

CHAPARRAL RESOURCES, INC.,
a Delaware corporation

By: /s/ Boris Zilbermints
-----------------------------------------
Boris Zilbermints
Chief Executive Officer
(Principal Executive Officer)

By: /s/ Charles Talbot
-------------------------------------
Charles Talbot
Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: March 17, 2006

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated:

| Date | Name and Title | Signature |
|---|---|---|
| March 17, 2006 | Alan D. Berlin<br>Director and Corporate secretary | /s/ Alan D. Berlin |

| | | |
|---|---|---|
| March 17, 2006 | Peter G. Dilling<br>Director | /s/ Peter G. Dilling<br>------------------------- |
| March 17, 2006 | Oktay Movsumov<br>Director | /s/ Oktay Movsumov<br>------------------------- |
| March 17, 2006 | Dmitry Timoshenko<br>Director | /s/ Dmitry Timoshenko<br>------------------------- |
| March 17, 2006 | Boris Zilbermints<br>Director | /s/ Boris Zilbermints<br>------------------------- |



Consolidated Financial Statements

Chaparral Resources, Inc.

As of December 31, 2005 and 2004 and for the Three Years ended December 31, 2005 with Report of Independent Registered Public Accounting Firm

Chaparral Resources, Inc.

Consolidated Financial Statements

Contents

Chaparral Resources, Inc.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
Chaparral Resources, Inc.

We have audited the accompanying consolidated balance sheets of Chaparral Resources, Inc. and subsidiaries (the "Company") as of December 31, 2005 and 2004, and the related consolidated statements of operations, cash flows, and changes in stockholders' equity for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Chaparral Resources, Inc. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with US generally accepted accounting principles.

/s/ Ernst & Young Kazakhstan LLP
-----------------------------------
Ernst & Young Kazakhstan LLP

March 17, 2006
Almaty, Kazakhstan

CHAPARRAL RESOURCES, INC.
CONSOLIDATED BALANCE SHEET

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | 20,995 | 9,611 |
| Accounts receivable: | | |
| Oil sales receivable | 15,767 | 316 |
| VAT receivable (Note 2) | 6,671 | 2,212 |
| Other receivables from affiliates | 17 | 1,002 |
| Prepaid expenses (Note 3) | 4,716 | 3,472 |
| Income taxes recoverable | 2,301 | -- |
| Crude oil inventory | 596 | 36 |
| Total current assets | 51,063 | 16,649 |
| Materials and supplies | 8,082 | 5,238 |
| Other (Note 4) | 2,119 | 336 |
| Property, plant and equipment: | | |
| Oil and gas properties, full cost (Note 5) | 183,505 | 153,001 |
| Other property, plant and equipment (Note 6) | 12,143 | 10,974 |
| | 195,648 | 163,975 |
| Less - accumulated depreciation, depletion and amortization | (88,120) | (62,495) |
| Property, plant and equipment, net | 107,528 | 101,480 |
| Total assets | 168,792 | 123,703 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED BALANCE SHEET

December 31,

| | 2005 | 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable (Note 19) | 8,497 | 8,540 |
| Advances received | -- | 387 |
| Prepaid sales (Note 7) | 361 | 6,590 |
| Accrued liabilites: | | |
| Accrued compensation | -- | 241 |
| Other accrued liabilities (Note 9) | 6,000 | 1,822 |
| Accrued interest payable (Note 12) | 106 | 713 |
| Current income tax liability (Note 14) | 62 | 2,052 |
| Current portion of loans payable (Note 12) | 24,679 | 19,778 |
| Total current liabilities | 39,705 | 40,123 |
| Accrued production bonus (Note 10) | 395 | 299 |
| Loans payable (Note 12) | 7,333 | 12,000 |
| Deferred income tax liability (Note 14) | 62 | 3,258 |
| Minority interest | 34,164 | 12,099 |
| Asset retirement obligation (Note 11) | 1,624 | 1,232 |
| Commitments and contingencies (Note 16) | -- | -- |
| Stockholders' equity | | |
| Common Stock (Note 13) - authorized 100,000,000 shares of $0.0001 par value; issued and outstanding 38,209,502 shares as of December 31, 2005 and December 31, 2004 | 4 | 4 |
| Capital in excess of par value | 107,226 | 107,226 |
| Preferred stock - 1,000,000 shares authorized, 925,000 shares undesignated. Issued and outstanding - none | -- | -- |
| Accumulated deficit | (21,721) | (52,538) |
| Total stockholders' equity | 85,509 | 54,692 |
| Total liabilities and stockholders' equity | 168,792 | 123,703 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED STATEMENT OF OPERATIONS

| | December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |

| | | | |
|---|---|---|---|
| Revenue | 150,584 | 78,451 | 57,615 |
| Costs and expenses: | | | |
| Transportation costs | 16,951 | 14,046 | 11,474 |
| Operating expenses | 15,828 | 8,319 | 5,915 |
| Excess Profits Tax | 3,220 | -- | -- |
| Impairment of materials inventory | -- | 409 | -- |
| Marketing fee (Note 19) | 548 | 274 | -- |
| Depreciation, depletion and amortization | 25,375 | 18,180 | 18,038 |
| Management fee (Note 19) | 677 | 450 | -- |
| Advisory fee (Note 19) | -- | 100 | 300 |
| Hedge losses (Note 8) | 267 | -- | -- |
| Accretion expense | 148 | 112 | 73 |
| General and administrative | 7,088 | 8,390 | 7,762 |
| | 70,102 | 50,280 | 43,562 |
| Income from operations | 80,482 | 28,171 | 14,053 |
| Other income/(expense): | | | |
| Interest income | 251 | 118 | 24 |
| Interest expense | (4,678) | (5,552) | (4,526) |
| Currency exchange loss | (259) | (628) | (62) |
| Minority interest | (22,064) | (7,464) | (4,314) |
| Other | (20) | 997 | (11) |
| | (26,770) | (12,529) | (8,889) |
| Income before income taxes and cumulative effect of change in accounting principle | 53,712 | 15,642 | 5,164 |
| Income tax expense (Note 14) | (22,895) | (7,120) | (4,121) |
| Income before cumulative effect of change in accounting principle | 30,817 | 8,522 | 1,043 |
| Cumulative effect of change in accounting principle, net of taxes of $436,000 (Notes 1 & 11) | -- | -- | 1,018 |
| Net income available to common Stockholders | 30,817 | 8,522 | 2,061 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED STATEMENT OF OPERATIONS

| | December 31, | |
|---|---|---|
| 2005 | 2004 | 2003 |

| | | | |
|---|---|---|---|
| | ---- | ---- | ---- |
| Basic earnings per share (Note 13): | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.81 | $ 0.22 | $ 0.03 |
| Cumulative effect of change in accounting principle | $ - | $ - | $ 0.02 |
| Net income per share | $ 0.81 | $ 0.22 | $ 0.05 |
| Weighted average number of shares outstanding (basic) | 38,209,502 | 38,209,502 | 38,209,502 |
| Diluted earnings per share (Note 13): | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.77 | $ 0.22 | $ 0.03 |
| Cumulative effect of change in accounting principle | $ - | $ - | $ 0.02 |
| Net income per share | $ 0.77 | $ 0.22 | $ 0.05 |
| Weighted average number of shares outstanding (diluted) | 40,111,817 | 38,407,283 | 38,209,502 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

| | | December 31, | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |
| Cash flows from operating activities | | | |
| Net income | 30,817 | 8,522 | 2,061 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation, depletion and amortization | 25,375 | 18,180 | 18,038 |
| Impairment of materials inventory | -- | 409 | -- |
| Loss on disposition of assets | -- | 3 | 11 |
| Deferred income taxes | (3,196) | 201 | 2,311 |
| Cumulative effect of change in accounting principle | -- | -- | (1,018) |
| Accretion expense | 148 | 112 | 73 |
| Amortization of note discount | 222 | 494 | 286 |
| Currency exchange loss | 259 | 628 | 62 |
| Minority interest | 22,064 | 7,464 | 4,314 |
| Changes in assets and liabilities: | | | |
| (Increase)/decrease in: | | | |
| Accounts receivable | (18,925) | (407) | 870 |
| Prepaid expenses and income tax recoverable | (3,545) | (237) | (775) |
| Crude oil inventory | (309) | 110 | 55 |
| Increase/(decrease) in: | | | |
| Accounts payable and accrued liabilities | 1,645 | 2,463 | (2,156) |
| Accrued interest payable | (607) | (63) | 526 |

| | | | |
|---|---|---|---|
| Other liabilities | (6,520) | 7,212 | 213 |
| Net cash provided by operating activities | 47,428 | 45,091 | 24,871 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED STATEMENT OF CASH FLOWS

| | December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| | $ 000 | $ 000 | $ 000 |
| Cash flows from investing activities | | | |
| Additions to property, plant and equipment | (31,429) | (33,324) | (24,800) |
| Materials and supplies inventory | (2,844) | (2,459) | (732) |
| Proceeds from disposition of assets | -- | -- | 5 |
| Net cash used in investing activities | (34,273) | (35,783) | (25,527) |
| Cash flows from financing activities | | | |
| Proceeds from loans | 59,000 | 7,000 | 6,500 |
| Payments on loans | (58,988) | (9,000) | (7,500) |
| Other long-term assets | (1,783) | (336) | -- |
| Net cash used by financing activities | (1,771) | (2,336) | (1,000) |
| Net increase/(decrease) in cash and cash equivalents | 11,384 | 6,972 | (1,656) |
| Cash and cash equivalents at beginning of year | 9,611 | 2,639 | 4,295 |
| Cash and cash equivalents at end of year | 20,995 | 9,611 | 2,639 |
| Supplemental cash flow disclosure | | | |
| Interest paid, net of amounts capitalized | 4,069 | 4,839 | 4,282 |
| Income taxes paid | 30,382 | 1,984 | 5,019 |
| Supplemental schedule of non-cash investing and financing activities | | | |
| Non-cash additions to oil and gas properties | 244 | 372 | 3,939 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.
CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

| | Common Stock | | Capital in Excess | Accumulated | |
|---|---|---|---|---|---|
| | Shares | Amount | of Par Value | Deficit | Total |
| | | $ 000 | $ 000 | $ 000 | $ 0 |
| Balance at December 31, 2002 | 38,209,502 | 4 | 107,226 | (63,121) | 44,1 |
| Net income for the year 2003 | -- | -- | -- | 2,061 | 2,0 |
| Balance at December 31, 2003 | 38,209,502 | 4 | 107,226 | (61,060) | 46,1 |
| Net income for the year 2004 | -- | -- | -- | 8,522 | 8,5 |
| Balance at December 31, 2004 | 38,209,502 | 4 | 107,226 | (52,538) | 54,6 |
| Net income for the year 2005 | -- | -- | -- | 30,817 | 30,8 |
| Balance at December 31, 2005 | 38,209,502 | 4 | 107,226 | (21,721) | 85,5 |

See accompanying notes.



CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies and Organization

Organization, Principles of Consolidation and Basis of Presentation

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 greater than 50% owned subsidiaries, ZAO 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 through CAP-D. Hereinafter, Chaparral and its subsidiaries are collectively referred to as the "Company". All significant intercompany transactions have been eliminated.

Since May 2002 Chaparral has owned a 60% interest in KKM, a limited liability company incorporated in Kazakhstan. 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'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.

KKM is owned jointly by CAP-G (50%), MTI (10%) and Caspian Investments Resources Ltd. ("Caspian") (40%). In May 2002, Chaparral increased its ownership in KKM from 50% to 60% through the acquisition of 100% of the outstanding stock of MTI, a Kazakhstan company.

As a result of the acquisition of MTI during 2002, the Company obtained a controlling interest in KKM. Consequently, the Company's financial statements have been consolidated with KKM on a retroactive basis to January 1, 2002. The Company previously accounted for its 50% investment in KKM using the equity method of accounting, which is reflected in the Company's financial statements for periods prior to 2002.

In May 2004, Nelson became the majority shareholder in Chaparral when it purchased 22,925,701 shares from Central Asian Industrial Holdings, N.V. In December 2004 KazMunayGaz JSC ("KMG"), the state owned national petroleum and transportation company of the Republic of Kazakhstan, which owned a 40% interest in KKM, sold its entire interest in KKM to Nelson. Since May 2004, Nelson has owned approximately 60% of the outstanding common stock of Chaparral. On October 14, 2005 LUKOIL Overseas, a wholly owned subsidiary of OAO LUKOIL acquired a 65% interest in Nelson. On December 5, 2005 LUKOIL Overseas acquired the remaining shares of Nelson. On the same date Nelson was amalgamated with Caspian Investments Resources Limited ("Caspian") and Nelson ceased to exist. See Note 12 for further details.

Certain comparative figures presented for the 2003 financial statements have been reclassified to conform to the 2004 presentation.

Acquisitions

In May 2002, the Company acquired 100% of the outstanding shares of MTI from Dardana Limited. MTI's only asset was its 10% ownership interest in KKM. The Company acquired MTI to obtain a controlling interest in KKM as well as to increase the Company's ownership interest in the Karakuduk Field. The aggregate purchase price was $3.9 million, comprising $1.2 million of cash and common stock valued at $2.7 million. The value of the 1 million common shares issued was determined based on the average market price of the Company's common shares over the 3-day period before and after the terms of the acquisition were agreed and announced. As a result, the total purchase price of $3.9 million was recorded as an addition to the Company's oil and gas properties.



CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

1. Summary of Significant Accounting Policies and Organization (continued)

Exercise of Right of First Refusal of Purchase of Minority Interest in KKM

In November 2004 the Company entered into an agreement with its former majority stockholder, Nelson, which provided that in the event Chaparral, through CAP-G and/or MTI, received notice from KazMunayGaz JSC ("KMG"), the state owned national petroleum and transportation company of the Republic of Kazakhstan, that KMG desired to sell its 40% equity interest in KKM, then the Company would, if requested by Nelson, exercise its right of first refusal under the Agreement to purchase such interest at the price and on the terms specified in such notice. In December 2004, pursuant to this agreement, the Company, through CAP-G, exercised its right of first refusal to purchase from KMG the remaining 40% equity interest in KKM. The Company entered into definitive sale and purchase agreements with both KMG and Nelson, which provided that upon completion of the acquisition by CAP-G, ownership of the newly acquired 40% interest in KKM would be transferred to Nelson. The transfer of the 40% interest from KMG to CAP-G occurred in December 2004, and the transfer from CAP-G to Nelson was completed in January 2005. The purchase price of $34.6 million paid by CAP-G to KMG was determined on an open tender, and the funds for this were made available to CAP-G by Nelson. In addition, Nelson paid the Company a fee of $1.0 million, recorded as part of Other Income, as well as all documentation and transaction costs relating to the acquisition.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid investments purchased with an original maturity of three months or less.

Revenue Recognition

Revenue and related costs are recognized upon delivery of commercial quantities of oil production from proved reserves, in accordance with the accrual method of accounting. Losses, if any, are provided for in the period in which the loss is determined to occur.

Revenue is presented gross of transportation expenses in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs.

Foreign Currency Translation

The Company's 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 in 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 (133.77 and 130.00 Kazakh Tenge per U.S. Dollar as of December 31, 2005 and 2004, 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 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 that the Company could realize or settle these assets and liabilities in U.S. Dollars.

The Company had $1.8 million of net monetary liabilities denominated in Tenge as of December 31, 2005, compared to $8.2 million at December 31, 2004.





1. Summary of Significant Accounting Policies and Organization (continued)

Interest Capitalization

The Company capitalizes interest on significant construction projects. Statement of Financial Accounting Standards ("SFAS") 34, Capitalization of Interest Costs, provides standards for the capitalization of interest costs as part of the historical cost of acquiring assets. FASB Interpretation No. 33 ("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 depreciation, depletion and amortization (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. The Company incurred interest costs of $4.67 million and $5.76 million for the years ended December 31, 2005 and 2004, respectively. In the year ended December 31, 2004 the Company capitalized interest totaling $213,000. No interest was capitalized in 2005.

Oil and Gas Properties - Full Cost Method

The Company follows the full cost 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 using the unit-of-production method based on 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.

In addition, the capitalized costs are subject to a "ceiling test." 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.

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. Abandonment of properties is accounted for as adjustments of capitalized costs with no loss recognized.

Other Property, Plant and Equipment

Other property, plant and equipment are valued at historical cost and depreciated on a straight line basis over the estimated useful lives of the assets, as follows:

| Description | Period |
|---|---|
| Office buildings and apartments | 20 years |
| Office equipment | 3 years |
| Vehicles | 5 years |
| Field buildings | 15 years |
| Field equipment | Up to 10 years |





1. Summary of Significant Accounting Policies and Organization (continued)

Inventory

Crude oil inventory is valued using the first-in, first-out method, at the lower of cost or net realizable value. Crude oil inventory value represents production costs associated with lifting and transporting crude oil from the Karakuduk Field to the KazTransOil pipeline. Crude oil placed into the KazTransOil pipeline is held as inventory until formally nominated and delivered for sale. Crude oil inventory as of December 31, 2005 and 2004 was approximately 53,000 barrels and 4,000 barrels of crude oil, respectively.

Materials and supplies inventory is valued using the first-in, first-out method, at the lower of cost or net realizable value. Certain unique items, such as drilling equipment, are valued using the specific identification method. Materials and supplies represent plant and equipment for development activities, drill bits, tubing, casing, wellheads, etc. required for development drilling operations, spare parts, diesel fuel and various other materials for use in oil field operations.

Earnings Per Common Share

Basic Earnings Per Share ("EPS") is computed by dividing the income or loss available to common stockholders by the weighted-average number of common shares outstanding during the period. The computation of diluted EPS is similar to the computation of basic EPS except that the numerator is increased to exclude certain charges which would not have been incurred, and the denominator is increased to include the number of additional common shares that would have been outstanding (using the if-converted and treasury stock methods), if securities containing potentially dilutive common shares (warrants, convertible notes payable and options) had been converted to such common shares, and if such assumed conversion is dilutive. The Company's basic and diluted EPS for the first three quarters of 2004 and for the year ended December 31, 2003 are the same, as the assumed conversion of all potentially dilutive securities would have been anti-dilutive. Diluted EPS has been calculated for the years ended December 31, 2005 and 2004 as the assumed conversion of all potentially dilutive securities would have been dilutive for the last quarter of 2004 and all quarters of 2005.

New Accounting Standards

In April 2003, the Financial Accounting Standards Board ("FASB") issued SFAS No. 149, Amendment of Statement 133 on 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 had no effect on the Company's consolidated 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 the Company as of July 1, 2003. The adoption of the applicable provisions of this statement as of the indicated dates had no effect on the Company's financial statements.

In January 2003, the FASB issued Interpretation No. 46 ("FIN 46"), Consolidation of Variable Interest Entities, an interpretation of ARB 51. The primary objectives of this interpretation are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities") and how to determine which business enterprise (the "primary beneficiary") should consolidate the variable interest entity and when.





1. Summary of Significant Accounting Policies and Organization (continued)

New Accounting Standards (continued)

This new model for consolidation applies to an entity in which either (i) the equity investors (if any) do not have a controlling financial interest; or (ii) the equity investment at risk is insufficient to finance that entity's activities without receiving additional financial support from other parties. In addition, FIN 46 requires that the primary beneficiary, as well as all other enterprises with a significant variable interest in a variable interest entity, make additional disclosures. Certain disclosure requirements of FIN 46 were effective for financial statements issued after January 31, 2003.

In December 2003, the FASB issued FIN No. 46 (revised December 2003), Consolidation of Variable Interest Entities ("FIN 46-R") to address certain FIN 46 implementation issues. The effective dates and impact of FIN 46 and FIN 46-R are as follows:

(i) Special purpose entities ("SPEs") created prior to February 1, 2003. The company must apply either the provisions of FIN 46 or early adopt the provisions of FIN 46-R at the end of the first interim or annual reporting period ending after December 15, 2003.

(ii) Non-SPEs created prior to February 1, 2003. The company is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

(iii) All entities, regardless of whether a SPE, that were created subsequent to January 31, 2003. The provisions of FIN 46 were applicable for variable interests in entities obtained after January 31, 2003. The company is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after March 15, 2004.

The adoption of the provisions of FIN 46-R did not have a material impact on the Company's financial statements.

In June 2001, the FASB issued 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 11 for the effect of the adoption of SFAS 143.

In November 2004, the FASB issued SFAS 151, Inventory Costs, an Amendment of APB Opinion No. 43, Chapter 4. SFAS 151 clarifies the accounting treatment for various inventory costs and overhead allocations and is effective for inventory costs incurred after July 1, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In December 2004, the FASB issued SFAS 153, Exchanges of Non-monetary Assets, an Amendment of APB Opinion No. 29. SFAS 153 specifies the criteria required to record a non-monetary asset exchange using carryover basis and is effective for non-monetary asset exchanges occurring after July 1, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In December 2004, the FASB issued SFAS 123 (revised 2004) ("SFAS 123R"), Share Based Payments. SFAS 123R requires that the cost from all share-based payment transactions, including stock options, be recognized in the financial statements at fair value and is effective for public companies in the first interim period after June 15, 2005. It has not had a material impact on the Company's financial statements upon adoption.

In May 2005, the FASB issued SFAS 154, Accounting Changes and Error Corrections. SFAS 154 changes the accounting for and reporting of a change of accounting principle. It requires retrospective application of a change of accounting principle unless impracticable. SFAS 154 is effective for fiscal years beginning after December 15, 2005 and is not expected to have a material impact on the company's financial statements when adopted.

Fair Value of Financial Instruments

All of the Company's financial instruments, including cash and cash equivalents, accounts receivable, notes receivable, and loans payable, have fair values which approximate their recorded values as they are either short-term in nature or carry interest rates which approximate market rates.





1. Summary of Significant Accounting Policies and Organization (continued)

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Risks and Uncertainties

The ability of the Company to realize the carrying value of its assets is dependent on being able to develop, transport and market hydrocarbons. Currently, exports from the Republic of Kazakhstan are restricted since they are dependent on limited transport routes and, in particular, access to the Russian pipeline system. Domestic markets in the Republic of Kazakhstan do not permit world market prices to be obtained. Management believes, however, that over the life of the project, transportation restrictions will be alleviated by additional pipeline capacity being planned or currently under construction and prices will be achievable for hydrocarbons extracted to allow full recovery of the carrying value of its assets.

Customer credit concentration

During 2005 we sold all of our crude oil for export to Vitol Central Asia S.A. ("Vitol"). This accounted for approximately 98% of the Company's revenues during the year. KKM has a five year crude oil sales agreement in place with Vitol. Under this agreement the price for each month's delivery of crude oil is agreed in advance between the off-taker and KKM. KKM has the absolute right, at its own discretion, to sell its oil to a third party if a price cannot be agreed. Crude oil is a fungible product and, as such, a ready market is available subject to commodity price risk. All sales to Vitol are covered by an irrevocable letter of credit issued by an international bank having a long term credit rating of no less than 'A'.

2. VAT Receivable

The value added tax (VAT) receivable is a Tenge denominated asset due from the Republic of Kazakhstan. The VAT receivable consists of VAT paid on local expenditures and imported goods. Under the Agreement, VAT charged to the Company is recoverable in future periods as either cash refunds or offsets against the Company's fiscal obligations, including future income tax liabilities. Periodically, the Company reviews its outstanding VAT receivable for possible impairment. During the years ended December 31, 2005 and 2004, the Company utilized its VAT receivable to offset fiscal obligations for approximately $2.22 million and $3.33 million, respectively.





3. Prepaid Expenses

The breakdown of prepaid expenses is as follows:

| Description | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Prepaid transportation costs | 1,787 | 1,151 |
| Advanced payments for materials and supplies | 1,111 | 11,461 |
| Prepaid insurance | 486 | 568 |
| Deferred financing charges | 838 | -- |
| Other prepaid expenses | 494 | 292 |
| Total prepaid expenses | 4,716 | 3,472 |

Prepaid transportation costs represent prepayments to CJSC KazTransOil ("KTO"), a 100% subsidiary of KMG, for export tariffs necessary to sell oil on the export market, which is expensed in the period the related oil revenue is recognized. Advanced payments for materials and supplies represent prepayments for general materials and supplies to be used in the development of the Karakuduk Field.

4. Other Non-current Assets

| | Year ended December 31, 2005 | 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Liquidation fund deposit | 504 | 336 |
| Collection account for BNP / KBC loan (see Note 12) | 1,500 | -- |
| Other deferred charges | 115 | -- |
| | 2,119 | 336 |

In January 2004, KKM, as part of its obligations under the Agreement, commenced payments into an escrow account controlled by KKM and the Government of the Republic of Kazakhstan. The purpose of the payments is to provide a cash fund to use for future site restoration costs at the Karakuduk Field when operations cease. Monthly payments of $14,000 will be made until the fund reaches $3 million. In January 2004, an extra amount of $168,000 was paid for amounts due in 2003.

5. Oil and Gas Properties - Full Cost

The Company has capitalized all direct costs associated with acquisition, exploration, and development of the Karakuduk Field. These costs include geological and geophysical expenditures, license acquisition costs, tangible and intangible drilling costs, production facilities, pipelines and related equipment, access roads, gathering systems, management fees related to the salary costs of individuals directly associated with exploration and development activities, related interest costs associated with unproved properties and other costs permitted to be capitalized under the full cost method of accounting. Overhead and general and administrative costs have been expensed as incurred.





5. Oil and Gas Properties - Full Cost (continued)

The Company calculates depreciation, depletion and amortization of oil and gas properties using the unit-of-production method. A depletion rate is computed by dividing the unamortized costs of proved oil and gas properties by the total estimated proved reserves. This depletion rate is applied to the physical units of oil and gas produced during the relevant period. The unamortized costs of proved oil and gas properties include all capitalized costs net of accumulated amortization, estimated future costs to develop proved reserves and estimated dismantling and abandonment costs. Estimates of proved oil and gas reserves are prepared 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 existing contractual arrangement.

Estimation of oil and gas reserve quantities 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. The Company's estimates of reserves are expected to change as additional information becomes available. A material change in the estimated volumes of reserves could have an impact on the DD&A rate calculation and the financial statements.

The Company recognized total amortization expense of $24.54 million and $17.55 million for the years ended December 31, 2005 and 2004, respectively. For the same periods, the Company has an effective amortization rate of $6.94 and $6.19 per barrel produced, respectively. The Company's amortization expense during 2003 was $17.30 million.

In accordance with SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, the Company includes amortization of crude oil production as a component of crude oil inventory value until the related crude oil is sold. For the years ended December 31, 2005 and 2004, the Company had $331,000 and

$24,000 of amortization expense allocated to crude oil inventory, respectively.

Costs capitalized to oil and gas properties consist of:

| Description | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Acquisition costs | 10,633 | 10,633 |
| Exploration and appraisal costs | 22,277 | 22,277 |
| Development costs | 142,209 | 111,950 |
| Other capitalized costs | 1,097 | 1,097 |
| Capitalized interest | 6,088 | 6,088 |
| Asset Retirement Obligation | 1,201 | 956 |
| Total oil and gas properties at cost | 183,505 | 153,001 |
| Accumulated amortization | (82,881) | (58,035) |
| Net properties subject to amortization | 100,624 | 94,966 |





5. Oil and Gas Properties - Full Cost (continued)

The condensed financial statements of KKM are as follows:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Condensed balance sheet | | |
| Current assets | 49,908 | 14,427 |
| Non-current assets (primarily oil and gas properies, full cost method) | 112,710 | 100,893 |
| Current liabilities | 36,235 | 38,790 |
| Non-current liabilities: | | |
| Loans payable | 38,892 | 41,492 |
| Other non-current liabilities | 2,081 | 4,789 |
| Charter capital | 200 | 200 |
| Retained earnings | 85,210 | 30,049 |
| Condensed income statement | | |
| Revenues | 150,584 | 78,451 |
| Costs and expenses | (95,423) | (59,791) |
| Net income | 55,161 | 18,660 |

6. Other Property, Plant and Equipment

A summary of other property, plant and equipment is provided in the table below:

| Description | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Office buildings and apartments | 971 | 960 |
| Office equipment and furniture | 1,712 | 1,146 |
| Vehicles | 2,107 | 1,626 |
| Land | 25 | 25 |
| Field buildings | 6,349 | 6,327 |
| Field equipment and furniture | 979 | 890 |
| Total cost | 12,143 | 10,974 |
| Accumulated depreciation | (5,239) | (4,460) |
| Property, plant and equipment, net | 6,904 | 6,514 |

Depreciation expense for property, plant and equipment was $837,000, $625,000, and $734,000 for the years ending December 31, 2005, 2004 and 2003, respectively.





7. Prepaid Sales

Under the terms of its sales agreements with Vitol Central Asia S.A. ("Vitol"), KKM can receive up to one months forecast revenues one month in advance. Vitol charges interest on these prepaid sales amounts at LIBOR plus 3%. At December 31, 2005 and 2004, KKM had $0.36 million and $6.59 million respectively of prepaid sales.

8. Hedge Agreement

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, 138, and 149, is effective for years beginning after June 15, 2000. The Company adopted SFAS 133 on January 1, 2001. 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 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, which require derivative financial instruments to be recorded at their fair value.

Nelson entered into a hedging agreement with BNP, for the benefit of KKM, in April 2005, and this agreement was novated in favor of KKM during September 2005. Under this agreement, KKM had the option each month, from April 2005 to December 2005, to require BNP to pay it an amount per barrel of specified monthly amounts of crude oil equivalent to the excess of $33.00 per barrel over the monthly average for that month of dated Brent. The crude oil amounts specified were 75,000 barrels per calendar month during the second quarter of 2005, 160,000 barrels per calendar month during the third quarter of 2005 and 170,000 barrels per calendar month during the last quarter of 2005. Nelson paid BNP $267,300 as consideration, equivalent to $0.22 per barrel. This hedging arrangement was entered into to ensure that variable receipts from oil revenues were sufficient to meet obligations falling due under the BNP / KBC note facility. The cost of this hedge was recorded as an expense during 2005.

The Company did not enter into any hedge agreements during 2003 and 2004.

9. Other Accrued Liabilities

| Description | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Accrued taxes payable | 2,306 | 1,178 |
| Excess profits tax | 3,220 | -- |
| Other accrued liabilities | 474 | 644 |
| Total accrued liabilities | 6,000 | 1,822 |





10. Accrued Production Bonus

Accrued production bonus represents production based bonuses payable to the Government of Kazakhstan, of $500,000 when cumulative production reaches 10 million barrels and $1.2 million when cumulative production reaches 50 million barrels. Under current Kazakhstan tax law, the production bonuses will be considered tax deductible expenditures in the calculation of income taxes. The Company accrues the production bonuses in relation to cumulative oil production. The Company accrued $96,000, $109,000 and $213,000 in production bonuses for the years ended December 31, 2005, 2004 and 2003, respectively. The first production bonus of $500,000 was settled in July 2004 via offset against VAT repayable to the Company.

11. Asset Retirement Obligation

As discussed in Note 1, 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. Under the new accounting method, the Company now recognizes 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.

The cumulative effect of the change on prior years resulted in a gain of $1.02 million, net of tax of $436,000, or $0.02 per share, which is included in income for the year ended December 31, 2003.

Since 1995, the core business of the Company has been the development of the Karakuduk Field. The Company has developed an asset that is capable of producing, processing and transporting crude oil to export markets. The field still requires up to possibly 80 new wells, but the oil processing and transportation infrastructure, apart from the obligatory gathering lines and up to four more gathering stations, are in place. However, further infrastructure development is planned to increase profitability of the operation, utilize gas and to maximise oil and produced fluid processing. 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 unit-of-production method over proved reserves.

The following table describes all changes to the Company's asset retirement obligation liability:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Asset retirement obligation at beginning of year | 1,232 | 804 |
| Accretion expense | 148 | 112 |
| Liability incurred | 244 | 316 |
| Asset retirement obligation at end of year | 1,624 | 1,232 |





## 12. Loans Payable

### The Note

In May 2002, the Company received a total equity and debt capital infusion of $45 million, which was partially utilized to repay a substantial portion of the Company's loan agreement with Shell Capital, Inc. (the "Shell Capital Loan"). The Company received a total investment of $12 million from Central Asian Industrial Holdings, N.V. ("CAIH"), including $8 million in exchange for 22,925,701 shares, or 60%, of the Company's outstanding common stock, and $4 million in exchange for a three year note bearing interest at 12% per annum (the

"Note"). Along with the Note, CAIH received a warrant to purchase 3,076,923 shares of the Company's common stock at $1.30 per share (the "Warrant"). Additionally, Kazkommertsbank, an affiliate of CAIH, provided KKM with a credit facility totaling $33 million (the "KKM Credit Facility"), consisting of $28 million that was used to repay a portion of the Shell Capital Loan and $5 million that was made available for KKM's working capital requirements. The Company paid CAIH $1.79 million as a related restructuring fee. After May 2002, the Company has no further commitments or obligation under the Shell Capital Loan.

The Note was recorded net of a $2.47 million discount, based on the fair market value of the Warrant issued in conjunction with the Note. The discount is amortized using the effective interest rate over the life of the Note. The principal balance of the Note is due on May 10, 2005 and accrued interest is payable quarterly. The Warrant is fully discussed in Note 13.

In June 2002, the Company prepaid $2 million of the $4 million outstanding principal balance of the 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 Note. The extraordinary loss was netted against the extraordinary gain from the restructuring of the Shell Capital Loan. In March 2004, the Company re-borrowed the $2 million.

In May 2004, the CAIH shares, the Warrant and the Note were purchased by Nelson. On March 24, 2005, Chaparral and CAP-G signed a Promissory Note Amendment Agreement with Nelson. This provided for a prepayment of $1 million of the $4 million due to be repaid to Nelson on May 10, 2005 under the existing $4 million loan note and the replacement of the existing loan note with a new loan note for $3 million on substantially similar terms, but with an increase in the interest rate from 12% to 14% from May 10, 2005 and an extension of the maturity date of one year to May 10, 2006. On March 31, 2005 the $1 million prepayment was made, the existing loan note was cancelled and the new loan note was signed. The benefit of the Warrant and the Note passed to Caspian upon its amalgamation with Nelson in December 2005.

The Company recognized the following amounts of interest relating to the Note:

| | December 31, 2005 | December 31, 2004 | December 31, 2003 |
|---|---|---|---|
| | $000 | $000 | $000 |
| Interest on principal | 430 | 422 | 240 |
| Discount amortization | 222 | 494 | 286 |
| | 652 | 916 | 526 |

Of the $422,000 interest paid by the Company during 2004, $362,000 was paid to Nelson. All of the interest during 2005 was paid to Nelson or Caspian.

KKM Credit Facility

As mentioned above, in May 2002, KKM established the KKM Credit Facility, a five-year, $33 million credit line with Kazkommertsbank. The KKM Credit Facility consisted 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 $1.71 million, $4.18 million and $4.0 million of interest expense on the KKM Credit Facility for the years ended December 31, 2005, 2004 and 2003, respectively.





12. Loans Payable (continued)

KKM Credit Facility (continued)

The non-revolving portion of the KKM Credit Facility accrued simple interest at an annual rate of 14% and was repayable over a five-year period with final maturity in May 2007. Accrued interest was payable quarterly, beginning in December 2002, and KKM began making quarterly principal repayments in May 2003. The proceeds of the BNP / KBC loan described below were utilized to repay the KKM Credit Facility in full on July 1, 2005.

The revolving portion of the KKM Credit Facility accrued simple interest at an annual rate of 14%. As at December 31, 2004, there was an outstanding balance of $3 million on the revolving portion of the loan which matured and was repaid on February 9, 2005. The revolving portion of the KKM Credit Facility was classified as current as of December 31, 2004. Accrued interest on the revolving loan was payable at maturity.

The original KKM Credit Facility included repayment terms of three years and four years for the non-revolving and revolving portions, 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 as of May 2002.

BNP / KBC Credit Facility

On March 24, 2005, KKM signed a $40 million Structured Crude Oil Pre-export Credit Facility Agreement with BNP Paribas (Suisse) SA ("BNP") and KBC Bank N.V. (the "BNP / KBC Credit Facility"). On June 30, 2005, $32 million was drawn down from this facility. For six months from 30 June, 2005 the facility is a revolving credit, after which the amount outstanding becomes a term loan repayable in 36 equal monthly installments commencing on December 30, 2005. The purpose of the loan is to refinance the KKM Credit Facility, fund future development costs and fund fees related to the facility.

Each year the lenders may propose, but are under no obligation to do so, an extension of the facility by one year, for an agreed fee, and/or an increase of the facility amount for an agreed fee. Each month during the term loan period, KKM may make full or partial prepayments of the facility at no extra cost. Partial prepayments must be for amounts of $2 million or more. The interest rate applicable under the facility is LIBOR plus 3.25% in the first year and LIBOR plus 4.00% thereafter. Interest is payable monthly. Fees paid by KKM include a 1.75% arrangement fee, a 1.65% p.a. commitment fee on the unused commitment during the revolving credit period, $100,000 for the lenders' legal costs and $15,000 for agency and technical bank fees. Fees payable include $15,000 per quarter in advance for agency and technical bank fees. A total of $0.8 million has been accrued for the arrangement fee and legal costs which is being amortized over the life of the facility.

As part of the BNP/KBC Credit Facility conditions, an Offtake Agreement was signed in June 2005 with Vitol Central Asia S.A. ("Vitol") whereby KKM is obligated to sell to Vitol, and Vitol is obligated to buy, all of KKM's crude oil production available for export at international market prices for five years from July 1, 2005, with step-in rights in favor of the lenders. In accordance with the BNP/KBC Credit Facility conditions, accounts receivable from Vitol are pledged as collateral for the loan. In addition, a performance and financial guarantee was issued by Nelson (the "Nelson Guarantee") in support of all amounts owing by KKM under the BNP/KBC Credit Facility. Under a separate agreement, in consideration for issuing the Nelson Guarantee, KKM will pay Nelson, annually in advance, a fee of 2.5% p.a. on the facility amount of $40 million for the first six months and on the daily principal amount of the loan outstanding during the term period. An amount of $1.0 million, which was paid in July for the estimated first years guarantee fee, has been accrued in June and is being amortized over twelve months.

A further condition of the BNP/KBC Credit Facility is that KKM enter into a Crude Oil Hedging Agreement before the end of August 2005. Nelson entered into such a hedging agreement with BNP, for the benefit of KKM, in April 2005, and this agreement was subsequently novated in favor of KKM. Under this agreement, KKM has the option each month, from April 2005 to December 2005, to require BNP to pay it an amount per barrel of specified monthly amounts of crude oil equivalent to the excess of $33.00 per barrel over the monthly average for that month of dated Brent. The crude oil amounts specified are 75,000 barrels per calendar month during the second quarter of 2005, 160,000 barrels per calendar month during the third quarter of 2005 and 170,000 barrels per calendar month during the last quarter of 2005. Nelson paid BNP $267,300 as consideration, equivalent to $0.22 per barrel.





12. Loans Payable (continued)

BNP / KBC Credit Facility (continued)

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

- (i) KKM has signed an Offtake Agreement for 100% of its export production, with step-in rights in favor of the lenders;
- (ii) Nelson has provided a written guarantee to the lenders that it will repay the BNP/KBC 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 the lenders;
- (iv) Subordination of existing loans, including inter-company, and any additional loans;
- (v) KKM may not pay dividends without the written consent of the lenders;
- (vi) Nelson to maintain a controlling interest in KKM; and
- (vii) A requirement to maintain a minimum credit balance in a "Collection Account". This balance should always exceed $1.5 million.

The BNP/KBC Credit Facility stipulates certain events of default, including, but not limited to, KKM's inability to meet the terms of the BNP/KBC Credit Facility and the Offtake Agreement, default by KKM or Nelson under any other agreements and material litigation involving Nelson or KKM. If an event of default does occur and is not waived by the lenders, they can require KKM to immediately repay the full amount outstanding under the facility and may enforce the Nelson

Guarantee and their step-in rights under the Offtake Agreement.

The maturity schedule of the Company's indebtedness as of December 31, 2005 is as follows:

| Date | Principal Amount Due |
|---|---|
| | $000 |
| 2006 | 24,677 |
| 2007 | 7,333 |
| Later years | - |
| Total principal due | 32,000 |

A prepayment of $12.0 million was made against the BNP / KBC credit facility in January 2006 and this amount is included in amounts falling due within 2006.

Balances as of December 31, 2005 under the different facilities are as follows:

| Date | Principal Amount Due |
|---|---|
| | $000 |
| BNP / KBC Credit Facility | 29,000 |
| The Note | 3,000 |
| Other | - |
| Total principal due | 32,000 |

The loans are shown in the balance sheet net of the Note discount, which amounted to nil at December 31, 2005 and $222,000 at December 31, 2004.





## 13. Common Stock

### General

### 1998 Incentive and Non-statutory Stock Option Plan

On June 26, 1998, the stockholders approved the 1998 Incentive and Non-statutory Stock Option Plan (the "1998 Plan"), pursuant to which up to 50,000 options to acquire the Company's common stock may be granted to officers, directors, employees or consultants of the Company and its subsidiaries. The stock options granted under the 1998 Plan may be either incentive stock options or non-statutory stock options. The 1998 Plan has an effective term of ten years, commencing on May 20, 1998. The Company has not granted any options under the 1998 Plan as of December 31, 2005.

### 2001 Stock Incentive Plan

In June 2001, the Company's stockholders approved the 2001 Stock Incentive Plan, which sets aside a total of 2.14 million shares of the Company's common stock for issuance to the Company's officers, directors, employees and consultants. The Company has not made any grants under the 2001 Stock Incentive Plan as of December 31, 2005.

Common Stock Offerings and Common Stock Warrant Issuances

As discussed in Note 12, the Company issued to CAIH a warrant to purchase 3,076,923 shares of the Company's common stock at an exercise price of $1.30 per share, subject to certain anti-dilution provisions. The Warrant is exercisable for five years from May 10, 2002, the date of grant. The fair market value of the Warrant of $2.47 million was recorded as a discount on the Note. The fair market value of the Warrant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 4.09%, dividend yield of 0%, volatility factor of the expected market price of the Company's common stock of 0.624, and a weighted average life expectancy of 3.5 years. The Warrant was sold to Nelson in May 2004. Nelson was amalgamated with Caspian in December 2005.

As discussed in Note 12, the Company received a total investment of $12 million from CAIH, including $8 million in exchange for 22,925,701 shares, or 60%, of the Company's outstanding common stock. These shares were sold to Nelson in May 2004.

SFAS 123 Disclosure

SFAS 123 requires that pro-forma information regarding net income and earnings per share are determined as if the Company had accounted for its employee stock options under the fair value method as defined in SFAS 123. The fair value for the options issued is estimated at the date of grant using the Black-Scholes option pricing model by using weighted average assumptions, volatility factors of the expected market price of the Company's common stock and the weighted average life expectancy of the options. The Company did not issue any options during the period 2000 to 2005 and all outstanding options were fully vested as of December 31, 1999, therefore pro-forma information is not presented.

Restrictions on dividend payments

Under the terms of the BNP / KBC credit facility KKM may not pay dividends without the written consent of the lenders. The total net assets of KKM at December 31, 2005 amounted to $85.41 million.





13. Common Stock (continued)

A summary of the Company's stock option activity and related information for the three years ended December 31, 2005 is as follows:

| | Shares under option | Weighted average exercise price $ | Weighted average fair value $ |
|---|---|---|---|
| Unexercised options at December 31, 2002 | 2,816 | 95.10 | - |
| Options Cancelled | (2,816) | 95.10 | - |

| | | | |
|---|---|---|---|
| Unexercised options at December 31, 2003 | - | - | - |
| Unexercised options at December 31, 2004 | - | - | - |
| Unexercised options at December 31, 2005 | - | - | - |
| Exercisable options - December 31, 2003 | - | - | |
| December 31, 2004 | - | - | |
| December 31, 2005 | - | - | |

The following table summarizes all common stock purchase warrant activity:

| | Number of stock warrants | Exercise price range $ |
|---|---|---|
| Outstanding, December 31, 2002 | 3,077,256 | 0.60 - 1.30 |
| Expired | (333) | 0.60 |
| Outstanding as of December 31, 2003 | 3,076,923 | 1.30 |
| Expired/cancelled/granted | - | - |
| Outstanding as of December 31, 2004 | 3,076,923 | 1.30 |
| Expired/cancelled/granted | - | - |
| Outstanding as of December 31, 2005 | 3,076,923 | 1.30 |





13. Common Stock (continued)

Earnings per Share

The following table reconciles basic and diluted earnings per share calculations:

| | Income $000 | Shares | Per share amount $ |
|---|---|---|---|
| Basic Earnings per Share | | | |
| Income available to common stockholders | 30,817 | 38,209,502 | 0.807 |
| Effect of Dilutive Securities | | | |
| Warrants | - | 1,902,315 | - |
| Diluted Earnings per Share | | | |

| | | | |
|---|---|---|---|
| Income available to common stockholders and assumed conversions | 30,817 | 40,111,817 | 0.768 |

14. Income Taxes

The Company accounts for income taxes under FASB 109, Accounting for Income Taxes. Deferred income tax assets and liabilities are determined based upon differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

For financial reporting purposes, income before income taxes, extraordinary gain, and cumulative effect of change in accounting principle includes the following components:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |
| Domestic | (1,357) | (1,745) | (3,883) |
| Foreign | 55,069 | 17,387 | 9,047 |
| | 53,712 | 15,642 | 5,164 |





14. Income Taxes (continued)

The components of the income tax provision are as follows:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |
| Income tax provision: | | | |
| Current: | | | |
| Domestic | -- | -- | -- |
| Foreign | 26,091 | 6,919 | 2,246 |
| Total current | 26,091 | 6,919 | 2,246 |
| Deferred: | | | |
| Domestic | -- | -- | -- |
| Foreign | (3,196) | 201 | 1,875 |
| Total deferred | (3,196) | 201 | 1,875 |

| | | | |
|---|---|---|---|
| Total provision for income taxes | 22,895 | 7,120 | 4,121 |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's net deferred income taxes are as follows:

| | Year ended December 31, 2005 | 2004 |
|---|---|---|
| | $ 000 | $ 000 |
| Deferred tax assets: | | |
| Oil and gas assets | 1,527 | 1,279 |
| Sales of assets | -- | 25 |
| Obsolete inventory | 103 | 82 |
| Amortization of derivatives | 1,400 | 1,400 |
| Compensation and accrued expenses | 639 | 517 |
| Capital loss on transfer of net profits interest | 1,529 | 1,529 |
| Net operating loss carry-forwards | 8,989 | 8,428 |
| Other | -- | 93 |
| Deferred tax assets | 14,187 | 13,353 |
| Valuation allowance | (13,303) | (12,517) |
| Total deferred tax assets | 884 | 836 |
| Deferred tax liabilities: | | |
| Depreciation and other basis differences | (869) | (4,094) |
| Other | (77) | -- |
| Net deferred tax liabilities | (62) | (3,258) |





14. Income Taxes (continued)

SFAS 109 requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. After consideration of all the evidence, both positive and negative, management has determined that a $13.30 million valuation allowance at December 31, 2005 is necessary to reduce the deferred tax assets to the amount that will more likely than not be realized. The change in the valuation allowance for the current year is $0.79 million. The increase in valuation allowance is mainly due to net operating losses arising in 2005, that in the opinion of the Company are unlikely to be realized, partially offset by the expiration of net operating losses from prior years.

As of December 31, 2005, the Company has estimated domestic tax loss carry-forwards of $25.7 million. These carry-forwards will expire at various times between 2006 and 2022.

| | Expiration of domestic tax loss carry-forward | | | | |
|---|---|---|---|---|---|
| | 1 Year | 2 - 3 Years | 4 - 5 Years | Later Years | Total |
| | $000 | $000 | $000 | $000 | $000 |
| Tax loss carry-forward | 272 | 741 | 1,079 | 23,590 | 25,682 |

During 2000, 2002, 2004 and 2005 the Company had an ownership change under ss.382 of the Internal Revenue Code, which significantly limits the Company's use of its net operating tax loss carry-forwards.

Undistributed earnings associated with the Company's interest in KKM amounted to approximately $51.13 million at December 31, 2005. Those earnings are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends, the Company would be subject to both U.S. income taxes (subject to an adjustment for foreign tax credits) and withholding taxes payable to the Republic of Kazakhstan. Determination of the amount of unrecognized deferred U.S. income tax liability is not practical because of the complexities associated with the hypothetical calculation; however, unrecognized foreign tax credit carry forwards would be available to reduce some portion of the U.S. liability. Withholding taxes of approximately $7.67 million would be payable upon remittance of the Company's share of all previously unremitted earnings at December 31, 2005.





14. Income Taxes (continued)

The following table summarizes the significant differences between the statutory tax rate and the Company's effective tax rate for financial statement purposes:

| | Year ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |
| Income before minority interest, income taxes, and cumulative effect of change in accounting principle | 75,776 | 23,106 | 9,478 |
| Statutory tax rate | 35% | 35% | 35% |
| Income taxes computed at statutory rate | 26,522 | 8,087 | 3,317 |
| Losses and expenses with no tax benefit | (784) | 1,662 | 1,919 |
| Excess Profits Tax with no tax benefit | 966 | -- | -- |

| | | | |
|---|---|---|---|
| Expiration of NOL carry forwards | 95 | 152 | 320 |
| Difference in foreign tax rate | (3,737) | (1,289) | (694) |
| Valuation allowance | 785 | (529) | 295 |
| Reversal of provision for tax | (952) | (791) | (899) |
| Additional foreign taxes/(benefit) | -- | (172) | (137) |
| Income tax provision | 22,895 | 7,120 | 4,121 |

Foreign taxes applicable to the Company are specified under the Agreement with the Government of the Republic of Kazakhstan. As of December 31, 2005, the Company has utilized all available foreign tax loss carry forwards.

In December 2002, KKM received a claim from the Ministry of State Revenues of the Republic of Kazakhstan for $9.1 million (the "Tax Claim") relating to taxes and penalties covering the three years from 1999 to 2001. KKM appealed the claim through the courts in Kazakhstan, which eventually ruled in favor of KKM with the exception of $255,000 which was upheld. As a result, KKM reversed $899,000 of income taxes accrued during 2002 for the Tax Claim net of $255,000 which was settled in January 2004.

The Ministry of State Revenues of the Republic of Kazakhstan had been considering penalties with respect to the Tax Claim in the amount of $970,000. In March 2004 a court hearing was conducted which resulted in a reduction of these penalties to $53,000. This amount was paid in full during 2004.

The Company has used the best estimates available to determine the Company's deferred tax assets and liabilities. Refer to Note 16 regarding the uncertainties of taxation in the Republic of Kazakhstan.

15. Operating Leases

The Company entered into a sublease agreement for office space extending from March 2000 through November 2003. At the expiration date of the lease, the Company moved its registered office from Houston, Texas to White Plains, New York. In addition, the Company entered into a new 6 month lease agreement for reduced office space at a new location in Houston; as of March 31, 2004 this lease was renewed for a further 6 months. Effective June 30, 2004 the Company relocated its administrative offices to London and the Houston office lease was cancelled as at the same date. The remaining lease payments of approximately $6,000 were contractually paid in full for the remainder of the lease. The Company also cancelled





15. Operating Leases (continued)

its lease for its executive office in Almaty, Kazakhstan. The Almaty office was subleased from Nasikhat, an affiliate of Kazkommertsbank, for approximately $3,000 per month renewable at the Company's option on September 1, 2004. The remaining lease payments of approximately $10,200 were contractually paid in full for the remainder of the lease.

The Company's rental expense for 2005, 2004 and 2003 was approximately nil,

$30,000 and $144,000 respectively.

16. Commitments and Contingencies

Taxation

As part of the process of preparing the Company's consolidated financial statements, the Company is required to estimate its taxes in each of the jurisdictions of operation. This process involves management estimating the actual current tax expense together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheets. Management then must assess the likelihood that the deferred tax assets will be recovered from future taxable income and, to the extent recovery is not likely, management must establish a valuation allowance. Future taxable income depends on the ability to generate income in excess of allowable deductions. To the extent the Company establishes a valuation allowance or increases this allowance in a period, an expense is recorded within the tax provision in the consolidated statement of operations. Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance recorded against net deferred tax assets. In the event that actual results differ from these estimates or the Company adjusts these estimates in future periods, the Company may need to establish a valuation allowance that could materially impact the Company's financial condition and results of operations.

In addition, 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 central tax authorities. Instances of inconsistent opinions between local, regional and national tax authorities are not unusual.

In December 2002, KKM received an amendment to the Agreement to provide for the stabilization of taxes and clarification on tax laws applicable to KKM. The amendment increased the KKM royalty rate from 8% to 8.14% and allowed KKM to use the lower current tax rates for payroll taxes, social taxes and pension taxes. In addition, during 2003 the royalty rate was increased to 8.4% from 8.14%. The effect of these changes is reflected in the Company's financial statements from the year ended December 31, 2003 onwards.

Basis of Accounting

KKM maintains its statutory books and records in accordance with U.S. generally accepted accounting principles 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.

17. Local Oil Sales Requirements and Export Quotas

The ability of the Company to realize the carrying value of its assets is dependent on being able to transport hydrocarbons and finding appropriate markets for their sale. Domestic markets in the Republic of Kazakhstan currently do not permit world market prices to be obtained. The Company is responsible for obtaining export quotas and finalizing access routes through the KTO pipeline and onward through the Russian pipeline system. The Company has a right to export, and receive export quota for, 100% of the production from the Karakuduk Field under the terms of the Agreement.

During 2005, the Company sold all of its exported crude oil to Vitol Central Asia S.A.

Oil and gas producers within Kazakhstan are required to sell a certain portion of their crude oil production to the local market to supply local energy needs.

Sales to export and local markets can be summarized as follows:

| | Year Ended December 31, 2005 | 2004 |
|---|---|---|
| Export market sales | | |
| bbls | 3,108,000 | 2,544,000 |
| $000 | 147,015 | 75,631 |
| % by value | 98% | 96% |
| Local market sales | | |
| bbls | 189,000 | 214,000 |
| $000 | 3,569 | 2,820 |
| % by value | 2% | 4% |

The Company continues to seek an amicable resolution with the Government to eliminate local market requirements and is no longer considering commencing formal arbitration proceedings pursuant to its contractual arrangements with the Government.

18. Capital Commitments

The Company's drilling and operations related contracts can either be cancelled within 30 days or are on a call-off (as required) basis. On January 16, 2006 the drilling contract with OGEC expired and the rig was demobilized.

At December 31, 2005 the Company had made purchase commitments for work associated with the rail rack and reservoir facilities of $3.3 million. It had no other significant commitments other than those incurred during the normal performance of the work program to develop the Karakuduk Field.

19. Related Party Transactions

In 2003, the Company approved a one-year agreement with OJSC Kazkommerts Securities ("KKS"), an affiliate of Kazkommertsbank. The agreement was effective as of January 7, 2003 and provided for KKS to assist the Company's senior management with financial advisory and investment banking services. In consideration for the services KKS received a monthly fee of $25,000 (the "Advisory Fee"). The agreement was extended for four months and ended April 30, 2004.

CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

19. Related Party Transactions (continued)

Kazkommerts Policy, an affiliate of Kazkommertsbank, is the major insurer of KKM's oil and gas activities. The current insurance policy expires in March 2006 and was awarded following an open tender process.

KKM has a contract to transport 100% of its oil sales through the pipeline owned and operated by KTO, a wholly owned subsidiary of KMG, the 40% minority shareholder in KKM until December 2004. The rates for transportation are in accordance with those approved by the Government of the Republic of Kazakhstan. Currently, the use of the KTO pipeline system is the only viable method of exporting KKM's production. As KTO notifies KKM of the export sales allocated to it on a monthly basis, KTO controls both the volume and transportation cost of export sales.

KKM makes a prepayment for crude transportation based upon the allocation of export sales received from KTO. This prepayment includes pipeline costs charged by the operators of the Russian and Ukrainian pipeline systems which are dependent upon the point of sale of KKM's exports. During 2004, KKM paid $13.35 million to KTO, of which $13.14 million related to transportation costs for sales during 2004. Comparably during 2003, KKM paid $11.56 million to KTO, of which $11.29 million related to transportation costs for sales during 2003. See Note 3 for prepaid transportation as of December 31, 2004 and 2003.

KTO charges KKM for associated costs of oil storage within their pipeline system, sales commission and customs clearance fees in respect to export sales. KTO also provides KKM with water through the Volga Water pipeline. Amounts recognized for these services during 2004 and 2003 were $204,000 and $267,000, respectively.

KMGD, a subsidiary of KMG, provided a drilling rig for the drilling campaign, which commenced February 12, 2003 and was contracted to provide the services of a drilling rig until the end of December 2004.

The total amounts of the transactions with the above related companies are as follows:

| | Year ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| | $000 | $000 | $000 |
| Kazkommerts Policy | * | 778 | 524 |
| KTO | * | 13,348 | 11,561 |
| KMGD | * | 5,256 | 5,999 |

* No longer a related party.

Included in accounts payable as of December 31 are the following amounts:

| Year ended December 31, 2005 | 2004 |
|---|---|
| $000 | $000 |

| | | |
|---|---|---|
| Kazkommerts Policy | * | 195 |
| KTO | * | 8 |
| KMGD | * | 371 |
| | - | 574 |

* No longer a related party.



CHAPARRAL RESOURCES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

19. Related Party Transactions (continued)

In August 2004, the Company approved a two-year agreement with Nelson to provide corporate administrative services and financial advisory services (the "Service Agreement") to support its business activities. The Service Agreement is effective as of June 1, 2004 and can be terminated upon 30 days written notice by either party. In consideration for these services Nelson will receive a fixed monthly fee of $20,000 for administrative services and $25,000 for financial advisory services (the "Management Fee"). As part of the Service Agreement, Nelson is also required to provide personnel to cover Chaparral's executive and managerial needs. The cost of executive and managerial personnel will be allocated on the basis of the cost of personnel involved and on the percentage of time actually spent by such personnel on matters related to Chaparral, as mutually agreed by the parties from time to time. In addition, Nelson will use its greater buying power to obtain more favorable rates for goods and services, including insurance coverage, for Chaparral. These expenditures will be passed to Chaparral at cost with a ten percent mark-up. The total amount charged for the Management Fee, the executive and managerial cost, insurance coverage and the mark-up under the Service Agreement during the year ended December 31, 2005 amounted to $677,000 and $682,000 during the year ended December 31, 2004.

On June 3, 2004, KKM entered into a three year agency agreement with Nelson (the "Marketing Agreement"), whereby Nelson becomes the duly authorized, exclusive agent for the purpose of marketing crude oil, and is empowered to represent the interests of KKM in relations with governmental authorities and commercial organizations and also enter into contracts and agreements and any other documents necessary for and related to the marketing of crude oil. The Marketing Agreement is effective as of June 1, 2004 and can be terminated upon 90 days written notice by either party. As consideration for the services provided under the Marketing Agreement, KKM shall pay Nelson a fixed fee of $20,000 per month and a variable fee of five US cents per barrel of total production in a reporting calendar month, if the amount of supplies to the local market in that month is more than 10% of the total amount of production, or eight US cents per barrel of total production in a reporting calendar month, if the amount of supplies to the local market in that month is less than 10% of the total amount of production (the "Marketing Fee"). In 2005 a total of $548,000 was charged under the marketing agreement compared to $274,000 during 2004.

All other related party transactions are disclosed in other notes to the financial statements. The loans with Kazkommertsbank and Nelson are disclosed in Note 12 and prepaid transportation to KTO in Note 3.

20. Subsequent Events

On March 13, 2006 Chaparral announced that it had entered into an agreement with LUKOIL Overseas Holding Limited ("LUKOIL Overseas") to effect a merger into a wholly owned subsidiary of LUKOIL Overseas. On the effective date of this merger, all issued and outstanding common stock of Chaparral will be exchanged for $5.80 per share in cash. The transaction is subject to the approval of a meeting of stockholders expected to be held in May 2006 and certain other conditions including the receipt of all regulatory approvals and consents. Further details are contained within the form 8-K filed by the Company with the SEC on March 14, 2006, which is incorporated herein by reference.

On March 14, 2006, a lawsuit was filed in the Court of Chancery in the State of Delaware in and for New Castle County by Robert Kelly against Chaparral, LUKOIL Overseas and the directors of Chaparral requesting among other things, that the suit be designated a class action in favor of stockholders, that the merger be declared unlawful and unenforceable because it was entered into in breach of the individual defendants' fiduciary duties and that the merger be enjoined.



CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS
PRODUCING ACTIVITIES - UNAUDITED

The following supplemental information regarding the oil and gas activities of the Company is presented pursuant to the disclosure requirements promulgated by the Securities and Exchange Commission (the "SEC") and SFAS 69, Disclosures About Oil and Gas Producing Activities.

The following estimates of reserve quantities and related standardized measure of discounted net cash flows are estimates only, and are not intended to reflect realizable values or fair market values of the Company's reserves. The Company emphasizes that reserve estimates are inherently imprecise and that estimates of new discoveries are more imprecise than producing oil and gas properties. Additionally, the price of oil has been very volatile and downward changes in prices can significantly affect quantities that are economically recoverable. Accordingly, these estimates are expected to change as future information becomes available and these changes may be significant.

KKM sold 3.30 million barrels of crude oil in 2005, of which 189,000 barrels, or approximately 6%, were sold to the local market. Comparatively, the Company sold 2.76 million barrels of crude oil in 2004, of which 214,000, or approximately 8%, was sold to the local market. Under the Agreement, KKM has the right to sell 100% of its production on the export market for world market prices and a right to export 100% of its production under the terms of its Agreement with the Government. Although the Company expects to sell 100% of its production on the export market in future years, the year-end prices used for the standardized measure of discounted net cash flows for 2005 reflects the assumption that 7% of KKM's production will be sold on the local market for a substantially lower net oil price. Year-end prices used for the standardized measure of discounted net cash flows for 2004 and 2003 reflect the assumption that 10% and 5% of KKM's production would have been sold on the local market for a substantially lower net oil price, respectively.

Proved reserves are estimated reserves of crude oil and natural gas that geological and engineering data demonstrate with reasonable certainty to be recoverable in future years from known reservoirs under existing economic and operating conditions. Proved developed reserves are those expected to be recovered through existing wells, equipment and operating methods.

The standardized measure of discounted future net cash flows is computed by applying year-end prices of oil and gas (with consideration of price changes only to the extent provided by contractual arrangements) to the estimated future production of proved oil and gas reserves, less estimated future expenditures (based on year-end costs) to be incurred in developing and producing the proved reserves and estimated future income tax expenses. The estimated future net cash flows are then discounted using a rate of 10% a year to reflect the estimated timing of the future cash flows.

F-33

CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES - UNAUDITED

Proved Oil & Gas Reserve Quantities (All within the Republic of Kazakhstan)
All figures are stated net of government royalties.

| | Year Ended December | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Oil Reserves (mbbls.) | Gas Reserves (Mcf.) | Oil Reserves (mbbls.) | Gas Reserv (Mcf. |
| Proved developed and undeveloped reserves: | | | | |
| Balance January 1 | 40,594 | - | 25,616 | |
| Revision of previous estimates | 8,271 | - | 17,813 | |
| Extensions, discoveries and other additions | - | - | - | |
| Production | (3,534) | - | (2,835) | |
| Balance December 31 | 45,331 | - | 40,594 | |
| Minority interest in KKM's proved developed and undeveloped reserves | 18,132 | - | 16,238 | |
| Proved developed reserves | 28,121 | - | 10,714 | |
| Minority interest in KKM's proved developed reserves | 11,248 | - | 4,286 | |

Capitalized Costs Relating to Oil and Gas Producing Activities (All within the Republic of Kazakhstan)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |

| | | | |
|---|---|---|---|
| Unproved oil and gas properties | | | |
| Expenditures on oil and gas properties | -- | -- | 2,942 |
| Material and supplies inventory | 8,082 | 5,238 | 3,189 |
| Proved oil and gas properties | 183,505 | 153,001 | 118,347 |
| | --------- | --------- | --------- |
| | 191,587 | 158,239 | 124,478 |
| Accumulated depreciation and depletion | (82,881) | (58,035) | (40,915) |
| | --------- | --------- | --------- |
| Net capitalized cost | 108,706 | 100,204 | 83,563 |
| | ========= | ========= | ========= |



CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES - UNAUDITED

Cost Incurred in Oil and Gas Property Acquisition, Exploration and Development Activities
(All within the Republic of Kazakhstan)

| | Year Ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| | ------- | ------- | ------- |
| | $ 000 | $ 000 | $ 000 |
| Acquisition costs | -- | -- | -- |
| Exploration and appraisal costs | -- | -- | -- |
| Development costs (1) | 30,504 | 31,712 | 27,642 |
| | ------- | ------- | ------- |
| | 30,504 | 31,712 | 27,642 |
| | ======= | ======= | ======= |

(1) Development costs include costs for asset retirement obligations.

Results of Operations for Producing Activities
(All within the Republic of Kazakhstan)

| | Year Ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| | --------- | --------- | --------- |
| | $ 000 | $ 000 | $ 000 |
| Oil revenue | 150,584 | 78,451 | 57,615 |
| Transportation costs | (16,951) | (14,046) | (11,474) |
| Operating expenses | (15,828) | (8,319) | (5,915) |
| Depreciation, depletion and amortization | (25,375) | (18,180) | (18,038) |
| Accretion expense | (148) | (112) | (73) |

| | | | |
|---|---|---|---|
| | 92,282 | 37,794 | 22,115 |
| Provision for income taxes (1) | (26,469) | (11,595) | (6,964) |
| | 65,813 | 26,199 | 15,151 |

(1) Income tax expense is calculated by applying the statutory tax rate to operating profit, adjusted for applicable net operating loss carry forwards.



CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION - DISCLOSURES ABOUT OIL AND GAS PRODUCING ACTIVITIES - UNAUDITED

Standardized Measure of Discounted Future Net Cash Flows and Changes Therein Relating to Proven Oil and Gas Reserves
(All within the Republic of Kazakhstan)

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| | $ 000 | $ 000 | $ 000 |
| Future cash inflows | 1,865,188 | 971,463 | 476,969 |
| Future development costs (1) | (182,619) | (171,210) | (73,642) |
| Future production costs | (509,892) | (293,295) | (53,338) |
| Future income tax expenses | (250,090) | (136,557) | (90,699) |
| Future net cash flows | 922,587 | 370,401 | 259,290 |
| 10% annual discount for estimated timing of cash flows | (367,585) | (165,816) | (92,108) |
| Standardized measure of discounted net cash flows | 555,002 | 204,585 | 167,182 |
| Minority interest | 222,001 | 81,834 | 66,873 |

(1) Development costs include costs for asset retirement obligations.

Principal Sources of Change in the Standardized Measure of Discounted Future Net Cash Flows

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |

| | | | |
|---|---|---|---|
| | $ 000 | $ 000 | $ 000 |
| Beginning balance | 204,585 | 167,182 | 128,739 |
| Sales of oil produced, net of production and transportation costs | (116,767) | (56,086) | (40,226) |
| Extensions and discoveries | -- | -- | -- |
| Net changes in prices, production costs and future development costs | 267,117 | (186,144) | (3,377) |
| Net changes due to revisions of previous quantity estimates | 208,897 | 267,752 | 79,054 |
| Development cost incurred | 31,017 | 31,712 | 27,642 |
| Accretion of discount | 40,118 | 9,892 | 463 |
| Net change in income taxes | (79,965) | (29,723) | (25,113) |
| Ending balance | 555,002 | 204,585 | 167,182 |

F-36

CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION
SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED

2005 Quarterly Information

| | For the Three Months Ended | | |
|---|---|---|---|
| $000 (except share amounts) | March 31, 2005 | June 30, 2005 | September 30 2005 |
| Revenue (1) | 24,327 | 33,160 | 50,437 |
| Transportation and operating costs | (7,313) | (7,624) | (9,015 |
| Depreciation and depletion | (5,018) | (5,829) | (7,440 |
| Operating income | 11,996 | 19,707 | 33,982 |
| Income before taxes and cumulative effect of change in accounting principle | 6,270 | 11,677 | 21,595 |
| Income taxes | (2,436) | (5,075) | (8,280 |
| Income before extraordinary gains | 3,834 | 6,602 | 13,315 |
| Cumulative effect of change in accounting principle | -- | -- | -- |
| Net income available to common Stockholders | 3,834 | 6,602 | 13,315 |
| Basic earnings per share: | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.10 | $ 0.17 | $ 0.35 |
| Cumulative effect of change in accounting principle | $- | $- | $- |
| Net income per share | $ 0.10 | $ 0.17 | $ 0.35 |

| | | | |
|---|---|---|---|
| Basic weighted average number of shares outstanding | 38,209,502 | 38,209,502 | 38,209,502 |
| Diluted earnings per share: | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.10 | $ 0.17 | $ 0.33 |
| Cumulative effect of change in accounting principle | $- | $- | $- |
| Net income per share | $ 0.10 | $ 0.17 | $ 0.33 |
| Diluted weighted average number of shares outstanding | 39,117,455 | 39,500,312 | 40,475,014 |

(1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs



CHAPARRAL RESOURCES, INC.
SUPPLEMENTAL INFORMATION
SELECTED QUARTERLY FINANCIAL DATA - UNAUDITED

2004 Quarterly Information

| | For the Three Months Ended | | |
|---|---|---|---|
| $000 (except share amounts) | March 31, 2004 | June 30, 2004 | September 30 2004 |
| Revenue (1) | 15,609 | 17,471 | 22,078 |
| Transportation and operating costs | (5,363) | (4,755) | (5,089 |
| Depreciation and depletion | (4,386) | (4,150) | (4,276 |
| Operating income | 5,860 | 8,566 | 12,713 |
| Income before taxes and cumulative effect of change in accounting principle | 1,776 | 3,182 | 6,681 |
| Income taxes | (1,142) | (1,882) | (3,122 |
| Income before extraordinary gains | 634 | 1,300 | 3,559 |
| Cumulative effect of change in accounting principle | -- | -- | -- |
| Net income available to common Stockholders | 634 | 1,300 | 3,559 |
| Basic earnings per share: | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.02 | $ 0.03 | $ 0.09 |
| Cumulative effect of change in accounting principle | $- | $- | $- |
| Net income per share | $ 0.02 | $ 0.03 | $ 0.09 |
| Basic weighted average number of shares outstanding | 38,209,502 | 38,209,502 | 38,209,502 |

| | | | |
|---|---|---|---|
| Diluted earnings per share: | | | |
| Income per share before cumulative effect of change in accounting principle | $ 0.02 | $ 0.03 | $ 0.09 |
| Cumulative effect of change in accounting principle | $- | $- | $- |
| Net income per share | $ 0.02 | $ 0.03 | $ 0.09 |
| Diluted weighted average number of shares outstanding | 38,209,502 | 38,209,502 | 38,209,502 |

(1) Revenue is presented gross of transportation and marketing cost in accordance with EITF 00-10, Accounting for Shipping and Handling Fees and Costs