

NELSON RESOURCES LIMITED

FORM 51-102F3

MATERIAL CHANGE REPORT

Item 1. Name and Address of Company

Nelson Resources Limited (the "Company")
Chancery Hall
52 Reid Street
Hamilton HM12
Bermuda

Item 2. Date of Material Change

July 19, 2004

Item 3. News Release

A press release disclosing the nature and substance of the material change was issued through the facilities of Canada NewsWire on July 14, 2004 and July 19, 2004 and were both filed on SEDAR.

Item 4. Summary of Material Change

On July 14, 2004, the Company successfully placed 112,144,128 new common shares in the Company with off-shore institutional investors at a price of CDN\$1.40 per share conditional on the common shares of the Company being admitted to the Alternative Investment Market ("AIM") of the London Stock Exchange plc. On July 19, 2004, these new common shares, together with the existing common shares of the Company, were admitted to AIM.

Item 5. Full Description of Material Change

The Company announced that Canaccord Capital (Europe) Limited and Hoare Govett Limited have successfully placed (the "Placing") 112,144,128 new common shares in the Company (the "Placing Shares") with off-shore institutional investors at a price of CDN\$1.40 per share (the "Placing Price"). The Placing Shares, together with the existing common shares of the Company, have been admitted to AIM (the "Admission") effective July 19, 2004 (the "Admission Date") and dealings commenced on that date. The Placing Shares are also listed on the Toronto Stock Exchange (the "TSX") but will not trade on the TSX until four months and one trading day after the Admission Date.

Gross proceeds from the Placing equal approximately CDN\$157 million (U.S.\$119.3 million).

The net proceeds from the Placing will be added to working capital and used for general corporate purposes, which may include, without limitation, funding to support the development of existing fields and funding future growth.

Canaccord Capital (Europe) Limited acted as nominated adviser and joint broker to the Company. Hoare Govett Limited acted as financial adviser and joint broker to the Company.

An admission document required in connection with the Admission and the financing and containing current, detailed information about the Company is attached hereto.

Due to Canadian re-sale restrictions, the Placing Shares will not be available for settlement into Canada for a period of four months and one day from the Admission Date. In order to distinguish the Placing Shares from the existing common shares over this restricted period, the Placing Shares have the ISIN “CA6403831051” (CUSIP: 640383105, SEDOL: B01WRV4) and trade under the London Stock Exchange symbol “NLGa”. The existing common shares, which have the ISIN “BMG641801052” (CUSIP: G64180105) and trade under the London Stock Exchange symbol “NLG”, carry no such restrictions. Following the end of the restricted period of four months and one day referred to above, the Placing Shares will assume the ISIN “BMG641801052”, will trade under the symbol “NLG” and there will be no re-sale restrictions in Canada.

Item 6. Reliance on Subsection 7.1(2) or (3) of National Instrument 51-102

Not applicable.

Item 7. Omitted Information

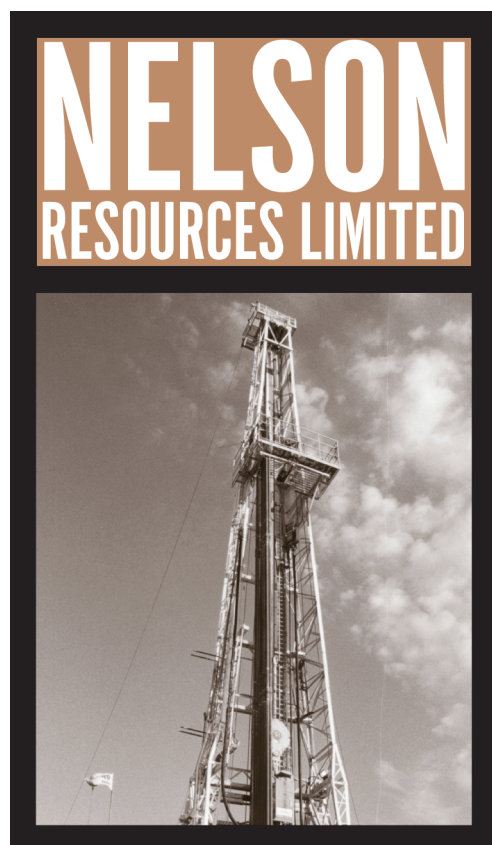
No information has been omitted on the basis that it is confidential information.

Item 8. Executive Officer

Frederick Hodder
Chief Financial Officer
Telephone: +44 20 7 495 8908

Item 9. Date of Report

Dated this 19th day of July, 2004.



PLACING AND ADMISSION TO AIM

THIS DOCUMENT IS IMPORTANT AND REQUIRES YOUR IMMEDIATE ATTENTION. If you are in any doubt about the contents of this document, you should consult a person authorised under the Financial Services and Markets Act 2000 who specialises in advising on the acquisition of shares and other securities.

Application has been made for the whole of the Common Share capital of the Company, issued and to be issued pursuant to the Placing, to be admitted to trading on AIM. AIM is a market designed primarily for emerging or smaller companies to which a higher investment risk tends to be attached than to larger or more established companies. AIM securities are not admitted to the Official List of the United Kingdom Listing Authority. A prospective investor should be aware of the risks of investing in such companies and should make the decision to invest only after careful consideration and, if appropriate, consultation with an independent financial adviser. The London Stock Exchange has not examined or approved the contents of this document.

This document is an admission document relating to the Company for the purposes of AIM, a market of the London Stock Exchange. Whilst it has been drawn up in accordance with the Public Offers of Securities Regulations 1995, as amended, and the AIM Rules, it does not comprise a prospectus for the purposes of such regulations.

The Directors of the Company, whose names appear on page (vi), accept responsibility, collectively and individually, for the information contained in this document, including individual and collective responsibility for compliance with the AIM Rules. To the best of the knowledge and belief of the Directors (who have taken all reasonable care to ensure that such is the case), the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information.

This document does not constitute an offer to sell, or a solicitation of an offer to buy, Common Shares in any jurisdiction in which such offer or solicitation is unlawful. In particular, this document is not for public distribution in Canada, or distribution in Australia, South Africa, the Republic of Ireland or Japan. The Common Shares have not been and will not be registered under the securities legislation of any province or territory of Canada, Australia, South Africa, the Republic of Ireland or Japan or in any country, territory or jurisdiction where to do so may contravene local securities law or regulations. Accordingly, the Common Shares may not, subject to certain exemptions, be offered or sold directly or indirectly in or into, or to any national, citizen or resident of Canada, Australia, South Africa, the Republic of Ireland or Japan.

The Common Shares have not been, and will not be, registered under the United States Securities Act of 1933, as amended (the "Securities Act") and, subject to certain exceptions, may not be offered or sold within the United States, or for the account or benefit of, or to U.S. persons (as defined in Regulation S under the Securities Act ("Regulation S")). The Common Shares are being offered and sold outside the United States to non-U.S. persons in reliance on Regulation S and within the United States in transactions exempt from registration requirements of the Securities Act.

Nelson Resources Limited

(Incorporated in Bermuda with limited liability under the Companies Act 1981 of Bermuda with registered number 18154)

Placing of 112,144,128 Common Shares of U.S.\$0.01 each at Cdn.\$1.40 (57.25p) per share and

Admission to trading on AIM, a market of the London Stock Exchange plc

Nominated Adviser and Joint Broker
Canaccord Capital (Europe) Limited

Financial Adviser and Joint Broker
Hoare Govett Limited

SHARE CAPITAL IMMEDIATELY FOLLOWING THE PLACING

Authorised			Issued and fully paid	
Amount	Number		Amount	Number
15,000,000	1,500,000,000	Common Shares of U.S.\$0.01 each	8,572,581	857,258,095
500,000	50,000,000	Preference Shares of U.S.\$0.01 each	0	0

Upon Admission, the Placing Shares will rank *pari passu* in all respects with all other Common Shares, including the right to receive all dividends or other distributions declared, made or paid on the Common Share capital of the Company after Admission.

The existing Common Shares are listed and posted for trading on the TSX. The Company has made an application to list the Placing Shares on the TSX. The Placing Shares will not commence trading on the TSX until four months and one day following Admission, during which period trading will take place on the London Stock Exchange and settlement of the Placing Shares will only occur in CREST. The Company has not filed with any regulatory authority in Canada a prospectus in connection with the Placing of the Placing Shares and accordingly, the Placing Shares are not qualified for sale in Canada and may not be offered or sold directly or indirectly in Canada except pursuant to an exemption from the prospectus and registration requirements in Canada. No Canadian securities regulatory authority has expressed an opinion about the Placing Shares or in respect of any information contained in this document and it is an offence to claim otherwise.

Canaccord is regulated in the United Kingdom by the Financial Services Authority and is acting solely for the Company in connection with the Placing and Admission and no-one else. Canaccord has been appointed as nominated adviser and joint broker to the Company. Canaccord will not regard any other person as its client or be responsible to any other person for providing the protections afforded to clients of Canaccord nor for providing advice in relation to the Placing and Admission. In accordance with the AIM Rules, Canaccord has confirmed to the London Stock Exchange that it has satisfied itself that the Directors have received advice and guidance as to the nature of their responsibilities and obligations to ensure compliance by the Company with the AIM Rules and that, in its opinion and to the best of its knowledge and belief, all relevant requirements of the AIM Rules have been complied with. Canaccord is not making any representation or warranty, express or implied, as to the contents of this document. Canaccord accepts no liability whatsoever for the accuracy of any information or opinions contained in this document or for the omission of any information. The responsibilities of Canaccord as nominated adviser and joint broker are owed solely to the London Stock Exchange.

Hoare Govett is regulated in the United Kingdom by the Financial Services Authority and is acting solely for the Company in connection with the Placing and Admission and no-one else. Hoare Govett has been appointed as financial adviser and joint broker to the Company. Hoare Govett will not regard any other person as its client or be responsible to any other person for providing the protections afforded to its clients nor for providing advice in relation to the Placing and Admission. Hoare Govett is not making any representation or warranty, express or implied, as to the contents of this document. Hoare Govett accepts no liability whatsoever for the accuracy of any information or opinions contained in this document or for the omission of any information.

Prospective investors should read the entire text of this document. The attention of prospective investors is drawn in particular to the "Risk Factors" set out in Part II of this document.

Copies of this document will be available free of charge during normal business hours on any weekday (except Saturdays and public holidays) at the offices of Canaccord at 1st Floor, Brook House, 27 Upper Brook Street, London W1K 7QF from the date of this document for the period of one month from Admission.

LEGAL AND OTHER MATTERS

Prospective investors should rely only on the information contained in this document. The Company has not authorised any person to give any information or make any representation not contained in this document in connection with this offering and, if given or made, such information or representation must not be relied upon as having been authorised by the Company. Prospective investors should not assume that the information contained in this document is accurate as of any date other than the date of this document.

This document does not constitute an offer to sell or a solicitation of an offer to purchase the Common Shares by any person in any jurisdiction where it is unlawful to make such an offer or solicitation. The distribution of this document and the offering or sale of the Common Shares in certain jurisdictions is restricted by law. This document may not be used for, or in connection with, and does not constitute, any offer to, or solicitation by, anyone in any jurisdiction or under any circumstance in which such offer or solicitation is not authorised or is unlawful. Persons into whose possession this document may come are required by the Company to inform themselves about and to observe such restrictions.

Prospective investors should not construe anything in this document as legal, business or tax advice. Each prospective investor should consult its own advisors as needed to make its investment decision and to determine whether it is legally permitted to purchase the securities under applicable investment or similar laws or regulations. Investors should be aware that they may be required to bear the financial risks of this investment for an indefinite period of time.

The Common Shares have not been approved or disapproved by the SEC, any state securities commission in the United States or any other U.S. regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Common Shares or the accuracy or the adequacy of this document. Any representation to the contrary is a criminal offence in the United States.

FORWARD-LOOKING STATEMENTS

Certain statements in this document constitute “forward-looking statements”.

Forward-looking statements include statements concerning the plans, objectives, goals, strategies and future operations and performance of the Company and the assumptions underlying these forward-looking statements. The Company uses the words “anticipates”, “estimates”, “expects”, “believes”, “intends”, “plans”, “may”, “will”, “should”, and any similar expressions to identify forward-looking statements. These statements involve risks and uncertainties, including the risks that are identified in this document, which are primarily described in “Risk Factors”. See “Risk Factors” set out in Part II of this document.

Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the Company’s actual results, performances or achievements to be materially different from any future results, performances or achievements expressed or implied by such forward-looking statements. Such forward-looking statements are based on numerous assumptions regarding present and future business strategies and the environment in which the Company will operate in the future. Among the important factors that could cause its actual results, performance or achievements to differ materially from those in the forward-looking statements include those factors set out in Part II – “Risk Factors” and elsewhere in this document.

These forward-looking statements speak only as at the date of this document. The Company is not obliged, and does not intend, to update or to revise any forward-looking statements, whether as a result of new information, future events or otherwise. All subsequent written or oral forward-looking statements attributable to the Company, or persons acting on behalf of the Company, are expressly qualified in their entirety by the cautionary statements contained throughout this document. As a result of these risks, uncertainties and assumptions, a prospective investor should not place undue reliance on these forward-looking statements.

BERMUDA

The Company was incorporated as an “exempted company” under the laws of Bermuda on 31 March 1993. As an exempted company, the Company is exempt from laws of Bermuda that restrict the percentage of share capital that may be held by non-Bermudians. However, except as necessary in furtherance of the business of the Company carried on outside Bermuda, as an exempted company, the Company may not carry on business in Bermuda without a licence from the Minister of Finance of Bermuda granted pursuant to the Companies Act 1981 of Bermuda.

For exchange control purposes, the Bermuda Monetary Authority has classified the Company as a non-resident of Bermuda. Accordingly, the Bermuda Monetary Authority does not restrict the ability of the Company to convert currency, other than Bermuda dollars, held for its own account to any other currency, to transfer funds in and out of Bermuda or to pay dividends or other forms of payment to non-Bermuda residents who are Shareholders or holders of any other securities of the Company, other than in Bermuda dollars.

The Company has obtained the permission of the Bermuda Monetary Authority for the issuance and free transferability of the Common Shares that the Company may offer as described in this document to non-residents of Bermuda for exchange control purposes. This permission is subject to the condition that the Common Shares be listed on an appointed stock exchange, which includes AIM and the TSX. No further permission from the Bermuda Monetary Authority will be required to issue the Common Shares or to transfer the Common Shares between persons regarded as non-resident in Bermuda for exchange control purposes. Approvals or permissions received from the Bermuda Monetary Authority do not constitute a guarantee by the Bermuda Monetary Authority as to the Company’s performance or creditworthiness. Accordingly, in giving those approvals or permissions, the Bermuda Monetary Authority will not be liable for the Company’s performance or default or for the correctness of any opinions or statements expressed in this document.

ENFORCEABILITY OF JUDGMENTS

The Group is organised under the laws of Bermuda and many of its officers and directors referred to in this document are residents of Kazakhstan. All or a substantial portion of the assets of the Group and such persons are located in Kazakhstan. As a result, it may not be possible for investors (i) to effect service of process upon the Group or such persons outside Bermuda or Kazakhstan, (ii) to enforce against any of them, in courts of jurisdictions other than Bermuda or Kazakhstan, judgments obtained in such courts that are predicated upon the laws of such other jurisdictions or (iii) to enforce against any of them, in Bermuda’s or Kazakhstan’s courts, judgments obtained in jurisdictions other than Bermuda or Kazakhstan, as the case may be, including judgments obtained in the courts of England.

There are two basic procedures for the enforcement of foreign judgments in Bermuda: (1) under The Judgments (Reciprocal Enforcement) Act 1958; and (2) at common law. The Judgments (Reciprocal Enforcement) Act 1958, which is derived from the English Foreign Judgments (Reciprocal Enforcement) Act 1933, provides for enforcement by registering a foreign judgment, to which the Act applies, in the Supreme Court of Bermuda. The 1958 Act applies to judgments of Courts in the United Kingdom, and of the following countries or territories: Australia, Bahamas, Barbados, British Guyana, Gibraltar, Grenada, Leeward Islands, St. Vincent, Jamaica, Nigeria, Dominica, St. Lucia. In order to qualify for registration under the Act the judgment must be: (a) final and conclusive as between the parties, and (b) for a sum of money, not being a sum payable in respect of taxes or other charges of a like nature or in respect of a fine or other penalty. The effect of registration is that the foreign judgment is of the same force and effect as a judgment of the Supreme Court of Bermuda entered at the date of registration, and such steps may be taken to enforce it as if it were such a judgment. Registration of the foreign judgment is liable to be set aside if the foreign court did not have jurisdiction over the judgment debtor.

At common law, judgments against the Group rendered in courts outside of Bermuda would only be enforceable against the Group in Bermuda if such judgments were final and conclusive monetary judgments for a definite sum (other than a sum of money payable in respect of multiple damages, taxes or other charges of a like nature) and the Bermuda courts were satisfied that (i) the original court had jurisdiction in the matter and the Group either submitted to such jurisdiction or was resident or carrying on business within the original court’s jurisdiction and was duly served with process; (ii) the judgment given by the original court was not in respect of penalties, taxes, fines or similar fiscal or revenue obligations; (iii) in obtaining judgment there was no fraud on the part of the person in whose favour judgment was given or on part of the original court itself; (iv) recognition or enforcement of the judgment in Bermuda

would not be contrary to public policy; and (v) the proceedings pursuant to which judgment was obtained were not contrary to principles of natural justice. Bermuda is a party to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards adopted by the United Nations Conference on International Commercial Arbitration on 10 June 1958 (the “Convention”) and arbitral awards against the Group rendered in other contracting states may be enforced in Bermuda under the provisions of the Convention.

The courts of Kazakhstan will not enforce any judgment obtained in a court established in a country other than Kazakhstan unless Kazakh law so provides or there is in effect a treaty between such country and Kazakhstan providing for reciprocal enforcement of judgments, and then only in accordance with the terms of such treaty. There is no such treaty currently in effect between Kazakhstan and the United Kingdom. However, each of Kazakhstan and the United Kingdom are parties to the Convention, and English arbitration awards are generally recognised and enforceable in Kazakhstan provided the conditions to enforcement set out in the Convention are met.

The Group is a reporting issuer in Ontario and British Columbia. Although the Group has appointed Gowling Lafleur Henderson LLP as its agent for service of process at its respective offices in British Columbia (1055 Dunsmuir Street, Suite 2300, P.O. Box 49122, Bentall IV, Vancouver, British Columbia, V7X 1J1), Alberta (1400 Scotia Centre, 700-2nd Street S.W., Calgary, Alberta, T2P 4V5), Ontario (Suite 5800, Scotia Plaza, 40 King Street West, Toronto, Ontario, M4H 3Z7), and Quebec (1 Place Ville Marie, 37th Floor, Montreal, Quebec, H3B 3P4), it may not be possible for investors to collect from the Group judgments obtained in Canadian courts predicated on civil liability provisions of Canadian securities legislation.

FINANCIAL INFORMATION

Unless otherwise specified or the context requires, references to “dollars”, “U.S. dollars” and “U.S.\$” are to United States dollars, references to “Cdn.\$” are to Canadian dollars, references to “£” are to British pounds sterling, and all references to “Tenge” are to Kazakh Tenge.

In relation to the Placing (and, in particular, the Placing Price and the proceeds of the Placing), this document contains conversions of certain amounts into U.S. dollars, solely for the convenience of the reader. On 8 July 2004, the noon buying rate in the City of New York for cable transfers in Canadian dollars as certified by the Federal Reserve Bank of New York was U.S.\$1.00 equals Cdn.\$1.3164. No representation is made that the Canadian dollar or U.S. dollar amounts referred to in this document could have been or could be converted into U.S. dollars or Canadian dollars, as the case may be, at any particular rate at all. Unless otherwise stated, in relation to the Placing (and, in particular, the Placing Price and the proceeds of the Placing), this document translates figures in U.S. dollars into pounds sterling, or vice versa, at the exchange rate £1.00 equals U.S.\$1.8577, being the closing mid-point spot exchange rate set out in the Financial Times on 9 July 2004, the latest practicable date prior to the publication of this document.

Some numerical figures included in this document have been subject to rounding adjustments. Accordingly, numerical figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that preceded them.

KEY SUMMARY

Introduction

Nelson is a leading independent oil development and production company operating in Kazakhstan. The Company has interests in 4 onshore oil fields in Kazakhstan. These are the Alibekmola and the Kozhasai fields (Nelson's share of production Q1 04 7,975 bopd), the Karakuduk field (Nelson's share of production Q1 04 approximately 2,880 bopd), and the North Buzachi field (Nelson's share of production Q1 04 3,400 bopd). In addition, the Company holds an option to participate in 2 offshore blocks in the Caspian Sea. The Company has operated in the Kazakh oil sector since 2000 and its management team, comprising both international and Kazakh executives, has extensive experience of the Kazakh operating and regulatory environment.

Business

Each of the onshore fields is at an early stage of development. The Company intends to grow the proven and probable reserves by a programme of further drilling at each of the fields. The Company uses the latest western reservoir management practices to maximise productivity and recovery. As at 31 March 2004, Nelson's share of production from the 4 onshore fields was approximately 14,200 bopd. As at 31 December 2003, the 4 onshore fields had aggregate estimated remaining proved and probable reserves of approximately 437 million barrels, of which Nelson's share was approximately 210 million barrels.

Group strategy

Management intends to exploit its position as a leading independent oil development and production company operating in Kazakhstan to grow by further acquisitions of additional reserves in Kazakhstan and by strategic partnering with new and existing participants in the Kazakh oil industry. The recent acquisitions of the interests in North Buzachi, Chaparral and the Zhambai/Zaburunye Option reflect, in part, this strategy. Management believes the strategy will generate economies of scale and portfolio management benefits.

Management

The Board and senior management have extensive operational experience in the international oil industry, in the CIS and specifically in Kazakhstan and the Caspian Basin, and are comprised of both international and Kazakh executives.

Current trading and prospects

The Company recorded a net loss of U.S.\$4.73 million for the quarter ended 31 March 2004, compared to a net loss of U.S.\$1.67 million for the quarter ended 31 March 2003. However, exclusion of the non-cash flow charges for derivative instruments and other compensation costs, of U.S.\$4.02 million and U.S.\$7.81 million, respectively, would have resulted in a net profit of U.S.\$7.11 million compared to the net loss recorded of U.S.\$4.72 million. The Directors consider that the Group is well placed to exploit the potential opportunities arising from its growing portfolio of oil properties in Kazakhstan, including its recently acquired interests in the North Buzachi and Karakuduk fields, and to progress its growth strategy.

Reasons for Placing and use of proceeds

The Company is proposing to raise U.S.\$119.3 million (£64.2 million) (before expenses) through a conditional placing by Canaccord and Hoare Govett of 112,144,128 Placing Shares at U.S.\$1.0635 (57.25p) per Common Share. The Placing has not been underwritten and will not proceed unless Hoare Govett and Canaccord receive commitments from placees pursuant to which placees agree to subscribe, in aggregate, for all of the Placing Shares which would, at the Placing Price, raise U.S.\$119.3 million (£64.2 million) (gross) for the Company or such lesser amount as the Company, Hoare Govett and Canaccord may agree.

The Company is seeking admission of the Common Shares to trading on AIM in order to raise the Company's profile and to provide additional access to the international capital markets. The net proceeds of the Placing, after estimated expenses of the Admission and Placing of U.S.\$8.6 million (£4.6 million), will be added to working capital and used for general corporate purposes, which may include, without limitation, funding to support the development of existing fields and funding future growth.

Risk factors

Prior to investing in the Placing Shares, prospective investors should consider, together with the other information contained in this document, the risks and other factors attaching to an investment in the Company, including in particular, the factors set out in "Risk Factors" in Part II of this document.

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DIRECTORS AND ADVISERS

Directors

E. Nick Zana	Chairman, Chief Executive Officer, Executive Director
Baltabek Kuandykov	President, Executive Director
Mirbulat Abuov	Non-executive Director
Azziz Ait-Said	Non-executive Director
Askar Alshinbayev	Non-executive Director
Robert Connon.....	Non-executive Director
Peter Luis O. Gross	Non-executive Director
Arvind Tiku	Non-executive Director
Gilles Thieffry	Non-executive Director

each of 7th floor, 19 Berkeley Street, London W1J 8ED, England.

Registered Office

Chancery Hall, 52 Reid Street
Hamilton HM12, Bermuda

Bermuda Resident Representative

Fraser Ross
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Hamilton HM12, Bermuda

**Nominated Adviser and Joint Broker
to the Company**

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**Financial Adviser and Joint Broker
to the Company**

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Branch Registrar and Transfer Agent

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Financial Public Relations

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London SE1 2YE
England

Newman Consulting
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London W1J 8ED
England

PLACING STATISTICS

Placing Price	Cdn.\$1.40	U.S.\$1.0635 57.25p
Market capitalisation following the Placing at the Placing Price ⁽¹⁾	U.S.\$911.7 million	£490.8 million
Number of new Common Shares being placed on behalf of the Company	112,144,128	
Number of Common Shares in issue immediately following the Placing	857,258,095	
Percentage of Common Shares being placed	13.1 per cent.	
Net proceeds of the Placing ⁽²⁾	U.S.\$110.7 million	£59.6 million

EXPECTED TIMETABLE OF PRINCIPAL EVENTS

Admission effective and dealings commence on AIM.....	19 July 2004
CREST accounts credited (where applicable)	19 July 2004
Dealings in Placing Shares enabled on TSX	22 November 2004

Notes:

(1) Market capitalisation has been calculated based on the number of Common Shares in issue following the Placing at the Placing Price.

(2) Net proceeds receivable by the Company are stated after the deduction of estimated total expenses relating to the Placing (excluding VAT) of approximately U.S.\$8.6 million (£4.6 million).

DEFINITIONS

The following definitions apply throughout this document, unless the context otherwise requires:

“AIM”	AIM, a market of the London Stock Exchange plc.
“AIM Rules”	Rules issued by the London Stock Exchange governing admission to and the operation of AIM.
“AMS”	Aktobe Munai Services Limited Liability Partnership, a limited liability partnership organised under the laws of Kazakhstan.
“ARNMPC”	Agency of Kazakhstan responsible for regulation of natural monopolies and the protection of competition.
“Admission”	Admission of the existing Common Shares and the Placing Shares to trading on AIM becoming effective in accordance with the AIM Rules.
“Alibekmola”	Alibekmola field.
“Alyco”	Alyco Advisory A.G., a company registered in Zurich, Switzerland, and the management company of Center Finance Corp.
“BBV”	Nelson Petroleum Buzachi B.V., a limited liability company organised under the laws of The Netherlands, having its registered office at Koninginneweg 6, 1075CX, Amsterdam, The Netherlands.
“BHBV”	Nelson Petroleum Buzachi Holdings B.V., a limited liability company organised under the laws of The Netherlands, having its registered office at Koninginneweg 6, 1075CX, Amsterdam, The Netherlands.
“BNP Paribas Facility”	Term loan facility dated 27 August 2003 (as amended) between BNP Paribas (Suisse) S.A. (as lender) and KOA (as borrower).
“Board” or “Directors”	Directors of the Company.
“CAIH”	Central Asian Industrial Holdings N.V., a company organised under the laws of The Netherlands Antilles, having its registered office at Schartooweg 81, Curaçao, Netherland Antilles.
“CAIH Note”	A promissory note of Chaparral, payable to CAIH, with a principal amount of U.S.\$4,000,000.
“CAP-D”	Central Asian Petroleum Inc., a company organised under the laws of the State of Delaware.
“CAP-G”	Central Asian Petroleum (Guernsey) Limited, a company organised under the laws of Guernsey.
“CBS”	Commonwealth & British Services Limited, incorporated as a private company under the laws of England and Wales with registered number 2880545, and having its registered office at 19 Berkeley Street, London W1J 8ED, England.
“CDI”	CREST depositary interests.
“CIS”	Commonwealth of Independent States comprising certain of those states forming the Soviet Union prior to its dissolution in December 1991.
“CNPC”	CNPC International Ltd., an affiliate of the China National Petroleum Corporation.

“CNPC (Buzachi)”	CNPC International (Buzachi) Inc., a company organised under the laws of the State of Delaware and the current operator of the North Buzachi field.
“CPC”	Caspian Pipeline Consortium.
“CPF”	Central production facility.
“CREST”	Paperless settlement system operated by CRESTCo Limited that facilitates the transfer of title to shares in unregistered form.
“CSFB”	Credit Suisse First Boston, London Branch.
“CSFB Bridge Loan”	Credit facility agreement dated 15 December 2003 between CSFB (as lender) and BBV (as borrower) relating to the provision of a credit facility.
“Canaccord”	Canaccord Capital (Europe) Limited, a private limited company organised under the laws of England and Wales with registered number 2814897 and having its registered office at 1st Floor Brook House, 27 Upper Brook Street, London W1K 7QF, England.
“Chaparral”	Chaparral Resources, Inc., a company organised under the laws of the State of Delaware.
“Chaparral Guarantee”	Guarantee Agreement dated 17 May 2004 between the Company and CAIH.
“Chaparral Share Purchase Agreement”	Share purchase agreement dated 17 May 2004 between CAIH and NAC relating to, amongst other things, the acquisition by NAC from CAIH of approximately 60 per cent. of the issued and outstanding common stock of Chaparral.
“Chaparral Warrant”	Stock purchase warrant dated 10 May 2002 issued by Chaparral to CAIH to purchase further shares of the common stock of Chaparral.
“Combined Code”	The code of best practice, including the principles of good governance, set out in the “Combined Code on Corporate Governance” published in July 2003 by the Financial Reporting Council.
“Common Shares”	Common shares of U.S.\$0.01 each in the share capital of the Company.
“Company” or “Nelson”	Nelson Resources Limited, formerly known as Nelson Trade & Finance Limited and Nelson Gold Corporation Limited.
“Competent Persons’ Reports”	Reports on reserves of each of the Alibekmola, Kozhasai and North Buzachi fields prepared by McDaniel & Associates Consultants Ltd. and report on reserves of Karakuduk field prepared by Ryder Scott Company, L.P., summaries of which are included in Part III of this document.
“EII”	Energy Investments International Ltd, of Trident Chambers, P.O. Box 146 Road Town, Tortola, British Virgin Islands.
“Exchange Act”	United States Securities Exchange Act of 1934, as amended.
“Glencore”	Glencore Central Asia Limited.
“Glencore Off-take Agreement”	Crude oil sale and purchase agreement dated 8 August 2003 between KOA and Glencore.
“Group” or “Nelson Group”	The Company and all or any of its consolidated subsidiaries, and, unless the context requires otherwise, its interest in Chaparral.
“HSBK”	Joint Stock Company Halyk Bank, a joint stock company organised under the laws of Kazakhstan.

“Hoare Govett”	Hoare Govett Limited, a private limited company organised under the laws of England and Wales with registered number 2026375 and having its registered office at 250 Bishopsgate, London EC2M 4AA, England.
“KKB”	Joint Stock Company Kazkommertsbank, a joint stock company organised under the laws of Kazakhstan.
“KKB Credit Facility”	Credit facility agreement dated 4 June 2002 (as amended) between KKB (as lender) and AMS (as borrower) relating to the provision of a credit facility.
“KKM”	Closed Joint Stock Company Karakudukmunai, a closed joint stock company organised under the laws of Kazakhstan.
“KKS”	Kazkommerts Securities, the investment banking subsidiary of KKB.
“KMTI”	Korporatsiya Mangistau Terra International, a company organised under the laws of Kazakhstan.
“KOA”	Kazakhoil Aktobe Limited Liability Partnership, a limited liability partnership organised under the laws of Kazakhstan.
“KOA Constituting Documents”	KOA Foundation Agreement and the Charter of KOA dated 10 July 2000.
“KOA Hydrocarbon Contract”	Contract for production of hydrocarbon materials in the Alibekmola and Kozhasai fields dated 19 October 1998, as assigned to KOA on 13 June 2000 and any extension, renewal or amendment thereof.
“KOA Foundation Agreement”	Foundation agreement dated 10 July 2000 between the Company and Kazmunaigas (as successor) relating to the development of the Alibekmola and Kozhasai fields and any extension, renewal or amendment thereof.
“KTO”	Kaztransoil.
“Karakuduk”	Karakuduk field.
“Kazakhoil”	State-owned National Oil and Gas Company Kazakhoil, the closed joint stock company, incorporated under the laws of Kazakhstan, currently known as Kazmunaigas.
“Kazakhstan”	Republic of Kazakhstan.
“Kazmunaigas”	State-owned National Company Kazmunaigas, a closed joint stock company organised under the laws of Kazakhstan, formerly known as Kazakhoil.
“Kozhasai”	Kozhasai field.
“London Stock Exchange”	London Stock Exchange plc.
“MEMR”	Ministry of Energy and Mineral Resources of Kazakhstan currently the competent body designated by the Government of Kazakhstan, as responsible for sub-soil use issues.
“Management”	Each of E. Nick Zana (CEO), Frederick Hodder (CFO), S.A. Sehsuvaroglu (Senior Vice President), Paul Ties (KKM General Manager), Simon Gill (Aktau Regional Manager); and Nicholas Greene (Senior Vice President of Business Development and Director of Corporate Finance).
“Munai Tas”	Closed Joint Stock Company Severo-Zapadnaya Truboprovodnaya Kompaniya, Munai Tas.

“NAC”	NRL Acquisition Corp., a newly-incorporated corporation incorporated under the laws of the State of Delaware.
“NBH”	Nelson Buzachi Holdings Limited, a company organised under the laws of Jersey and a wholly-owned subsidiary of the Company.
“NBL”	Nelson Buzachi Limited, a company organised under the laws of England & Wales, with registered number 04182179, having its registered office at 19 Berkeley Street, London W1J 8ED, England.
“NBOC”	Buzachi Operating B.V., a joint venture operating company to be established pursuant to the North Buzachi Joint Operating Agreement.
“North Buzachi”	North Buzachi field.
“North Buzachi Hydrocarbon Contract”	Contract for development and production of hydrocarbons in the North Buzachi field dated 29 May 1997 and any extension, renewal or amendment thereof.
“North Buzachi Joint Operating Agreement”	Joint Operating Agreement dated 16 December 2003 between BBV and CNPC (Buzachi) relating to the development of the North Buzachi field.
“OPEC”	Organisation of Petroleum Exporting Countries.
“POS Regulations”	Public Offers of Securities Regulations 1995 (SI 1995 No. 1537) (as amended).
“Placing”	Conditional placing of the Placing Shares pursuant to the Placing Agreement.
“Placing Agreement”	Conditional agreement dated 13 July 2004 between Hoare Govett, Canaccord, the Company and the executive Directors relating to the placing of new Common Shares further details of which are set out in Part V of this document.
“Placing Price”	57.25p (U.S.\$1.0635) per Placing Share.
“Placing Shares”	112,144,128 new Common Shares which are the subject of the Placing.
“Plan”	Common Share option plan of the Company as amended.
“SEC”	United States Securities and Exchange Commission.
“Securities Act”	United States Securities Act of 1933, as amended.
“Shareholders”	Holders of Common Shares.
“TSX”	Toronto Stock Exchange.
“UK” or “United Kingdom”	United Kingdom of Great Britain and Northern Ireland.
“U.S. GAAP”	United States generally accepted accounting principles.
“UniOil”	UniOil A.G.
“VAT”	Value added tax on goods and services.
“Vitol”	Vitol S.A., a company organised under the laws of Switzerland.
“Vitol Off-take Agreement”	Crude oil sale and purchase agreement dated 28 May 2004 between BBV and Vitol.
“Zhambai LLP”	Zhambai Limited Liability Partnership, a limited liability partnership established under the laws of Kazakhstan on 26 May 1999 and registered under number 2728-1915-TOO.
“Zhambai/Zaburunye Option”	Option agreement dated 6 February 2002 (as amended) between the Company and Kazmunaigas relating to an option to acquire from Kazmunaigas an interest in Zhambai LLP.

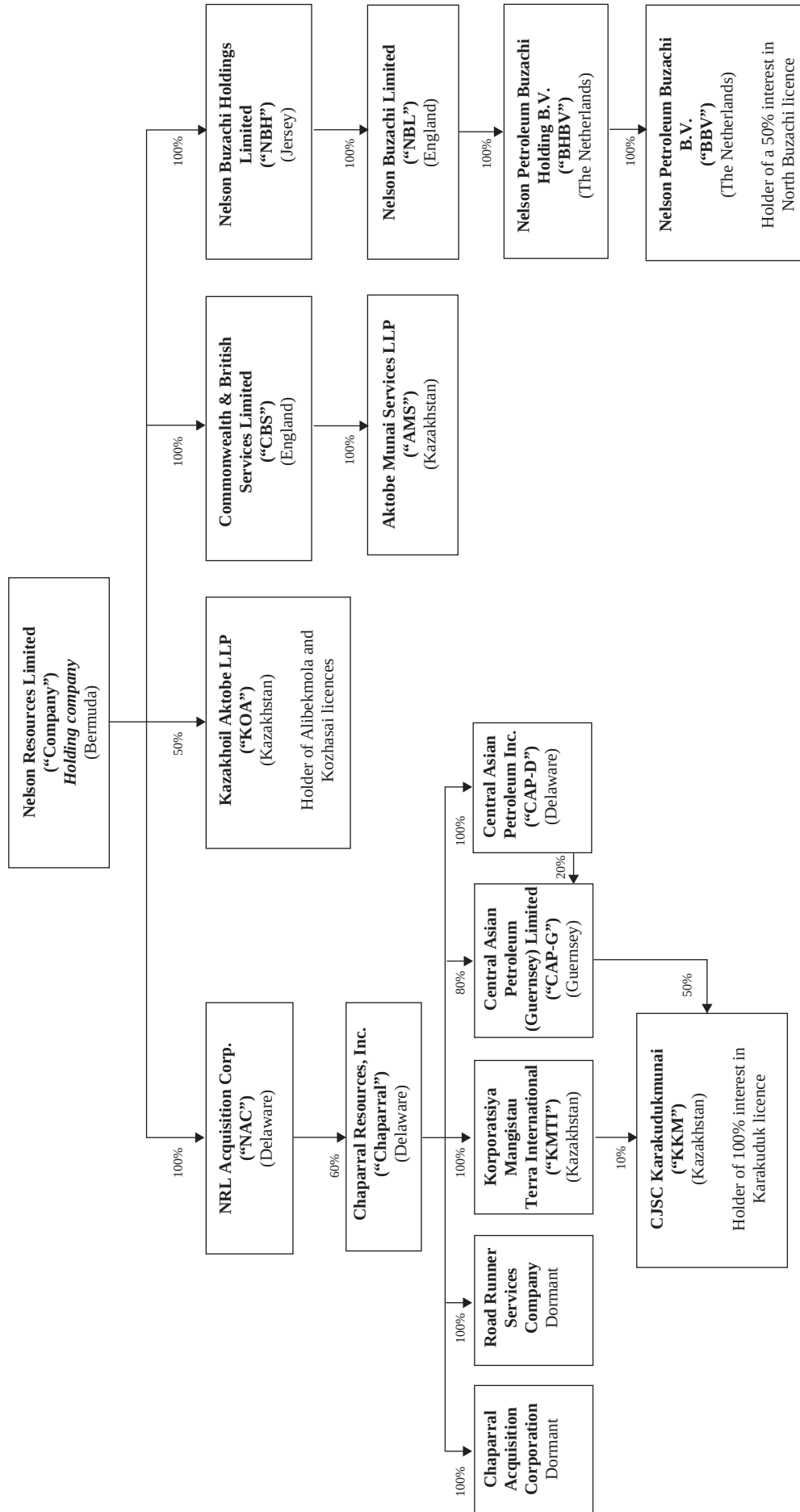
GLOSSARY OF TECHNICAL TERMS

Unless the context otherwise requires or unless otherwise provided, the following technical terms and abbreviations have the following meanings in this document.

2P	Proved and probable reserves.
3P	Proved, probable and possible reserves.
3D seismic survey	Seismic survey that is run, acquired and processed to yield a three-dimensional picture of the subsurface.
anticline	A fold in layered rocks originating below the surface in the form of an elongated dome.
bbls	Barrels (one barrel comprises 42 U.S. gallons).
bopd	Barrels of oil per day.
field	An area consisting of a single reservoir or multiple reservoirs all grouped on or related to the same individual geological structure feature and/or stratigraphic condition.
future net cash flows	Amounts that are the result of subtracting future development and production costs and future income tax expenses from future cash inflows, such cash inflows being computed by applying year-end prices of oil and gas relating to the enterprise's proved reserves to the year end quantities of those reserves.
hydrocarbon	Naturally occurring organic substances composed of carbon and hydrogen, including crude oil and gas, occurring in subsoil, recoverable as well as already extracted.
oil	Crude oil and condensate.
operator	Individual or company responsible for conducting oil and gas exploration, development and production activities on an oil and gas lease or concession on its own behalf and, if applicable, for other working interest owners, generally pursuant to the terms of a joint operating agreement or comparable agreement.
possible reserves	Additional reserves that are less certain to be recovered than probable reserves. There is at least a 10 per cent. probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable plus possible reserves.
present value	When used with respect to oil and gas reserves, the estimated future gross revenues to be generated from the production of proved reserves, net of estimated production and future development costs, using prices and costs in effect as of the date indicated without future escalation, except as otherwise provided by contract, without giving effect to non-property related expenses such as general and administrative expenses, debt service and future income tax expenses or to depreciation, depletion and amortization, discounted using specified discount rates.
probable reserves	Additional reserves that are less certain to be recovered than proved reserves. There is at least a 50 per cent. probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves.
producing well	A well capable of, and in the process of, producing oil and/or gas.

proved reserves	Reserves that can be estimated with a high degree of certainty to be recoverable. There is at least a 90 per cent. probability that the quantities actually recovered will equal or exceed the estimated proved reserves.
reservoir	Subsurface body of rock having sufficient porosity and permeability to store and transmit fluids (such reservoir being overlain by a layer of impermeable rock that forms a seal trapping the fluids within the reservoir).
royalty	Payment of a percentage of gross income less transportation costs and VAT (where applicable) from the production of oil and gas by the company licenced to produce these liquids, to the Government of Kazakhstan.
seismic	Use of shock waves generated by controlled explosions of dynamite or other means to ascertain the nature and contour of underground geological structures.
working interest	Operating interest that gives the owner the right to drill, produce and conduct operating activities on the property and to a share of production, subject to all royalties, overriding royalties and other burdens, and to all costs of exploration, development and operations and all risks in connection therewith.
work-over	Process of performing major maintenance or remedial treatments on an oil or gas well, which, in many cases, implies the removal and replacement of the production tubing string after the well has been killed and a work-over rig has been placed on location.

GROUP STRUCTURE



PART I: INFORMATION ON THE GROUP

Introduction

Nelson is a leading independent oil development and production company operating in Kazakhstan. The Company has interests in 4 onshore oil fields in Kazakhstan, which are, in order of production volumes in 2003, greatest first, the Alibekmola field, the Karakuduk field, the North Buzachi field and the Kozhasai field. In addition, the Company holds an option to participate in 2 offshore blocks in the Caspian Sea. The Company has operated in the Kazakh oil sector since 2000 and its management team, comprising both international and Kazakh executives, has extensive experience of the Kazakh operating and regulatory environment.

Each of the onshore fields is at an early stage of development. The Company intends to grow the proven and probable reserves by a programme of further drilling at each of the onshore fields. The Company uses the latest western reservoir management practices to maximise productivity and recovery. As at 31 March 2004, Nelson's share of production from the 4 onshore fields was approximately 14,200 bopd. As stated in the Competent Persons' Reports in Part III of this document, as at 31 December 2003, the 4 onshore fields had aggregate estimated remaining proved and probable reserves of approximately 437 million barrels, of which Nelson's share was approximately 210 million barrels.

Each onshore field benefits from being located close to existing energy and transportation infrastructure. This offers a choice of export options. Management believes that the Company is strategically well placed to serve its existing markets. In May 2004, the Chinese and Kazakh Governments announced an agreement to complete the Atyrau (Kazakhstan) – Dushanzi (China) pipeline. If completed, Management believes the pipeline will provide improved access from Kazakhstan to the potential Chinese market.

Management intends to exploit the position of the Company as a leading independent oil development and production company operating in Kazakhstan to grow by further acquisitions of additional reserves in Kazakhstan and by strategic partnering with new and existing participants in the Kazakh oil industry.

The Common Shares are currently traded on the Toronto Stock Exchange under the trading symbol "NLG". As at 8 July 2004, the Company had a market capitalisation of approximately U.S.\$735.8 million (£396.1 million) with a closing mid-market share price of U.S.\$0.9875 (53.15p) using an exchange rate of U.S.\$1.00: Cdn.\$1.3164.

Management expects the admission of the Common Shares to trading on AIM to increase public awareness and trade recognition of the Group, to raise the profile and status of the Group with customers and suppliers, and to provide additional access to the international capital markets.

The Group

The Company holds, directly and indirectly, its interests in each of its onshore fields through a number of subsidiaries. KOA, a joint venture with state-owned Kazmunaigas, holds the Alibekmola licence and the Kozhasai licence. BBV, holds a 50 per cent. interest in the North Buzachi licence. KKM holds the Karakuduk licence. In addition, the Company holds the Zhambai/Zaburunye Option to participate in the Caspian offshore blocks.

KOA

KOA is a 50:50 joint venture between the Company and Kazmunaigas (formerly Kazakhoil). KOA holds the 25-year licences to develop both the Alibekmola and Kozhasai fields in north-western Kazakhstan.

As at 31 March 2004, Nelson's share of production from the Alibekmola and Kozhasai fields was approximately 7,975 bopd. As set out in the Competent Persons' Reports in Part III of this document, as at 31 December 2003, the Alibekmola field and the Kozhasai field had estimated remaining proved and probable reserves of approximately 206 million and 9 million barrels, respectively. These estimates reflect the early stage of development of these fields.

KOA was registered as a limited liability partnership under the laws of Kazakhstan in September 1999. Prior to the purchase of the 50 per cent. interest in KOA in July 2000 by the Company, KOA was a wholly-owned subsidiary of Kazmunaigas.

The Company acquired the 50 per cent. interest in KOA from Kazmunaigas for an aggregate consideration of U.S.\$2.42 million. In addition, KOA assumed an obligation to pay to the Government of Kazakhstan U.S.\$69.6 million for historical exploration and development costs incurred by Kazakhstan in discovering the Alibekmola and Kozhasai fields. This historical cost obligation is payable in equal quarterly installments commencing on 1 January 2007 and ending on 31 December 2022.

The operations and management of KOA are governed by the terms of the KOA Hydrocarbon Contract and the KOA Constituting Documents. Further details of the KOA Hydrocarbon Contract and the KOA Constituting Documents are set out in Part V of this document.

Pursuant to the KOA Foundation Agreement and the KOA Hydrocarbon Contract, the Company has agreed to provide or arrange all of the financing for the annual working programme and budgets approved under the KOA Hydrocarbon Contract. Further details are set out in Part V of this document.

BBV

BBV is the holder of the 50 per cent. interest in the 25-year licence to develop the North Buzachi field located in western Kazakhstan. CNPC (Buzachi), a subsidiary of CNPC, owns the remaining 50 per cent. interest.

As at 31 March 2004, Nelson's share of production from the North Buzachi field was approximately 3,400 bopd. As set out in the Competent Persons' Reports in Part III of this document, as at 31 December 2003, the North Buzachi field had estimated remaining proved and probable reserves of approximately 160 million barrels. This estimate reflects the early stage of development of the field.

In December 2003, NBL acquired from CNPC the entire share capital of BHBV. BHBV owned BBV, the holder, at that time, of a 35 per cent. interest in the licence to develop the North Buzachi field. On 5 February 2004, BBV completed the acquisition from CNPC (Buzachi) of a further 15 per cent. interest in the North Buzachi licence. The aggregate purchase price for the 50 per cent. interest in the North Buzachi licence was approximately U.S.\$90 million in cash, financed through the CSFB Bridge Loan. Further details of the CSFB Bridge Loan are set out in Part V of this document.

The North Buzachi Joint Operating Agreement governs the relationship between BBV and CNPC (Buzachi). CNPC (Buzachi) is the current operator of the field. However, the operation of the field is under joint management with BBV, in accordance with the North Buzachi Joint Operating Agreement. Under the terms of the North Buzachi Joint Operating Agreement, the parties have agreed to establish a new joint operating company, NBOC, to act as the operator under the North Buzachi Hydrocarbon Contract. Further details of the North Buzachi Joint Operating Agreement and the North Buzachi Hydrocarbon Contract are set out in Part V of this document.

Chaparral

On 17 May 2004, pursuant to the Chaparral Share Purchase Agreement, NAC, a newly-incorporated wholly-owned subsidiary of the Company, acquired from CAIH approximately 60 per cent. of the issued and outstanding common stock of Chaparral. In addition, the Company acquired a warrant, the Chaparral Warrant, relating to additional shares in Chaparral and has the benefit of the CAIH Note.

Chaparral is an oil and gas exploration and production company. The only operating asset of Chaparral is its participation in the development of the Karakuduk field through KKM. Chaparral owns a 60 per cent. interest in KKM with the other 40 per cent. ownership interest being held by Kazmunaigas. The Karakuduk field is located in western Kazakhstan.

As at 31 March 2004, Nelson's share of production from the Karakuduk field was approximately 2,880 bopd. As set out in the Competent Persons' Reports in Part III of this document, as at 31 December 2003, the Karakuduk field had estimated remaining proved and probable reserves of approximately 63 million barrels. This estimate reflects the early stage of development of the field.

Further details of the Chaparral Share Purchase Agreement, the Chaparral Warrant and the CAIH Note are set out in Part V of this document.

The Zhambai/Zaburunye Option



In February 2002, the Company entered into an option agreement with Kazmunaigas, the Zhambai/Zaburunye Option, to acquire from Kazmunaigas an interest in Zhambai LLP. Zhambai LLP holds a licence for the exploration and production of hydrocarbons at and from the Caspian Sea offshore blocks known as South Zhambai and South Zaburunye. The South Zhambai and South Zaburunye blocks are located in proximity to the Astrakhan gas field (124 trillion cubic feet) in Russia, the Kashagan offshore field (13.6 billion bbls) and the Tengiz onshore field (8.5 billion bbls).

Kazmunaigas is in the process of seeking partners who will undertake the exploration of the blocks to determine the commercial viability of production from the blocks.

Pursuant to the Zhambai/Zaburunye Option, the Company is entitled to acquire 50 per cent. of the interest that Kazmunaigas holds in Zhambai LLP at the date of exercise of the option, provided that this equates to at least a 25 per cent. interest in Zhambai LLP. The option expires on the date 30 days after the announcement of a commercial discovery of hydrocarbons. Further details on the Zhambai/Zaburunye Option are set out in Part V of this document.

Acquisition strategy

The acquisitions of the interests in North Buzachi, Chaparral and the Zhambai/Zaburunye Option reflect the Group's strategy of acquiring interests in fields in Kazakhstan. Management believes that this strategy will generate economies of scale and portfolio management benefits.

Overview of the Kazakh oil industry



General

The extraction, production and transportation of oil and gas is a significant part of the Kazakhstan economy. The Caspian Basin is one of the world's largest untapped hydrocarbon reserves with Kazakhstan representing a substantial sector. Kazakhstan has explored reserves of 28 billion barrels of oil and condensate and 106 trillion cubic feet of gas. In 2003, Kazakhstan produced approximately

1.01 million bopd and 494 billion cubic feet of gas and it is forecasted that production will grow to approximately 1.09 million bopd and 565 billion cubic feet of gas by the end of 2004. Kazakhstan is not a member of OPEC and is not subject to the OPEC system of production quotas.



The largest deposits of explored oil reserves are located in the Tengiz, Zhetybai, Kalamkas and Uzen fields in the Caspian region, the Karachaganak and Zhanazhol fields in north-western Kazakhstan, the Kumkol field in central Kazakhstan and the Kashagan fields in the Kazakh sector of the Caspian Sea. KOA operations are located in north-western Kazakhstan while North Buzachi and Karakuduk are located in the Caspian region.

The Government of Kazakhstan encourages foreign direct investment in the oil and gas sector. In Kazakhstan, major international oil companies and smaller independent companies, such as the Company, compete for the acquisition of additional exploration and production rights as well as for access to export routes.

Abbreviations

tcf = trillion cubic feet bcf = billion cubic feet MMbbl = million barrels

Transportation and export

The production and export of hydrocarbons in Kazakhstan is influenced by its location and its general, but not exclusive, dependence on Russian transportation infrastructure for exports.

Russia imposes an annual quota on exports from Kazakhstan through Russia. Given the export limits and regulations associated with transit through Russia, the Government of Kazakhstan grants quotas for transportation through the Atyrau-Samara and Makhachkala-Tikhoretsk-Novorossisk pipelines to oil producers. The method of allocation of quota is not transparent. In practice, subject to domestic supply requirements, quotas are allocated on a *pro-rata* basis depending on the volume of oil production and the export route. The Atyrau-Samara pipeline is in the process of being modernised which should increase its annual throughput capacity.

In addition, the Government of Kazakhstan participates in the CPC. The CPC was established to develop a pipeline from the Tengiz oil field to Novorossisk on the Black Sea together with oil pumping stations and oil storage and loading facilities. The CPC plans to reconstruct certain existing systems and construct new facilities which CPC expects will increase its annual throughput capacity.

Kazmunaigas and CNPC are in the process of constructing a pipeline from Atyrau-Atasu (Kazakhstan) to Dushantszy (China) to provide access from west Kazakhstan to the Chinese market. The Atyrau-Kenkiyak pipeline, which became operational in March 2003, forms the first part of this link.

Regulation of the Kazakh oil industry

The Government of Kazakhstan owns the sub-soil rights in Kazakhstan. Kazakh regulation of the exploration and production of oil and gas prescribes a licensing and hydrocarbon contract regime. The MEMR (and its regional subdivisions, such as Zapkaznedra) monitors and controls the compliance by producers with their obligations under such licences, hydrocarbon contracts and other relevant regulations. State-owned Kazmunaigas represents national interests by means of mandatory share participation in producers.

Licences and hydrocarbon contracts

Before August 1999, Kazakhstan used a dual regime of licences and hydrocarbon contracts. Under this dual regime, the Government of Kazakhstan granted licences to exploit sub-soil for the production of hydrocarbons. Licences are for fixed periods of time, commencing on the date of registration of a related hydrocarbon contract. The licence prescribes a monetary value for a minimum programme of works and

field development capital expenditure. A producer may only market reserves from the licensed area after it has negotiated and entered into a hydrocarbon contract with the MEMR. If the producer and the MEMR are not able to agree the terms of such a hydrocarbon contract, the producer runs the risk of losing its rights under the related licence. The related hydrocarbon contract sets out specific provisions regulating the sub-soil rights granted under the licence including certain investment obligations.

From August 1999, Kazakhstan replaced the dual regime with a regime requiring only a hydrocarbon contract governing rights to exploit fields and to sell oil. However, the dual system still applies to earlier licences, including the Alibekmola licence, the Kozhasai licence and the North Buzachi licence.

Field development plan

In addition to the licence and hydrocarbon contract, the producer and the MEMR must agree a field development plan. The field development plan specifies drilling and production targets. From time to time, the producer and the MEMR will agree amendments to the field development plan to reflect changing circumstances.

Annual working programme and budget

The hydrocarbon contract requires the producer to submit an annual working programme and a budget to the relevant regional sub-division of the MEMR for its approval. The annual working programme and budget is based on the field development plan.

If the proposed annual working programme is inconsistent with the work scope defined for the corresponding year in the field development plan, the producer must first submit the changes to the work scope to the MEMR for approval.

The producer must submit quarterly status reports on the progress of the annual working programme. Repeated non-compliance with approved working programmes may result in suspension, revocation or termination of the licence and the related hydrocarbon contract.

Kazakh law provides that fines may be imposed and/or licences and/or hydrocarbon contracts may be suspended, amended, revoked or terminated if, amongst other things, a licence holder fails to comply with licence or contractual requirements, or to make timely payments of levies and taxes for the sub-soil use, to provide geological information to controlling bodies or to meet other reporting requirements.

Transportation

The Government of Kazakhstan regulates the transportation and export of oil by, amongst other things, quotas. Although Kazakh law and other applicable regulation does not expressly provide for the imposition of such quotas, in general the Government of Kazakhstan has regard to the condition of the Kazakh economy and domestic market supply. In practice, quotas are imposed annually (with possible revisions quarterly) on the basis of the preceding year's results, domestic supply requirements, the capacity of the internal pipeline system (run by KTO) and the size of the Kazakhstan export quota through Russia (when applicable), and field development plans.

ARNMPC approves tariffs for the transportation of oil by the KTO and Munai Tas pipelines. Such tariffs are based on the costs of services, profitability and, in some cases, on any required investment. Tariffs are the same for all users. Tariffs are reviewed twice a year and any revision becomes effective on 1 April and 1 October (as appropriate).

Overview of existing fields

The Company has interests in 4 onshore fields, Alibekmola, Kozhasai, North Buzachi and Karakuduk. The table below summarises the proven, probable and possible reserves for each field.



Nelson's share of reserves as at 31 December 2003

	Alibekmola	Kozhasai	N. Buzachi	Karakuduk	Total
	(in '000 bbls)				
Proved Developed.....	12,273	391	4,266	5,439	22,368
Proved Undeveloped.....	54,776	1,133	50,533	3,783	110,225
Total Proved.....	67,049	1,524	54,799	9,222	132,593
Probable Reserves.....	35,745	3,111	24,959	13,472	77,286
2P.....	102,794	4,635	79,758	22,693	209,879
Possible Reserves.....	76,869	58,793	50,379	N/A	186,041
3P.....	179,663	63,428	130,137	22,693	395,920

Notes

1. As Nelson and Chaparral report their reserves estimates under different regulatory regimes, Nelson is assessing the effect of Chaparral's reserves data on Nelson's reserves data and will disclose such assessment in due course.
2. Reserve estimates for Alibekmola, Kozhasai and North Buzachi were prepared by McDaniel & Associates according to policies set out by the Canadian National Instrument 51-101 — Standards of Disclosure for Oil and Gas Activities.
3. Reserve estimates for Karakuduk were prepared by Ryder Scott Company L.P. according to policies set out by the SEC.
4. No information is provided under the SEC parameters for Karakuduk's possible reserves.
5. Numbers may not add due to rounding.

Source: Competent Persons' Reports as set out in Part III of this document.

Each of the onshore fields is at an early stage of development. As stated in the Competent Persons' Reports in Part III of this document, as at 31 December 2003, the 4 oil fields had total estimated remaining proved and probable reserves of approximately 437 million barrels, of which Nelson's share was approximately 210 million barrels. Management believes that through its application of western recovery techniques and reservoir management practices it is able to maximise productivity and recovery from its fields.

The existing CPF at Alibekmola, the centre for all processing of KOA oil, has been upgraded and a second CPF is planned for completion in 2005. At North Buzachi, the Company plans to start to upgrade the existing CPF by the end of 2004 allowing all oil produced from the North Buzachi field, which is currently de-salted at the nearby Arman field, to be fully processed at the field. Management believes such developments of the processing facilities will increase processing capacity and reduce dependency on third party processing.

Drilling and Work Programme 2004

Alibekmola

1. Continue Drilling program with 4 rigs, 16 wells
2. CPF and de-mercaptanisation unit de-bottlenecking to 42,000 bopd
3. Expansion of oil and gas gathering system
4. Camp construction
5. Construction of new oil & gas treatment facility and DMU
6. Construction of water injection facilities
7. Construction of gas sweetening unit

North Buzachi

1. Drilling program with 1 rig, 15 wells
2. Construction of CPF
3. Modifying gauging and measuring station
4. Installing various flow and export pipelines
5. Applying to competent body for additional 45 wells to drill

Kozhasai

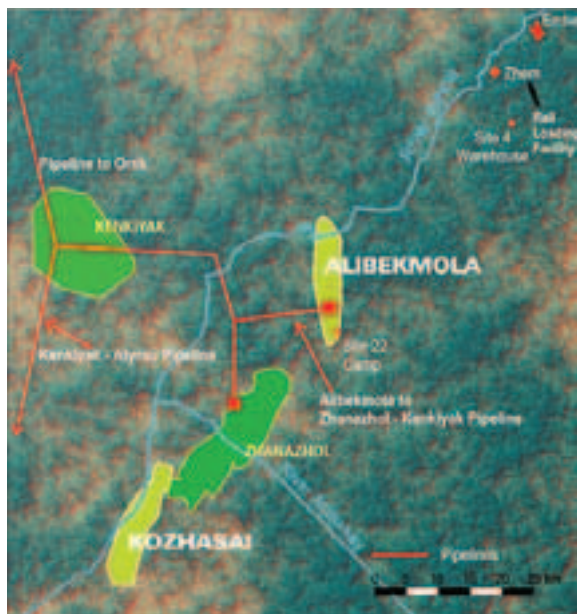
1. Drilling program with 1 rig, 2 wells
2. Construction of oil and gas gathering system
3. Camp construction
4. Construction of power supply system
5. Construction of oil pipeline and pump station

Karakuduk

1. Drilling program with 1 rig, 16 wells
2. Construction of group unit
3. Construction of oil gathering system
4. Upgrade of existing CPF

Total of 49 wells planned to be drilled in 2004

Alibekmola field and licence



General

The Alibekmola field is located in the Aktiubinsk region. The field contains oil and gas reserves in rocks of the carboniferous age at two main productive intervals. The first is located in carbonates at a depth of between 1,670 and 1,772 metres below sea level. The second, also a carbonate, is subdivided into an upper and lower unit and occurs from approximately 2,600 to 3,300 metres below sea level.

Licence

On 19 October 1998, the Government of Kazakhstan granted to Kazakhoil (now Kazmunaigas) a licence (GK1 No. 993) to develop the Alibekmola field. The licence term is 25 years, but may be extended by the Government of Kazakhstan. On 13 June 2000, the MEMR approved the assignment of the licence from Kazakhoil (now Kazmunaigas) to KOA.

The licence sets the minimum work programme for the licence term in the amount of U.S.\$47.5 million and expected capital expenses for field development in the amount of U.S.\$270.0 million. As at 31 December 2003, U.S.\$110.2 million had been invested in the Alibekmola field.

KOA Hydrocarbon Contract

On 10 August 1999, the MEMR and Kazakhoil (now Kazmunaigas) entered into the KOA Hydrocarbon Contract relating to both the Alibekmola and Kozhasai fields. On 13 June 2000, the MEMR approved the assignment of the KOA Hydrocarbon Contract from Kazakhoil (now Kazmunaigas) to KOA. On 7 November 2001, Government Decree 1415 ratified the assignment to KOA of the Alibekmola and Kozhasai licences and the KOA Hydrocarbon Contract. The term of the KOA Hydrocarbon Contract expires on the last day of the term of the licences.

The MEMR has extensive rights to terminate the KOA Hydrocarbon Contract. These include where either of the related licences is terminated, where KOA has suspended production under the working programme for a period exceeding 90 days or where KOA does not fulfil its obligations under the KOA Hydrocarbon Contract.

In certain circumstances, the MEMR must suspend the KOA Hydrocarbon Contract, while in certain other circumstances, the MEMR may suspend the KOA Hydrocarbon Contract. In both cases, the MEMR will give notice to the operator of the circumstance and the time period the operator has to remedy the situation. If the operator does not remedy the situation within the time period specified, the MEMR may terminate the KOA Hydrocarbon Contract.

Under the KOA Hydrocarbon Contract, the Government of Kazakhstan has the right to purchase a maximum of 25 per cent. of the total annual production of oil and gas from the licenced area. The mechanism for agreeing such prices is not transparent.

The KOA Hydrocarbon Contract requires KOA to pay certain taxes, royalties and historical cost charges during the development of the fields based on the combined production from both the Alibekmola and Kozhasai fields.

Further details of the KOA Hydrocarbon Contract are set out in Part V of this document.

Field development plan

In December 2002, the MEMR approved a field development plan for the southern portion of the Alibekmola field. KOA estimates that 90 per cent. of the proved and probable reserves of the Alibekmola field are located in this southern portion. KOA is in the process of drilling wells and undertaking further geological analysis of the northern portion of the field in order to submit to the MEMR a proposed field development plan for this northern portion.

The approved field development plan specifies detailed drilling and production targets to drill 54 production wells and 17 water injection wells in the southern portion of the field by 2006.

As at 31 March 2004, there were 19 producing wells within the Alibekmola and Kozhasai fields. Management expects KOA to drill 16 wells at the Alibekmola field during 2004.

Reserves

Details of the reserves are set out in the Competent Persons' Reports in Part III of this document.

Transportation

In October 2002, KOA signed a five year agreement with KTO (as amended on 15 April 2003) relating to the transportation of KOA oil via the KTO pipeline from Alibekmola to Kenkiyak. The current tariff is Tenge 303.44 (approximately U.S.\$2.20) per tonne.

In December 2002, KOA signed a contract for the transportation of KOA oil via the Munai Tas pipeline from Kenkiyak to Atyrau. The current tariff equals Tenge 1,100 (U.S.\$8.00) per tonne exclusive of VAT. The agreement is for 12 years from December 2002 with a total minimum volume guarantee of 32.3 million tonnes during the term.

At Atyrau, there are a number of export options (such as the CPC and Atyrau-Samara pipelines to Black Sea ports such as Novorossisk and Odessa). In April 2003, KOA signed a five-year agreement with the CPC, allowing KOA to transport all crude oil from Atyrau via the CPC pipeline to Novorossisk. Access to the CPC pipeline has resulted in significant financial benefits, including a decrease in overall transportation costs, different conversion factors, use of Brent rather than Urals as a reference price and use of a "quality bank" (which protects the value of higher quality oil such as that from Alibekmola by way of financial adjustment for differences between the quality of oil delivered into the system and the quality of the blend delivered out).

Sales and marketing

In August 2003, KOA entered into the Glencore Off-take Agreement pursuant to which Glencore has agreed to purchase 100 per cent. of KOA production until March 2007. Further details of the Glencore Off-take Agreement are set out in Part V of this document.

The following table provides sales information for the Alibekmola and Kozhasai fields for the relevant quarter. Nelson has a 50 per cent. entitlement to such sales revenue.

	<u>Q1 2003</u>	<u>Q2 2003</u>	<u>Q3 2003</u>	<u>Q4 2003</u>	<u>Year 2003</u>	<u>Q1 2004</u>
Sales of crude oil						
(U.S.\$):.....	5,815,632	17,886,411	30,857,532	25,249,068	79,808,643	38,574,156
Export sales.....	5,815,632	17,886,411	30,857,532	25,249,068	79,808,643	38,574,156
Domestic sales	—	—	—	—	—	—
Average sales price						
(U.S.\$/bbl)	27.87	23.52	27.87	27.42	26.63	29.38

The average sales price for the oil from the Alibekmola and Kozhasai fields sold by KOA for the year ended 31 December 2002 was U.S.\$20.22 per barrel and for the year ended 31 December 2003 was U.S.\$26.63 per barrel.

Kozhasai field and licence

General

The Kozhasai field is located in the Aktiubinsk region. The field comprises a faulted north-south trending anticline. Oil and gas have been found in two carbonate reservoirs of the carboniferous age at depths from 2,950 to 3,440 metres below sea level.

Licence/hydrocarbon contract

On 19 October 1998, the Government of Kazakhstan granted to Kazakhoil (now Kazmunaigas) a licence (GK1 No. 1009) to develop the Kozhasai field. The licence term is 25 years, but may be extended by the Government of Kazakhstan. On 13 June 2000, the MEMR approved the assignment of the licence from Kazakhoil to KOA. The licence sets the minimum work programme for the licence term in the amount of U.S.\$24.5 million and expected capital expenses for field development in the amount of U.S.\$150 million. As at 31 December 2003, U.S.\$3.2 million had been invested in the Kozhasai field. The KOA Hydrocarbon Contract governs production at the Kozhasai field.

Field development plan

KOA is in the process of relocating one of the drilling rigs in operation at Alibekmola to Kozhasai to commence drilling of further appraisal wells. Management estimates KOA will have completed the drilling of these five appraisal wells by early 2006, at which time KOA will submit to the MEMR a proposed field development plan.

Reserves

Details of the reserves are set out in the Competent Persons' Reports in Part III of this document.

Transportation

Currently, KOA stabilises oil at the Kozhasai field before transporting the oil by truck to the Alibekmola field where it is treated before being pumped via the Kenkiyak-Atyrau pipeline for export. Further details of the transportation of crude oil from Alibekmola are set out in "Alibekmola field and licence – Transportation" on page 7 of this document.

Sales and marketing

Sales and marketing information for Kozhasai is aggregated with Alibekmola and is set out in "Alibekmola field and licence – Sales and marketing", on page 8 of this document.

North Buzachi field and licence



General

The North Buzachi field is located in the Mangistau region in western Kazakhstan. The productive reservoirs are located at depths of 300 to 500 metres below sea level. The oil reservoirs are trapped in an anticlinal structure broken by a number of faults.

Licence

On 14 November 1996, the Government of Kazakhstan granted a licence to develop the North Buzachi field. The licence term is 25 years, but may be extended by the Government of Kazakhstan. On 5 February 2004, the MEMR approved the registration of BBV as the holder of a 50 per cent. interest in the licence/hydrocarbon contract. The minimum capital expenditure requirements under the licence for North Buzachi have been satisfied.

North Buzachi Hydrocarbon Contract

After a series of amendments to the North Buzachi Hydrocarbon Contract originally dated 29 May 1997, on 5 February 2004 the MEMR registered the North Buzachi Hydrocarbon Contract showing a 50:50 allocation between BBV and CNPC (Buzachi). The term of the North Buzachi Hydrocarbon Contract expires on the last day of the term of the licence.

If either party to the North Buzachi Hydrocarbon Contract materially breaches the contract, the other party may demand that the breach is remedied within a reasonable specified period. If the breach is not remedied within that time, the non-defaulting party may terminate the contract by giving 90 days' notice to the defaulting party. If the defaulting party contests such material breach, termination shall not occur unless pursuant to an arbitral award. Termination does not relieve the parties of all of their respective obligations under the North Buzachi Hydrocarbon Contract.

BBV may also terminate the North Buzachi Hydrocarbon Contract by giving notice that it intends to abandon production at the site; BBV and the MEMR will then agree on a date for the abandonment of production.

Under the North Buzachi Hydrocarbon Contract, the Government of Kazakhstan has the right to purchase up to 50 per cent. of the level of total production at the time of the exercise of this right. The price for such oil is equal to the prevailing world market at that time and is payable in U.S.\$.

The North Buzachi Hydrocarbon Contract requires the producer to pay certain taxes and royalties during the development of the field based on the production from the North Buzachi field.

Further details of the North Buzachi Hydrocarbon Contract are set out in Part V of this document.

Field development plan

On 26 June 2003, the MEMR approved a full field development plan for the North Buzachi field.

As at 31 March 2004, there were 44 producing wells. In accordance with the annual working programme for 2004, 15 wells are to be drilled in 2004.

Management expects to start to upgrade the North Buzachi CPF by the end of 2004 allowing all oil produced from the North Buzachi field to be fully processed at the field. The upgrade is aimed at eliminating dependency on third party processing at Arman.

Reserves

Details of the reserves are set out in the Competent Persons' Reports in Part III of this document.

Transportation

North Buzachi crude oil enters the KTO pipeline system from the Arman field processing plant, blends with other western Kazakh crude oils and is transported to Aktau. The tariffs for KTO services are regulated by ARNMPC.

From Aktau, production from the North Buzachi field is exported either by the KTO pipeline from Aktau-Atyrau-Samara to Black Sea ports such as Novorossisk and Odessa or by ship from Aktau.

Shipped crude oil is loaded at Aktau and is transported across the Caspian Sea to either Makhachkala (and then by the Transneft pipeline system to Novorossisk) or to either Sangachal or Baku from where crude oil is transported by railway through Azerbaijan and Georgia to Batumi.

Sales and marketing

Approximately 17 per cent. of the sales volumes from the North Buzachi field in 2003 was delivered to the Atyrau refinery for domestic use at a reduced domestic sales price.

On 28 May 2004, BBV entered into the Vitol Off-take Agreement pursuant to which Vitol and BBV will agree monthly the quantity of oil to be delivered to Vitol each month subject to a minimum quantity of 15,000 tonnes per month. Further details of the Vitol Off-take Agreement are set out in Part V of this document.

The following table provides sales information for the North Buzachi field for the relevant quarter. BBV became entitled to 35 per cent. of such sales revenue on 17 December 2003 and to 50 per cent. from 5 February 2004:

	<u>Q1 2003</u>	<u>Q2 2003</u>	<u>Q3 2003</u>	<u>Q4 2003</u>	<u>Year 2003</u>	<u>Q1 2004</u>
Sales of crude oil						
(U.S.\$):.....	10,050,080	16,584,390	16,990,394	19,451,111	63,075,974	16,897,455
Export sales.....	9,041,887	16,077,131	16,023,861	18,343,283	59,486,162	15,549,369
Domestic sales	1,008,194	507,258	966,532	1,107,828	3,589,812	1,348,086
Average sales price						
(U.S.\$/bbl)	16.83	22.77	23.79	23.50	22.00	22.58

The average sales price for the oil sold for the year ended 31 December 2002 was U.S.\$18.78 per barrel and for the year ended 31 December 2003 was U.S.\$22.00 per barrel.

Karakuduk field and licence



General

The Karakuduk field is located in western Kazakhstan, approximately 365 kilometres north-east of Aktau.

The Karakuduk field structure is an asymmetrical anticline. Oil was discovered in the structure from Jurassic age sediments between 8,500 and 10,000 feet.

Licence

In 1995, KKM was awarded a 25-year licence and approval to proceed with development.

Hydrocarbon Contract

In August 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 MEMR and KKM as long as production of petroleum and/or gas is continued in the Karakuduk field.

Field development plan

The full field development plan for the Karakuduk field was approved in 1996. KKM commenced development of the Karakuduk field in early 2000. As at 31 March 2004, there were 48 producing wells at the Karakuduk field. The drilling campaign is to be continued throughout 2004 when the Management anticipates that 16 wells will be drilled.

Reserves

Details of the reserves are set out in the Competent Persons' Reports in Part III of this document.

Transportation

The field is approximately 29 kilometres west of the main utility corridor, including the Makat-Mangishlak railroad and the Uzen-Atyrau-Samara pipeline. KKM has a right to use the existing oil export pipeline and related utilities. It also has a contract with KTO granting the right to use the export pipeline for transportation of crude oil to local and export markets. KKM has a crude oil pipeline from the field capable of transporting up to 18,000 barrels of oil per day to the export pipeline terminal.

Environmental matters

Extensive national, regional and local health, safety and environmental laws and regulations affect all Group operations in Kazakhstan.

These laws and regulations set various standards regulating certain aspects of health and environmental quality, provide for user fees, penalties and other liabilities for the violation of these standards and establish, in some circumstances, obligations to remediate current and former facilities and off-site locations.

The Group pays fees based on the volume of pollutants it generates as part of its ongoing operations. In 2003, KOA and the operator of the North Buzachi field made emission payments of U.S.\$448,861 and U.S.\$92,000, respectively. Management anticipates that these amounts will increase in 2004 to U.S.\$2.88 million and U.S.\$205,000, respectively and will increase again in 2005. In order to mitigate the effect of such increases on KOA operations, Management intends either to commercialise or to re-inject gas production.

The operations of the Group in Kazakhstan are subject to periodic inspection by the Government of Kazakhstan's environmental protection agencies. Typically, the Kazakh environmental authorities impose fines and penalties for any breach of applicable environmental protection laws and regulations. However, any material or continuing breach may result in the suspension or termination of the relevant subsoil licence. Management is not aware of any material or continuing breach.

Directors and senior management

Board

As at the date of this document, there are 9 members of the Board. The Company is in the process of seeking additional independent directors.

The Board and senior management have extensive operational experience in the international oil industry, in the CIS and specifically in Kazakhstan and the Caspian Basin, and are comprised of both international and Kazakh executives.

CAIH and EII may each nominate three Directors for election to the Board. CAIH is entitled to nominate the Chairman of the Board. Currently, CAIH is represented by Mr. Alshinbayev and EII is represented by Mr. Abouv and Mr. Tiku.

E. Nick Zana, Chairman, Chief Executive Officer, Executive Director (age 57)

Mr. Zana has been a Director since 16 January 2002. Before joining the Company, Mr. Zana was managing director of the Eurasia Business Unit of Chevron from October 1997 to October 2000, responsible for upstream and related infrastructure business in the CIS countries and Turkey. Prior to this, Mr. Zana was the managing director of the ACT offshore production joint venture in China and general director of TengizChevroil JV, which operated the Tengiz oil field in Kazakhstan. At the time of his retirement from Chevron in April 2001, Mr. Zana was president of Chevron Petroleum Technology Corporation.

Mr. Zana's contract expires in January 2005. Mr. Zana has indicated his willingness to continue to lead the Company and the Board is keen for Mr. Zana to continue in a key leadership role.

Baltabek Kuandykov, President, Executive Director (age 55)

Mr. Kuandykov has been a Director since 29 November 2001. Before joining the Company, Mr. Kuandykov was an executive consultant to the Eurasian Group of Chevron in the United States from August 1998 to October 2001. Previously, he was the president of Kazakhoil from October 1997 to April 1998. Prior to this he was president of state-owned KazakhstanCaspiShelf from February 1993 to October 1997. He was Deputy Minister of Energy for Kazakhstan in 1993 and 1994 and was Deputy Minister of Geology for Kazakhstan from 1992 to 1993.

Mirbulat Abuov, Non-executive Director (age 45)

Mr. Abuov has been a Director since 26 October 2000. Mr. Abuov is also a member of the Board of HSBK and a major shareholder of EII. EII has nominated Mr. Abuov as a Director pursuant to its right to nominate Directors.

Askar Alshinbayev, Non-executive Director (age 39)

Mr. Alshinbayev has been a Director since 26 October 2000. Mr. Alshinbayev is the chief executive officer of CAIH, a member of the board of directors of both KKB and KKS and has other extensive business interests in Kazakhstan. Mr. Alshinbayev is a managing director of Meridian Capital. CAIH has nominated Mr. Alshinbayev as a Director pursuant to its right to nominate Directors.

Robert Connon, Non-executive Director (age 60)

Mr. Connon has been a Director since 1 February 2003. During the period from 1964 to 2001, Mr. Connon held various positions with Chevron Corporation and predecessor companies, including managing director of Chevron Angola/Zaire and managing director of Chevron Europe. Mr. Connon served for four years as a director and for one year as president of the United Kingdom Offshore Operators Association.

Azziz Ait-Said, Non-executive Director (age 63)

Mr. Ait-Said has been a Director since 26 November 2003. During the period from 1969 to 2001, Mr. Ait-Said held various positions with Total, including senior vice-president, Middle East, senior vice-president and advisor to the chairman.

Peter Luis O. Gross, Non-executive Director (age 43)

Mr. Gross has been a Director since 1 February 2003. Prior to joining the Company, Mr. Gross advised private and corporate clients worldwide as an attorney-at-law and financial planning consultant in succession, asset protection and tax matters. Mr. Gross was deputy managing director and marketing director of a Credit Suisse Group company from 1998 to 2001. Currently, he is the chairman and managing director of Alyco.

Arvind Tikku, Non-executive Director (age 34)

Mr. Tikku has been a Director since 26 October 2000. Mr. Tikku is the managing director of EII. EII has nominated Mr. Tikku as a Director pursuant to its right to nominate Directors.

Gilles Thieffry, Non-executive Director (age 44)

Mr. Thieffry is a lawyer qualified to practice law in the UK (Solicitor of the Supreme Court, England and Wales), USA (Member of the New York Bar) and France (Avocat). Mr. Thieffry is currently a partner in the leading Swiss firm, Pestalozzi Lachenal Patry. Prior to joining Pestalozzi Lachenal Patry, he was a member of the executive board and head of the legal department of BNP Paribas (Suisse) S.A.. Previously, Mr. Thieffry was partner in charge of the Capital Markets practice at Norton Rose (London) then of Andersen Legal (Garretts) (London). Mr. Thieffry has also been the head of the legal department of BNP Capital Markets Limited.

Senior management

Currently, senior management consists of the following persons:

E. Nick Zana, Chief Executive Officer, Chairman (age 57)

The biography of Mr. Zana is set out under “Board” on page 12 of this document.

Baltabek Kuandykov, President (age 55)

The biography of Mr. Kuandykov is set out under “Board” on page 12 of this document.

Frederick Hodder, Chief Financial Officer (age 62)

Prior to joining the Company in July 2002, Mr. Hodder was president of Kazakhstan Investment Management LLC from 1998 to 1999 and was senior vice-president of the Central Asian-American Enterprise Fund from 1995 to 1998. Mr. Hodder has also served as the chief financial officer of Aspect Telecommunications Corporation (1986 to 1988) and chief financial officer of International Microelectronic Products (1983 to 1986).

S.A. Sehsuvaroglu, Senior Vice-President, Operations (age 49)

Prior to joining the Company in November 2001, Mr. Sehsuvaroglu was with Halliburton International where he spent 24 years in various engineering and management positions, four of those years being spent in Kazakhstan. Mr. Sehsuvaroglu is also the vice-chairman of the Kazakhstan Producers Association, a professional registered engineer in the State of Texas and a member of the Society of Petroleum Engineers.

Paul Ties, KKM General Manager (age 48)

Mr. Ties was previously manager (sub-surface) at the Company. Prior to joining the Company in August 2000, Mr. Ties was a director for one year of Kaltynor Holdings N.V. KZ (a wholly-owned subsidiary of KKB) and exploration manager of Vitol for over 6 years, working mainly in Russia and Kazakhstan. Before this, Mr. Ties worked for 13 years in a variety of drilling, geological and operational roles in the international oil business.

Simon K. Gill, Western Regional Manager (age 48)

From 1998 to October 2003, Mr Gill acted as general manager of Texaco North Buzachi. Before joining the Group in October 2003, Mr. Gill was employed by Texaco (ChevronTexaco) for 24 years. Between 1979 and 1990, Mr. Gill was engaged in a number of engineering positions in Trinidad and Angola, before moving into operations management positions. Mr. Gill is the chief executive officer of Chaparral. Mr. Gill is a member of the Society of Petroleum Engineers.

William Daily, General Director, KOA (age 61)

Prior to joining KOA in September 2003, Mr. Daily was president of Centaur Royalty Corp., a consulting company for start-up ventures, turnarounds and established businesses. Before this Mr. Daily was senior vice-president of Seven Seas Petroleum and president of its international subsidiary GHKCC for two years. Mr. Daily was an advisor for Occidental O&G Corp. and worked at Hondo O&G Company. Mr. Daily was employed by Arco for a period of 20 years and was vice-president of the China, Middle-East and Africa Region of Arco between 1985 and 1989.

Gavit Kurkimov, Commercial Director, KOA (age 40)

Prior to joining KOA in April 2003, Mr. Kurkimov held a number of positions at Chevron and Tengizchevroil in Atyrau, including financial accounting manager, manager of domestic banking, deputy treasurer and chief accountant for fixed assets and materials. Before joining Tengizchevroil, Mr. Kurkimov worked as deputy chief accountant for NGDU Oil Production Company in Kazakhstan.

Yermek Kudabayev, Finance Director, KOA (age 34)

Prior to joining KOA in September 2003, Mr. Kudabayev was director of the Astana office of Ernst & Young in Kazakhstan. For two years Mr. Kudabayev was a manager at Andersen. Mr. Kudabayev has also worked at KPMG, Bureau Janat Consulting and Feroalloys Plant (Aktiubinsk), in various positions. In 2003 Mr. Kudabayev was the chairman of the financial statement committee in the Chamber of Professional Accountants of Kazakhstan. In 2003 Mr. Kudabayev was listed by the Kazakhstan Chamber of Auditors to the Government Award for assistance in development of accounting and auditing practices in Kazakhstan.

Employees

Excluding employees of Chaparral, the average number of employees of the Company (and its subsidiaries other than KOA) and employees of KOA by principal activity for the year ended 31 December 2003 was as follows:

Category of activity

The Company and non-KOA subsidiaries:

Headquarters, administration, finance and management	40
KOA:	
Exploration and production	156
Marketing sales and transportation	35
Headquarters, administration, finance and management	90
Total	281

As at 24 February 2004, Chaparral had 4 full-time employees. KKM had 209 employees and retains independent consultants as necessary.

Pursuant to the North Buzachi Joint Operating Agreement, each of BBV and CNPC (Buzachi) will second employees to NBOC.

Each of the KOA Hydrocarbon Contract and the North Buzachi Hydrocarbon Contract require the relevant licence holder to employ Kazakh nationals in preference to foreign nationals.

Corporate governance

The Board believes the general approach of the Company to corporate governance is consistent with the objectives and guidelines for corporate governance applicable to companies listed on the TSX. However, in direct response to the U.S. Sarbanes-Oxley Act of 2002, Canadian securities regulatory authorities are in the process of implementing a number of mandatory rules and guidelines that will bring the corporate governance regime applicable to public companies whose shares are listed on a Canadian exchange substantially in line with that of the U.S.. For example, audit committees of public companies now have strict composition and defined responsibility requirements, and chief executive officers and chief financial officers are now required to certify annual and interim financial filings.

In addition, Canadian regulatory authorities are in the process of implementing “best practice” corporate governance guidelines and mandatory disclosure obligations, as regards to whether such guidelines are being met by a company. Among other things, the guidelines set high standards for board and board committee composition and responsibility, director education, and board and director assessment. The proposed guidelines recommend that all public companies have, among others, a compensation committee of the board made up of independent directors with defined responsibilities for reviewing executive compensation.

Furthermore, Canadian public companies involved in oil and gas activities are subject to new National Instrument 51-101 – Standards of Disclosure for Oil and Gas Activities, which mandates high standards of disclosure, assigns considerable responsibility to the reserves committee of the board and requires considerable independent reserves auditor involvement.

In addition, following Admission, the Company intends to adopt practices to comply, so far as practicable, with the Combined Code.

The Company intends to adopt a share dealing code for Directors and applicable employees and the Company will take all necessary steps to ensure their compliance with the AIM Rules on share dealing.

Corporate Governance Committee

The corporate governance committee identifies qualified individuals to become Board members, recommends to the Board the appropriate size, function, needs and composition of the Board and its committees, and advises the Board on corporate governance matters, including developing and recommending to the Board the corporate governance principles and plans. The corporate governance committee meets at least twice annually. The committee must have at least three members. Each member must be a Director and a majority of the membership should be independent under Canadian regulatory policy requirements. Each member is appointed annually, or until such member is no longer on the Board, or otherwise fails to qualify for membership. The current members of the corporate governance committee are Mr. Alshinbayev, Mr. Connon, Mr. Gross and Mr. Zana.

Audit Committee

Among other functions prescribed under Canadian securities laws, the audit committee oversees the relationship with independent audit firms, reviews management’s accounting procedures and controls, and recommends for approval by the full Board the contents of the financial statements of the Company. The audit committee meets at least three times annually. The audit committee must have at least three members. Each member must be a Director and satisfy the applicable Canadian securities laws’ independence and financial competency requirements. Each member is appointed annually, or until such member is no longer on the Board or otherwise fails to qualify for membership. The current members of the audit committee are Mr. Gross, Mr. Tiku and Mr. Thieffry.

Compensation Committee

The compensation committee is responsible for the performance evaluation and compensation of the Chief Executive Officer and other senior executives, and development of a compensation structure for executives, including annual mid-term and long-term compensation plans, benefit plans and share ownership guidelines for executives. The compensation committee meets at least once annually. The compensation committee must have at least three members. Each member must be a Director and a majority of the membership should be independent under Canadian regulatory policy requirements. Each member is appointed annually, or until such member is no longer on the Board, or otherwise fails to qualify for membership. The current members of the compensation committee are Mr. Abuov, Mr. Tiku, Mr. Ait-Said and Mr. Thieffry. The Board proposes to appoint one further member to this committee.

Environmental Committee

The environmental committee reviews and monitors the environmental policies and activities of the Group and the activities of the employees as they relate to the health and safety of the employees of the Group. The environmental committee meets as required.

The environmental committee must have at least two members. Each member must be a Director and a majority of the membership should be independent under Canadian regulatory policy requirements. Each member is appointed annually or until such member is no longer on the Board, or otherwise fails to qualify for membership. The environmental committee is in the process of being re-constituted as a general compliance committee responsible for the oversight of environmental and regulatory compliance.

Reserves Committee

The reserves committee has the general responsibility of overseeing the evaluation of the oil and gas reserves of the Group, including retaining an “independent” engineering firm to prepare a report of an evaluation of the oil and natural gas reserves of the Group. The reserves committee verifies the integrity of processes used to estimate volumes of proved, probable, and possible hydrocarbon reserves and the net present value of these reserves and confirms that these are determined according to industry accepted standards, by industry accepted methods and according to applicable Canadian rules and regulations as well as those of the appropriate stock exchange.

The reserves committee meets prior to the approval by the Company of its annual financial statements and reserves reports and as required. The reserves committee must have at least three members. Each member must be a Director and a majority must satisfy applicable Canadian securities laws’ independence requirements. Each member is appointed for such term as the Board may decide, or until such member is no longer on the Board or otherwise fails to qualify for membership. The current members of the reserves committee are Mr. Kuandikov, Mr. Connon and Mr. Ait-Said.

Current trading and prospects

The Company recorded a net loss of U.S.\$4.73 million for the quarter ended 31 March 2004, compared to a net loss of U.S.\$1.67 million for the quarter ended 31 March 2003. However, exclusion of the non-cash flow charges for derivative instruments and other compensation costs, of U.S.\$4.02 million and U.S.\$7.81 million, respectively, would have resulted in a net profit of U.S.\$7.11 million compared to the net loss recorded of U.S.\$4.72 million.

The Directors consider that the Group is well placed to exploit the potential opportunities arising from its growing portfolio of oil properties in Kazakhstan, including its recently acquired interests in the North Buzachi and Karakuduk fields, and to progress its growth strategy.

At the Alikbekmola and Kozhasai fields, the Company is expanding production. Since 31 December 2003, the Group has acquired an additional interest in the North Buzachi licence increasing the Company’s interest to 50 per cent. In May 2004, the Company acquired 60 per cent. of the share capital of Chaparral, which holds 60 per cent. of the Karakuduk licence. Each of these initiatives has broadened and strengthened the asset portfolio of the Company and enhanced growth prospects.

Summary financial information

Nelson

The table below summarises the recent trading results of Nelson. The information has been extracted without material adjustment from Part IV of this document. In order to make a proper assessment of the financial performance of the Group, a prospective investor should not rely solely on the summary information set out below but should read the whole of this document.

	Year ended 31 December (U.S.\$'000)		
	2001	2002	2003
Revenue from crude oil.....	—	6,911	40,591
Expenses.....	(6,106)	(18,114)	(47,553)
Loss from operations.....	(6,106)	(11,203)	(6,962)
Other (expenses)/income.....	(2,999)	(5,600)	186
Loss from continuing operations before income taxes.....	(9,105)	(16,803)	(6,776)
Income taxes.....	(42)	(333)	(4,235)
Net loss from continuing operations.....	(9,147)	(17,136)	(11,011)
Net loss from discontinued operations.....	(2,446)	(963)	—
Net loss.....	(11,593)	(18,099)	(11,011)
Basic and diluted loss per Common Share (U.S.\$ per share)....	(0.030)	(0.041)	(0.019)

Chaparral

The table below summarises the recent trading results of Chaparral. The information has been extracted without material adjustment from Part IV of this document. In order to make a proper assessment of the financial performance of the Group, a prospective investor should not rely solely on the summary information set out below but should read the whole of this document.

	Year ended 31 December (U.S.\$'000)		
	2001	2002	2003
Revenue.....	—	45,133	57,615
Expenses.....	5,320	37,685	43,489
(Loss)/profit from operations	(5,320)	7,448	14,126
Other (expenses).....	(8,376)	(5,984)	(8,962)
(Loss)/income before income taxes, extraordinary gain and cumulative effect of change in accounting principle	(13,696)	1,464	5,164
Income tax expense.....	—	(2,685)	(4,121)
(Loss)/income before extraordinary gain and cumulative effect of change in accounting principle.....	(13,696)	(1,221)	1,043
Extraordinary gain.....	—	5,338	—
Cumulative effect of change in accounting principle, net of taxes of U.S.\$436,000 for 2003 and \$nil for 2001	(2,519)	—	1,018
Net (loss)/income	<u>(16,215)</u>	<u>4,117</u>	<u>2,061</u>

Dividends

The declaration and payment of dividends on the Common Shares is at the discretion of the Board. The Company has not paid any dividends on the Common Shares in the last 5 years and it is not expected that it will declare any dividends in the foreseeable future.

Taxation

The attention of prospective investors is drawn to Part V of this document.

Reasons for the Admission and Placing and use of proceeds

The Directors expect the admission of the Common Shares to trading on AIM to increase public awareness and trade recognition of the Group, to raise the profile and status of the Group with customers and suppliers and to provide additional access to international capital markets.

The net proceeds of the Placing, after estimated expenses of the Admission and Placing of U.S.\$8.6 million (£4.6 million), will be added to working capital and used for general corporate purposes, which may include, without limitation, funding to support the development of existing fields and funding future growth.

Details of the Placing

The Company is to issue 112,144,128 Placing Shares, representing 13.1 per cent. of the enlarged issued share capital of the Company, at U.S.\$1.0635 (57.25p) per Placing Share. The gross proceeds of the Placing (assuming the issue of all of the Placing Shares), would be U.S.\$119.3 million (£64.2 million) and net of expenses will be approximately U.S.\$110.7 million (£59.6 million). Hoare Govett and Canaccord has each agreed to use its reasonable endeavours to procure subscribers for the Placing Shares. Assuming the issue of all of the Placing Shares, the Company would have a market capitalisation of approximately U.S.\$911.7 million (£490.8 million) at the Placing Price.

The Placing Shares will be issued credited as fully paid and will, when issued, rank *pari passu* with the existing Common Shares including the right to receive all dividends and other distributions thereafter declared, made or paid.

The Placing has not been underwritten and will not proceed unless Hoare Govett and Canaccord receive commitments from placees pursuant to which placees agree to subscribe, in aggregate, for all of the Placing Shares which would, at the Placing Price, raise U.S.\$119.3 million (£64.2 million) (gross) for the Company or such lesser amount as the Company, Hoare Govett and Canaccord may agree. As at 13 July

2004, Hoare Govett and Canaccord have received commitments from placees pursuant to which placees have agreed (subject to the terms of the Placing Agreement) to subscribe, in aggregate, for such number of the Placing Shares as would, at the Placing Price, raise U.S.\$119.3 million (£64.2 million) (gross) for the Company. The Placing is conditional on, amongst other things:

- (a) the Placing Agreement becoming unconditional and not having been terminated in accordance with its terms prior to Admission;
- (b) Hoare Govett and Canaccord receiving commitments from placees to subscribe for such number of Placing Shares as would, at the Placing Price, raise U.S.\$119.3 million (£64.2 million) (gross) for the Company or such lesser amount as the Company, Hoare Govett and Canaccord may agree; and
- (c) Admission becoming effective no later than 8.00 a.m. on 19 July 2004 or such later date as the Company, Hoare Govett and Canaccord may agree.

Immediately following Admission, as set out in paragraph 5.1 of Part V of this document, the Directors will be interested, in aggregate, in 222,547,950 Common Shares representing approximately 26.0 per cent. of the enlarged issued share capital of the Company.

Mr. Zana has an option to subscribe for further Common Shares as set out in paragraph 6.1 of Part V of this document.

Further details of the Placing Agreement are set out in Part V of this document.

Admission, dealings and settlement

The Placing Shares will only be sold in Canada on a private placement basis being exempt from the requirement to prepare and file a prospectus with securities regulatory authorities in the relevant provinces. Unless permitted under applicable securities legislation, any holder of the Placing Shares (whether a resident of Canada or not) shall not trade the Placing Shares in Canada before a date that is four months and one day from the date of Admission.

Application has been made to list the Placing Shares on the TSX. However, prior to a date that is four months and one day from the date of Admission, the Placing Shares cannot be traded through the facilities of the TSX since they will not be freely transferable in Canada before that date. Consequently, any certificate representing the Placing Shares will not be “good delivery” in settlement of transactions on the TSX prior to a date that is four months and one day from the date of Admission.

In order to distinguish the Placing Shares from the existing Common Shares over this restricted period, the Placing Shares will have the ISIN “CA6403831051” (CUSIP: 640383105) and will trade under the London Stock Exchange symbol “NLGa”. The existing Common Shares, which have the ISIN “BMG641801052” (CUSIP: G64180105) and will trade under the London Stock Exchange symbol “NLG”, carry no such restrictions. Following the end of the restricted period of four months and one day referred to above, the Placing Shares will assume the ISIN “BMG641801052”, will trade under the symbol “NLG” and there will be no re-sale restrictions in Canada.

The shares will be held in CREST in the form of CDIs. CREST is the UK system for paperless settlement of trades in securities and the holding of uncertificated securities. However, under English law, shares of non-UK companies cannot be held and transferred directly in the CREST system. CDIs facilitate trading and settlement of shares of non-UK companies in CREST. CDIs are uncertificated “mirror image” securities representing the shares, constituted under English law.

Under the CREST International Settlement Links Service shares are held in Crest International Nominees Limited on behalf of CDI holders.

The Placing Shares will not commence trading on the TSX until four months and one day following Admission.

Although the Common Shares will trade on AIM, the Company will not be subject to takeover regulation in the UK and consequently the UK City Code on Takeovers and Mergers will not apply to the Company. However, the Company will remain subject to takeover regulation in Canada where, generally speaking, the threshold for mandatory offers is 20 per cent. and not 30 per cent. as it is in the UK.

YOUR ATTENTION IS DRAWN TO THE ADDITIONAL INFORMATION SET OUT IN THE REMAINDER OF THIS DOCUMENT AND, IN PARTICULAR, TO THE RISK FACTORS THAT ARE SET OUT IN PART II OF THIS DOCUMENT.

PART II: RISK FACTORS

Before making any decision on whether to invest in the Common Shares, prospective investors should consider carefully the risks described in this Part II, together with all other information contained in this document. This Part II does not purport to be an exhaustive summary of all of the risks to which the Group may be subject. There may be additional risks, of which the Group is not aware or which the Group currently believes are immaterial. If any such risk were to materialise, the business, financial condition or results of operations of the Group could be materially and adversely affected, and, in such case, an investor may lose all or part of his or her investment.

General risk relating to emerging markets and AIM

Investors in emerging markets, such as Kazakhstan, should be aware that these markets are subject to greater risks than more developed markets (including significant legal, economic and political risks) and such markets are subject to rapid change so that the information set out in this document may become outdated relatively quickly. In general, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved.

The Common Shares will be traded on AIM rather than the Official List of the UK Listing Authority. An investment in shares traded on AIM may carry a higher risk than an investment in shares quoted on the Official List. AIM has only been in existence since June 1995 and its future success and liquidity in the market for the Group's securities cannot be guaranteed.

Investors should be aware that the value of the Common Shares may be volatile and may go down as well as up and investors may therefore not recover their original investment, especially as the market in the Common Shares on AIM may have limited liquidity.

The market price of the Common Shares may not reflect the underlying value of the net assets of the Group.

Risk factors relating to the financial condition and liquidity of the Group

The Group has a limited operating history in the oil exploration and production business.

Prior to 2000, the principal activity of the Group was the development and operation of open pit gold deposits in the Republic of Tajikistan. Since 2000, the Group has focused on oil exploration and production and has sold its other mining interests. Prospective investors should consider the risks, expenses and difficulties frequently encountered by companies in their early stages of development, particularly companies operating in emerging markets. The historical results of operations and financial condition of the Group may not be indicative of its future results.

The Group has had substantial net losses.

The Directors have prepared the consolidated financial statements of the Group on a going concern basis. The financial statements of Chaparral have also been presented on the basis that it is a going concern.

The Group requires a significant amount of cash to pursue its business strategy, to meet its liquidity needs and to service its debt obligations.

The Group requires a significant amount of cash in order to maintain its operations (including satisfying its field development capital expenditure obligations), to pursue its strategy of growth by acquisitions of additional fields and assets, to meet its liquidity needs and to service its debt obligations.

If its operations do not generate sufficient cash flow, the Group may be forced to reduce or delay its capital expenditure programme, to refinance all or a portion of its existing debt, to sell some of its assets or to obtain additional financing.

The financial and operational performance of the Group depends upon a number of factors, including factors that are beyond its control. These factors include amongst others, fluctuations in oil prices, exchange rates and interest rates, the success of the current and future exploration, development and production programmes of the Group, adverse regulatory change and general political, social, economic and business conditions in Kazakhstan and the region.

The ability of the Group to arrange additional financing and the cost of financing depends upon many factors, including, amongst others, economic and capital markets conditions, investor confidence in both the oil and gas industry in Kazakhstan and in the Group, regulatory developments, and credit availability from banks and other lenders.

The Group has significant indebtedness and may incur significant additional indebtedness in the future.

The Group has significant levels of indebtedness and may incur significant additional indebtedness in the future. This may affect the operations of the Group and have significant consequences for prospective investors in a number of ways. For example, the Group may be forced to dedicate a substantial portion of its cash flow to repayments of its indebtedness, thereby reducing the cash available to fund working capital, capital expenditure and for other general corporate purposes. It may limit the ability of the Group to borrow additional funds, which in turn may restrict its ability to pursue its business strategy. In addition, it might limit the flexibility of the Group in planning for, or reacting to, change and make it more vulnerable to a downturn in the industry or the economy generally.

If the Group is unable to comply with the restrictions and covenants under certain terms of the existing financing instruments of the Group, there could be a default under the terms of these instruments, which could result in the acceleration of repayments of funds that the Group has borrowed or termination of such instruments.

Certain existing financing arrangements of the Group include restrictions and covenants restricting or limiting the ability of the Group, among other things, to incur additional indebtedness, to make certain payments, including redemptions or repurchases of shares and investments, to create or incur certain liens, to have subsidiaries or joint ventures pay dividends or make other payments to it, and to transfer or sell assets.

Such restrictions and covenants may negatively affect the ability of the Group to react to changes in market conditions, to take advantage of business opportunities, to obtain financing, to fund capital expenditure, or to withstand a continuing or future downturn in its business.

If the Group were unable to comply with such restrictions and covenants, there could be a default under the terms of the relevant financial instrument. However, the ability of the Group to comply with such restrictions and covenants may be affected by events beyond its control. Typically the occurrence of an event of default would entitle a lender to terminate its commitment to lend and creditors to accelerate the indebtedness and to declare all amounts borrowed due and payable or to terminate the instrument, as the case may be. Debt instruments that contain cross-acceleration or cross-default provisions may also be accelerated and become due and payable. If any of these events occur, it would have a material adverse effect on the business, financial condition, results of operations and liquidity of the Group. The Group cannot assure prospective investors that its assets would be sufficient to repay in full all of its indebtedness or that it would be able to find alternative financing.

Risk factors relating to the business and industry of the Group

Oil sales are seasonal.

Oil sales in Kazakhstan are seasonal due to export sales restrictions imposed by the Government of Kazakhstan and weather conditions. Historically, during the winter months the Government of Kazakhstan has banned fuel exports for several months and, at harvest time, there is usually a ban on diesel oil export. These bans significantly reduce the market value of local crude oil.

The majority of the assets of the Group consist of interests in, and most of its operations are conducted through, joint ventures.

The Group operates its oil business through its joint ventures. In the future, the Group may enter into further joint ventures or make strategic investments as a means of conducting its business.

Joint ventures involve certain risks that are not present when operating through wholly-owned subsidiaries. For example, major decisions affecting the business and management of the joint venture (including, expansion plans and financing) require the agreement of each joint venture participant. The Group may face disagreements in relation to such decisions that it is unable to resolve. Accordingly, the Group can make no assurances that it will be able to pursue any particular strategy in respect of any joint venture.

In addition, the Group may have financial exposure in the event that the joint venture, or the other joint venture participant, encounters financial difficulty or becomes insolvent.

If any of such risks were to materialise, it would have a material adverse effect on the business, financial condition and results of operations of the Group.

The growth strategy of the Group depends on making successful acquisitions and the failure to make successful acquisitions and/or to realise the anticipated benefits could therefore prevent the Group from implementing its strategy.

The acquisitions of interests in oil fields and assets in Kazakhstan and, and in the longer term, elsewhere, are a key part of the growth strategy of the Group. Such an acquisition strategy involves certain risks including, amongst others, unidentified past or future liabilities relating to the operations the Group acquires, inability to receive accurate and timely information about these operations in order to make informed investment decisions, entry into new markets outside Kazakhstan where the Group has no previous experience, problems in integrating acquired operations and problems in hiring and retaining qualified personnel.

In particular, the integration of the North Buzachi and Karakuduk operations with the KOA operations will require significant time and effort by the Management. In addition, the Group has no prior experience of operating with its new joint venture parties. The expectation of available oil reserves from the North Buzachi and Karakuduk fields may prove to be wrong.

Recent revenue growth has taken place in a relatively short period of time. The management of that growth will require, among other things, rigid control of financial systems and operations, the continued development of its management controls and the training of new personnel. Failure to manage effectively such rapid growth could have a material adverse effect on the business, financial condition and results of operations of the Group.

The ability of the Group to achieve growth depends upon its success in finding, acquiring or gaining access to additional and economically productive reserves. In general, production declines as reserves are depleted, with the rate of decline depending on reservoir characteristics. If the Group does not conduct successful exploration activities, or if it does not acquire properties containing additional reserves, the total reserves of the Group will decline. However, such exploration activities expose the Group to a number of risks, including not finding any viable reserves, the uncertain costs of drilling, completing and operating wells, and numerous factors beyond the control of the Group may cause operations to be curtailed, delayed or cancelled. If these activities were unsuccessful, the future results of operations and financial condition of the Group would be adversely affected.

The Group is dependent on its key management and its ability to retain and hire new qualified personnel.

The Group depends on its key management for the operation of its day-to-day activities and implementation of its growth strategy. In addition, personal connections and relationships of its key management are important to the conduct of its business. If the Group were to lose a member of its key management, including Mr. Zana and Mr. Kuandykov, its business and results of operations might be adversely affected.

The service contracts of the current senior officers of the Group, including the Chief Executive Officer and the Chief Financial Officer, will terminate during 2005. If any such service contract were not renewed, or if the Group were unable to replace the relevant officer, in a timely manner, its business and results of operations might be adversely affected.

The volatility of crude oil prices could adversely affect the results of the operations and financial condition of the Group.

Crude oil exports are the primary source of revenues for the Group. The financial condition, operating results and future growth of the Group are dependent on prevailing crude oil prices. Historically, crude oil prices have been highly volatile. It is likely that such prices will continue to be volatile.

Crude oil prices are subject to a number of factors beyond the control of the Group, including, amongst others, global and regional economic and political developments in oil-producing regions, particularly in the Middle East, relatively minor changes in the supply of and demand for oil, the actions of the Organisation of Petroleum Exporting Countries, regulation in Kazakhstan and elsewhere, political stability in Kazakhstan, neighbouring countries and other oil producing regions, and the availability of alternate fuel sources.

The Group cannot assure prospective investors that crude oil prices will be at levels that will enable it to operate profitably. Lower crude oil prices may reduce the amount of crude oil that can be produced economically or reduce the economic viability of projects planned or in development, resulting in a reduction of any of revenues per barrel, total production volumes, and capital expenditures on development. Any such results would have a material adverse effect on the revenue growth rate of the Group.

Use of crude oil price collar hedging combined with the current historically high crude oil prices may have a negative impact on the results of operations and financial condition of the Group.

In August 2003, KOA entered into two separate commodity hedge agreements, each with BNP Paribas (New York Branch) establishing different commodity price index collars for a total of 270,000 barrels per month. Under each agreement, the parties have agreed on a crude oil price collar based on the arithmetic average of Brent crude oil prices in U.S. dollars per barrel during a pricing period. Any sales of crude oil within this collar are concluded at market prices.

If the crude oil price decreases below the floor price (for both agreements, U.S.\$18.0 per barrel), BNP Paribas (New York Branch) shall pay to KOA an amount equal to the amount by which the agreed average is below the floor price. However, the use of crude oil price collar hedging may have a negative impact on the results of operations and financial condition of the Group. If the crude oil price increases above the ceiling price (being U.S.\$29.5 or U.S.\$30.0 per barrel), KOA shall pay to BNP Paribas an amount equal to the amount by which the agreed average is above the ceiling price. Accordingly, if the crude oil price increases above the ceiling price, the fixed average price would prevent KOA from receiving the full benefit of the crude oil price increase for the volumes covered by the hedge agreements.

There are significant uncertainties in estimates of oil reserves used in this document.

The reserves data included in this document are estimates. Actual production, revenues, cash flows, royalties and development and operating expenditures may vary from these estimates. Such variances may be material. All estimates are to some degree speculative and are based on extensive engineering judgment. Any classification of reserves serves only to define the degree of speculation involved. Results of subsequent drilling, testing and production may require substantial upward or downward revisions of any estimate.

Estimates are based upon a number of factors, assumptions and variables, including, amongst others, historical production from the properties of the Group, comparisons with production from other producing areas, the assumed effects of regulation by governmental agencies, royalty rates, and assumptions regarding future oil prices and future operating costs. Many of these factors, assumptions and variables are beyond the control of the Group.

The estimated discounted future cash flows from proved and probable reserves in this document are based on prices and costs as of the date of the estimate. Investors should not interpret the present values of estimated future cash flows from reserves referred to in this document as being the same as the current market value of the estimated proved and probable reserves. Actual future prices and costs may be materially higher or lower. Actual future cash flows may be affected by a number of factors, including, the amount and timing of actual production, the supply and demand for oil, decreases or increases in consumption by purchasers, and changes in governmental regulations, royalties, taxes or export duties.

Non-compliance with obligations under the licences and related hydrocarbon contracts and field development plans would have a material adverse effect on the business, results of operations and financial condition of the Group.

The operations of the Group are subject to the terms of the exploration and production licences and the related hydrocarbon contracts, field development plans and annual working programmes and budgets agreed with the MEMR. The law provides that fines may be imposed and/or licences and/or hydrocarbon contracts may be suspended, amended, or terminated if a licence holder fails to comply with its obligations under such documents, or make timely payments of levies and taxes for the sub-soil use, provide geological information to controlling bodies or meet other reporting requirements.

KOA and the licence holders of the North Buzachi and Karakuduk fields have obligations to make various capital expenditures and to develop the fields in accordance with the specific requirements under their exploration and production licences, hydrocarbon contracts and field development plans. The Group cannot give any assurance that the Group will be able to satisfy such obligations in the future. If the Group

were to fail to satisfy such obligations with respect to a specific field, its licence and hydrocarbon contract for that field may be suspended or terminated. The termination or suspension of any of the licences or hydrocarbon contracts of the Group would have a material adverse effect on the business, results of operations and financial condition of the Group.

Repeated failure to fulfil approved working programmes may result in suspension, revocation or termination of the licence and the related hydrocarbon contract. There can be no assurance that the views of the government agencies on the development of the various fields coincide with those of the Group, which might lead to disagreements that cannot be resolved. Any delays in the continuous development of the fields by the Group caused by these disagreements would have a material adverse effect on the business of the Group, results of operations and its financial condition.

Under the terms of the North Buzachi Hydrocarbon Contract, BBV and its joint venture partner are jointly developing the North Buzachi field and are jointly and severally liable for all obligations arising under the North Buzachi Hydrocarbon Contract. Therefore, should CNPC (Buzachi) not fulfil its financing obligations relating to the North Buzachi field, BBV could also be liable for obligations of its partner to the Government of Kazakhstan. Such liability may result in a material adverse effect on the financial condition of the Group.

The Group relies upon transportation systems operated by third parties and is subject to export quotas.

The production and export of hydrocarbons in Kazakhstan is affected by the location of Kazakhstan and its dependence on export routes through Russia. Kazakh crude oil must be transported through pipelines or by rail. Any increase in the cost of using the pipelines or rail transportation or reduction or cessation in their availability could have a material adverse effect on the business, financial condition and results of operations of the Group.

Russia imposes an annual quota on exports from Kazakhstan through Russia. There can be no assurance that this quota will continue to be available for Kazakh oil exports or that Russia does not otherwise limit or restrict transit of Kazakh oil through Russia.

The Government of Kazakhstan has an absolute discretion to grant monthly quotas (including nil quotas) for transportation through the Atyrau-Samara and Makhachkala-Tikhoretsk-Novorossisk pipelines to oil producers on a *pro-rata* basis depending on the volume of oil production and other factors. In relation to Alibekmola and Kozhasai crude oil, KOA did not apply for, nor did it receive, any quota for these pipelines for 2004 as it has access to the CPC pipeline. For the years 2004 to 2008, the CPC quota for KOA is equal in total to 10.6 million tonnes (approximately 80 million barrels). However, in relation to North Buzachi and Karakuduk, quotas are allocated monthly.

Oil production in Kazakhstan is increasing. This is making access to export routes more competitive given the limitation on export capacity. New export pipelines or expansion of existing ones are underway or under evaluation. The Group cannot give any assurance that the Group will not be subject to future transportation or quota limitations or restrictions and that any such limitations or restrictions would not have a material adverse effect on the business, financial condition and results of operations of the Group.

The Group faces drilling and production risks and hazards.

The drilling and production operations of the Group are subject to all the risks typically associated with the drilling and production of oil. The risks include fire, explosion, blowouts, cratering and oil spills, each of which could result in substantial damage to oil wells, producing facilities, other property and the environment or in personal injury. Production operations are also subject to all the risks typically associated with those operations, including premature decline of reservoir pressure and the invasion of water into producing formations.

The Group is not fully insured against all such risks and all such risks are not insurable. Although the Group maintains liability insurance in amounts that Management believes is adequate, the nature of such risks is such that liabilities could exceed policy limits, in which event significant costs could be incurred which could have a material adverse effect upon the financial condition of the Group.

The cost of drilling, completing and operating wells is often uncertain. As a result, the Group may incur cost overruns or may be required to curtail, delay or cancel drilling operations because of a variety of factors, including unexpected drilling conditions, pressure or irregularities in geological formations, equipment failures or accidents, adverse weather conditions, compliance with governmental requirements and shortages or delays in the availability of drilling rigs and the delivery of equipment.

Drilling activities may be unsuccessful. Such failure may have a material adverse effect on the business, financial condition and results of operations of the Group.

The Government of Kazakhstan may mandate deliveries of crude oil.

The Government of Kazakhstan may require producers to supply a portion of their crude oil production to local refineries to meet domestic energy requirements. Such supplies generate substantially less revenue than oil sold on the export market.

Under the terms of the KOA Hydrocarbon Contract, the Government of Kazakhstan has the authority to purchase up to 25 per cent. of the total annual production of oil and gas produced. Similarly, the North Buzachi Hydrocarbon Contract gives the Government of Kazakhstan the right to purchase up to 50 per cent. of the oil produced in the North Buzachi field.

During the first quarter ended 31 March 2004, the Government of Kazakhstan limited the export quota of Chaparral to approximately 87 per cent. of production available for sale. Chaparral has the right to export 100 per cent. of all hydrocarbons produced from the Karakuduk field. On 17 July 2003, Chaparral took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of its export rights by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government of Kazakhstan. The consultation period expired without resolution. Chaparral continues to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration.

There can be no assurance that the Government of Kazakhstan will not use the option to purchase oil or gas produced in these fields in the future, and such exercise could adversely affect the revenues and business of the Group and its relations with other customers.

KOA crude oil is processed through a single processing unit located in Alibekmola and crude oil from the North Buzachi field is processed through a single processing unit located at the nearby Arman field.

At Alibekmola, the centre for all processing of KOA oil, the existing CPF is in the process of being upgraded and a second CPF is planned for completion in 2005. Kozhasai field production is transferred to the Alibekmola CPF by truck. At North Buzachi, the Group plans to start to upgrade the existing CPF by the end of 2004 allowing all oil produced from the North Buzachi field, which is currently de-salted at the nearby Arman field, to be fully processed at the field.

However, there is no alternative back-up CPF in Alibekmola or Arman. Accordingly, any significant increase in production or problems with any of these CPFs could have a material adverse effect on the business, financial condition and results of operations of the Group.

The Group operates in a highly competitive environment.

The oil industry is highly competitive. Competitors include oil companies that have greater financial resources, staff and facilities than the Group, some of whom carry out refining operations and market petroleum and other products on a worldwide basis. Competitive factors in the distribution and marketing of oil include price, methods and reliability of delivery and availability of imported products. As a result of such competition, the Group faces pressure on its margins.

Further consolidation in the oil industry is likely to continue, making it even more difficult to compete. The ability of the Group to increase reserves in the future will depend not only on its ability to develop existing properties but also on its ability to acquire further viable reserves and assets or prospects for exploratory drilling.

The Group could incur significant liabilities under environmental laws.

Extensive national, regional and local environmental laws and regulations affect nearly all of the oil operations of the Group. These laws and regulations set various standards regulating certain aspects of health and environmental quality, provide for user fees, penalties and other liabilities for the violation of those standards and, in some circumstances, establish obligations to remediate current and former facilities and off-site locations. Compliance with these standards is subject to periodic inspection by the government environmental protection agencies. The joint ventures of the Group may be subject to liabilities for environmental contamination if they do not comply with applicable laws and regulations concerning their operations and such liabilities can be substantial.

Specifically, Kazakh legislation provides for payments for environmental pollution within the established limits (ordinary payments) and payments for environmental pollution beyond the established limits (extraordinary payments). If the sub-soil user is found to be guilty of non-permitted pollution, then the user

will be subject to pay damages and might be subject to administrative or criminal sanctions. Ordinary pollution limits and ordinary payments are regulated by regional representative bodies. Extraordinary rates and rules of calculating of damage are established by the authorised government body in the field of environmental protection.

In September 2000, a sub-surface inspection found the North Buzachi field to be in violation of certain sub-surface rules and the field was shut down for a period of one month until the matter was resolved. Since this incident, the relevant regulatory authorities have not taken any material action against the operator of the North Buzachi field. The Group cannot, however, provide any assurances that material action will not be taken against its operations in Kazakhstan or that the Group will not incur substantially more expenses than it currently expects in connection with its environmental expenditure plans.

Furthermore, the Group may be subject to environmental liabilities as a result of acquisitions. There can be no assurance that material matters, not identified or fully investigated during due diligence investigations undertaken by the Group, will not subsequently be identified, that matters identified will not prove to be more significant than currently expected, or that the indemnification provisions included in acquisition agreements will be sufficient to compensate the Group for any future environmental losses or other future losses.

Under the KOA Hydrocarbon Contract, KOA is under an obligation to pay for the restoration of the licenced area, if any deterioration of environment or the licenced area has happened during the term of the contract and has been caused by KOA. The North Buzachi Hydrocarbon Contract provides that BBV, CNPC (Buzachi) and/or NBOC shall not be liable for environmental pollution caused by the preceding users and the existing users.

Moreover, the Group cannot predict what environmental legislation or regulations will be enacted in the future or how existing or future laws or regulations will be administered or enforced. Management estimates that abandonment costs of the wells that are in poor condition will be approximately U.S.\$10 million, however, there can be no assurance that this amount will not increase.

In the future, compliance with more stringent laws or regulations, or more vigorous enforcement policies of any regulatory agency, could require material expenditures by the Group for the installation and operations of systems and equipment for remedial measures, any or all of which could have a material adverse effect on the business, financial condition and results of operations of the Group.

The insurance coverage of the Group may be inadequate and the occurrence of significant uninsured events could materially and adversely affect the business, financial condition and results of operations of the Group.

The Group does not maintain full insurance coverage against losses from business interruption and damages or liability for accidents with respect to its properties. In addition, the insurance industry is not yet well developed in Kazakhstan and many forms of insurance protection used in economically developed countries are unavailable on the terms common in such countries, including coverage for business interruption. The occurrence of significant events against which the Group or its joint ventures are not, or are not fully, insured, or of a number of lesser events against which the Group or its joint ventures are fully insured but subject to substantial deductibles, could materially and adversely affect the business, financial condition and results of operations of the Group.

Inadequacy of infrastructure in Kazakhstan may adversely affect the business, financial condition and results of operations of the Group.

The drilling and production activities of the Group could suffer due to inadequate infrastructure in Kazakhstan. KOA has experienced power outages at its fields on a few occasions, although they have not materially impacted operations of KOA to date. Any problem or adverse change affecting the power supply for any of the operations or other operational infrastructure of the Group provided by third parties could have a material adverse effect on the business, financial condition and results of operations of the Group.

Risk factors relating to Kazakhstan

Kazakhstan has a relatively short history of political and economic stability as an independent nation and there is, therefore, significant potential for any instability to have a material adverse effect on the business, financial condition and results of operations of the Group.

Kazakhstan has a relatively short history of political stability as an independent nation. There is significant potential for social, political, economic, legal and fiscal instability. These risks include, amongst other things, local currency devaluation, civil disturbances, exchange controls or lack of availability of hard currency, changes in crude oil, export and transportation regulations, changes with respect to taxes, royalty rates, custom tariffs, and withholding taxes on distributions to foreign investors; changes in anti-monopoly legislation, nationalisation or expropriation of property, and interruption or blockage of oil exports. The occurrence of any of these factors could have a material adverse effect on the business, financial condition and results of operations of the Group.

Kazakhstan could be affected by military action taken in the region, including in Afghanistan and in Iraq, and the effect such military action may have on the world economy and political stability of neighbouring countries cannot be predicted.

The results of operations of the Group are significantly dependent on the Kazakh economy. Adverse economic conditions in Kazakhstan could have a material adverse effect on the business, financial condition and results of operations of the Group. The economy of Kazakhstan relies significantly on the oil and gas industry and could be adversely affected by any resulting volatility in oil prices caused by such political or economic instability.

Kazakhstan has actively pursued a programme of economic reform and inward foreign investment designed to establish a free market economy. However, there can be no assurance that such reforms and other reforms will continue.

The Group cannot assure that in the future the Government of Kazakhstan will not require the Group to act in a manner which may be against its commercial interests or restrict its ability to generate profits, freely convert currency or pay dividends free of currency or other controls.

Given Kazakhstan's short legislative, judicial and administrative history, the uncertainties, inconsistencies and contradictions in Kazakh laws, including their interpretation and application, could have a material adverse effect on the business, financial condition and results of operations of the Group.

The laws and regulations of Kazakhstan relating to foreign investment, petroleum, sub-soil use, licensing, companies, tax, customs, currency, banking and anti-monopoly are still developing and uncertain. Many such laws provide substantial discretion in their application, interpretation and enforcement. Accordingly, the best efforts of the Group to comply with applicable law may not always result in compliance.

The judicial system in Kazakhstan may not be fully independent of outside social, economic and political forces. Court decisions can be difficult to predict. In addition, senior officials of the Government of Kazakhstan may not be fully independent of outside economic forces.

The Government of Kazakhstan has stated that it believes in continued reform of the corporate governance processes and will ensure discipline and transparency in the corporate sector. However, there can be no assurance that the Government of Kazakhstan will continue such policy.

Given Kazakhstan's short legislative, judicial and administrative history, it is not possible to predict the effect of current and future legislation on the business and prospects of the Group. The ongoing rights of the Group under its exploration and production licences, hydrocarbon contracts and other agreements may be susceptible to revision or cancellation, and legal redress in relation to such revocation or cancellation may be uncertain.

To the extent that the Group or its subsidiaries or affiliates holds Tenge currency positions, there is a risk from foreign exchange fluctuations.

Many of the financial obligations of the Group are in U.S. dollars and, consistent with practice in the oil and gas industry, the financial statements of the Group are reported in U.S. dollars. If the exchange rate of the Tenge fluctuates substantially, or the rate of inflation in Kazakhstan materially increases, the financial statements of the Group may not accurately reflect the U.S. dollar value of its assets or operations.

The Group cannot assure prospective investors that the Tenge will not depreciate against the U.S. dollar. Further, the Group cannot assure investors that the Tenge will continue to be freely exchangeable into U.S. dollars or that the Group will be able to exchange sufficient amounts of Tenge into U.S. dollars to meet its foreign currency obligations.

The taxation system in Kazakhstan is at an early stage of development and the tax risks and problems with respect to the operations and investment in Kazakhstan of the Group are significant.

As tax legislation in Kazakhstan has been in force for only a short time, tax risks in Kazakhstan are substantially more significant than typically found in countries with more developed tax systems.

All legal entities carrying on activities in Kazakhstan must be registered with the tax inspectorate. Taxes include an income tax, a value added tax, an excise tax, a social tax, a land tax, a property tax, a vehicle tax, mandatory contribution to various funds, duties and fees for licences. Tax regulation and compliance is subject to review and investigation by a number of authorities who may impose extremely severe fines, penalties and interest charges.

Additional payments, such as signing bonuses, commercial discovery bonuses, royalties and excess profits taxes, may be required from oil and gas producers and other sub-soil users. A signing bonus is a one-time payment for the rights to explore, develop and produce resources. A commercial discovery bonus is a one-time payment and is payable once a discovery of commercial value is made in a contract territory. An excess profits tax is payable by all sub-soil users on that portion of their profits in excess of a specified rate of return set forth in the hydrocarbon contract for a specific project. The rate of excess profits tax can be as high as 60 per cent. of the negotiated excess profits amount. The amounts of these special payments are negotiated on a project-by-project basis as set forth in the hydrocarbon contracts between the sub-soil user and the Government of Kazakhstan.

Under tax stabilisation provisions in the KOA Hydrocarbon Contract, KOA is liable to tax under the tax regime existing as of the date of signing the contract (10 August 1999). Similarly, for North Buzachi, the licence holders are liable to tax under the tax regime existing as of 29 May 1997. In accordance with such provisions, and in compliance with such regimes, the Group has made charges in its financial statements for U.S.\$4.6 million relating to tax assessments for the years 2001, 2002 and 2003. However, there is a risk that the relevant government bodies may interpret and apply such provisions differently, including disregarding the contractual provision and applying a new tax regime adopted on 1 January 2004. The resulting effect on the tax liability of the Group could have a material adverse effect on the financial position of the Group.

PART III: COMPETENT PERSONS' REPORTS

SECTION 1

Alibekmola, Kozhasai and North Buzachi fields

The Directors
Nelson Resources Limited
19 Berkeley Street, 7th Floor
London, England, W1J 8ED

The Directors
Canaccord Capital (Europe) Limited
27 Upper Brook Street
London W1K 7QF
England

The Directors
Hoare Govett Limited
250 Bishopsgate
London EC2M 4AA
England

Reference: **Nelson Competent Person's Report**

13 July 2004

Dear Sirs

Pursuant to your request we have prepared an evaluation of the crude oil reserves and the net present values of these reserves for the interests of Nelson Resources Limited, hereinafter referred to as the "Company" or "Nelson", in the Alibekmola, Kozhasai and North Buzachi fields of Western Kazakhstan as of 31 December 2003.

The future net revenues and net present values presented in this report were calculated using forecast prices and costs using McDaniel & Associates opinion of future crude oil prices at 1 January 2004 and were presented in United States dollars. The reserves estimates and future net revenue forecasts have been prepared in accordance with standards set out in the Canadian National Instrument NI 51-101 and the Canadian Oil and Gas Evaluation Handbook (COGEH). The format and content of this report follows the guidelines set out in Chapter 19 of the Listing Rules of the UK Listing Authority.

This evaluation was prepared during the period from December 2003 to March 2004 and incorporated technical data to the end of February 2004. The effective date of the reserves estimates and revenue forecasts is 31 December 2003.

All of the basic information employed in the preparation of this report was obtained from Nelson. This information included 3D seismic interpretations, well logs, well descriptions, core data, production data, financial data and ownership information. This data was acquired by both Nelson and Soviet aged exploration wells. McDaniel & Associates personnel visited the offices of the Company and field operations in the Alibekmola and North Buzachi fields to acquire additional technical and financial data and to review geological and engineering interpretations with company engineers and geologists. It is our opinion that the data available was of very good quality and sufficient to prepare confident estimates of the reserves for the properties.

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

1. Corporate Summary

Nelson owns an interest in the Alibekmola, Kozhasai and North Buzachi fields of Western Kazakhstan. Nelson's share of the remaining crude oil reserves assigned to these three fields as of 31 December 2003 was estimated to be as follows:

	Proved Producing	Proved Undeveloped	Total Proved	Probable Additional	Proved Plus Probable	Possible	Proved Plus Probable Plus Possible
Gross, mbbl ⁽¹⁾	16,929	106,442	123,371	63,815	187,185	186,071	373,226
Net, mbbl ⁽²⁾	16,692	104,549	121,241	62,504	183,745		

(1) Gross reserves include the working interest reserves before deductions of royalties payable to others.

(2) Net reserves include gross reserves after royalties payable to others.

Table 1 – Company Share of Remaining Reserves as of 31 December 2003

The net present values of the reserves were based on future production and revenue analyses. The share of the Company of the net present values of the reserves based on forecast prices and costs assumptions as of 31 December 2003 were estimated to be as follows:

	Net Present Value (U.S.\$'000) Discounted At				
	0%	5%	10%	15%	20%
Before Income Taxes (1), (2), (3), (4), (5)					
Proved Developed Producing					
Reserves.....	140,620	129,663	120,465	112,650	105,936
Proved Undeveloped Reserves	814,541	582,098	426,144	317,870	240,460
Total Proved Reserves.....	955,161	711,761	546,609	430,520	346,396
Probable Additional Reserves	784,906	556,881	413,990	319,642	254,517
Total Proved & Probable Reserves	1,740,067	1,268,642	960,599	750,162	600,913
After Income Taxes (1), (2), (3), (4), (5)					
Proved Developed Producing					
Reserves.....	104,404	96,799	90,369	84,869	80,114
Proved Undeveloped Reserves	456,547	308,509	211,015	144,569	97,937
Total Proved Reserves.....	560,951	405,308	301,384	229,437	178,051
Probable Additional Reserves	387,524	269,535	197,751	151,506	120,218
Total Proved & Probable Reserves	948,475	674,843	499,135	380,943	298,269

(1) Based on forecast prices and costs at 31 December 2003.

(2) Interest expenses and corporate overhead, etc. were not included.

(3) The net present values may not necessarily represent the fair market value of the reserves.

(4) The value of all wells and facilities are included in the net present value estimates

(5) Net present values were not estimated for the possible reserves

Table 2 – Company Share of Net Present Values as of 31 December 2003

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

A map showing the location of the three fields in Kazakhstan is presented in Figure 1 below:



Figure 1 – Nelson Resources Ltd. Property Location Map

2. Price Forecasts

The net present value estimates were based on the McDaniel & Associates 1 January 2004 price forecast. A summary of the reference crude oil price forecasts, price differentials from the reference prices to the field and the field prices for each of the three Company interest fields is presented in Table 3 below:

Year	WTI	Brent	Alibekmola & Kozhasai	Alibekmola & Kozhasai	Alibekmola & Kozhasai	N. Buzachi	N. Buzachi	N. Buzachi	Inflation Forecast %
	Crude Oil Price \$/BBL	Crude Oil Price \$/BBL	Export Price Differential 2004 \$/BBL	Export Price \$/BBL	Deemed Gas Price \$/mcf	Export Price Differential 2004 \$/BBL	Export Price \$/BBL	Domestic Price \$/BBL	
2004.....	29.00	27.50	6.37	21.13	1.00	8.00	19.50	6.45	2.0
2005.....	26.50	24.97	6.37	18.47	1.02	8.25	16.56	6.64	2.0
2006.....	25.50	23.94	6.37	17.31	1.04	8.50	15.10	6.84	2.0
2007.....	25.00	23.41	6.37	16.65	1.06	8.75	14.12	7.05	2.0
2008.....	25.00	23.38	6.37	16.48	1.08	9.00	13.63	7.26	2.0
2009.....	25.50	23.84	6.37	16.81	1.10	9.00	13.91	7.48	2.0
2010.....	26.00	24.31	6.37	17.14	1.13	9.00	14.18	7.70	2.0
2011.....	26.50	24.78	6.37	17.46	1.15	9.00	14.44	7.93	2.0
2012.....	27.00	25.24	6.37	17.78	1.17	9.00	14.70	8.17	2.0
2013.....	27.50	25.71	6.37	18.09	1.20	9.00	14.95	8.42	2.0
2014.....	28.10	26.27	6.37	18.51	1.22	9.00	15.30	8.67	2.0
2015.....	28.70	26.83	6.37	18.91	1.24	9.00	15.64	8.93	2.0
2016.....	29.30	27.40	6.37	19.32	1.27	9.00	15.98	9.20	2.0
2017.....	29.90	27.96	6.37	19.72	1.29	9.00	16.32	9.47	2.0
2018.....	30.50	28.52	6.37	20.12	1.32	9.00	16.65	9.76	2.0
2019.....	31.10	29.08	6.37	20.51	1.35	9.00	16.97	10.05	2.0
2020.....	31.70	29.64	6.37	20.90	1.37	9.00	17.29	10.35	2.0
2021.....	32.30	30.20	6.37	21.28	1.40	9.00	17.60	10.66	2.0
2022.....	32.90	30.76	6.37	21.66	1.43	9.00	17.90	10.98	2.0
2023.....	33.60	31.41	6.37	22.13	1.46	9.00	18.30	11.31	2.0

WTI and Brent price forecast based on the McDaniel & Associates 1 January 2004 price forecast

Brent to field differentials were based on 2003 actuals

All Alibekmola and Kozhasai production is currently exported and was forecast to continue to be exported

85 per cent. of the North Buzachi production was forecast to be exported, 15 per cent. sold to domestic markets

The deemed gas price was used for calculating gas royalties payable in the Alibekmola and Kozhasai fields

Table 3 – McDaniel & Associates 1 January 2004 Price Forecasts

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

3. Reserves definitions

The crude oil reserves estimates presented in this report were based on the Canadian reserves definitions and guidelines prepared by the Standing Committee on Reserves Definitions of the CIM (Petroleum Society) as presented in the COGE Handbook. Reserves are classified according to the degree of certainty associated with the estimates as follows:

- **Proved** reserves are those reserves that can be estimated with a high degree of certainty to be recoverable. It is likely that the actual remaining quantities recovered will exceed the estimated proved reserves.
- **Probable** reserves are those additional reserves that are less certain to be recovered than proved reserves. It is equally likely that the actual remaining quantities recovered will be greater or less than the sum of the estimated proved plus probable reserves.
- **Possible** reserves are those additional reserves that are less certain to be recovered than probable reserves. It is unlikely that the actual remaining quantities recovered will exceed the sum of the estimated proved plus probable plus possible reserves.

The qualitative certainty levels referred to in the definitions above are applicable to individual reserves entities (which refers to the lowest level at which reserves calculations are performed) and to reported reserves (which refers to the highest-level sum of individual entity estimates for which reserves estimates are presented). Reported reserves should target the following levels of certainty under a specific set of economic conditions:

- at least a 90 per cent. probability that the quantities actually recovered will equal or exceed the estimated proved reserves;
- at least a 50 per cent. probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable reserves; and
- at least a 10 per cent. probability that the quantities actually recovered will equal or exceed the sum of the estimated proved plus probable plus possible reserves.

It should be noted however that reserves estimates were only prepared for the proved and probable categories in this report.

4. Alibekmola and Kozhasai Fields

The Alibekmola and Kozhasai fields are located in the Pre-Caspian sedimentary basin approximately 240 kilometers south of the city of Aktobe in the Aktyubinsk Oblast (see Figure 1). Nelson owns a 50 per cent. interest in these fields through its 50 per cent. interest in the Kazakhoil Aktobe Limited Liability Partnership (“KOA”). The state oil company Kazmunaigas owns the other 50 per cent. interest of KOA. Nelson acquired its interest in KOA in mid-2000. KOA has considerable expertise in the exploration, development and production in the two fields.

Kazmunaigas received a 25-year production licence to develop the Alibekmola and Kozhasai fields on 19 October 1998 and negotiated a hydrocarbon contract for these fields in August 1999. Kazmunaigas assigned all of its development and production rights in the production licence and hydrocarbon contract to KOA in June 2000, which was approved by the government on 13 June 2000. The hydrocarbon contract specifies the royalties, taxes, and other fiscal terms applicable to future production as well as the general rights and obligations of KOA. The hydrocarbon contract will expire on the last date of the term of the licences.

4.1 Property Overview

A brief overview of the development of each field is presented below.

4.1.1 Alibekmola Field

The Alibekmola field is a north-south trending anticlinal structure approximately 20 km long by 4 km wide and contains a light 40 degree crude oil. There are three Carboniferous age oil bearing zones in the field referred to as the KT-1, KT-2-1 and KT-2-2 zones that range in depth from 6,500 feet to 12,000 feet (2,000 to 3,600 meters). The KT-1 zone consists of limestone interbedded with dolomites and shale layers and contains an oil pool with an overlying gas cap. The KT-2-1 and KT-2-2 zones consist of algal, foraminiferal and biomorphic limestone with primary and secondary porosity and contain an undersaturated oil pool with an underlying aquifer.

The average net pays in the KT-1, KT-2-1 and KT-2-2 are 58, 100 and 144 feet respectively and the porosity 12.3, 9.2 and 9.4 per cent. respectively. Permeabilities measured in core data range from 0.4 to 100 md. A structure map on the top of the KT-2-1 zone is presented in Figure 2 below:

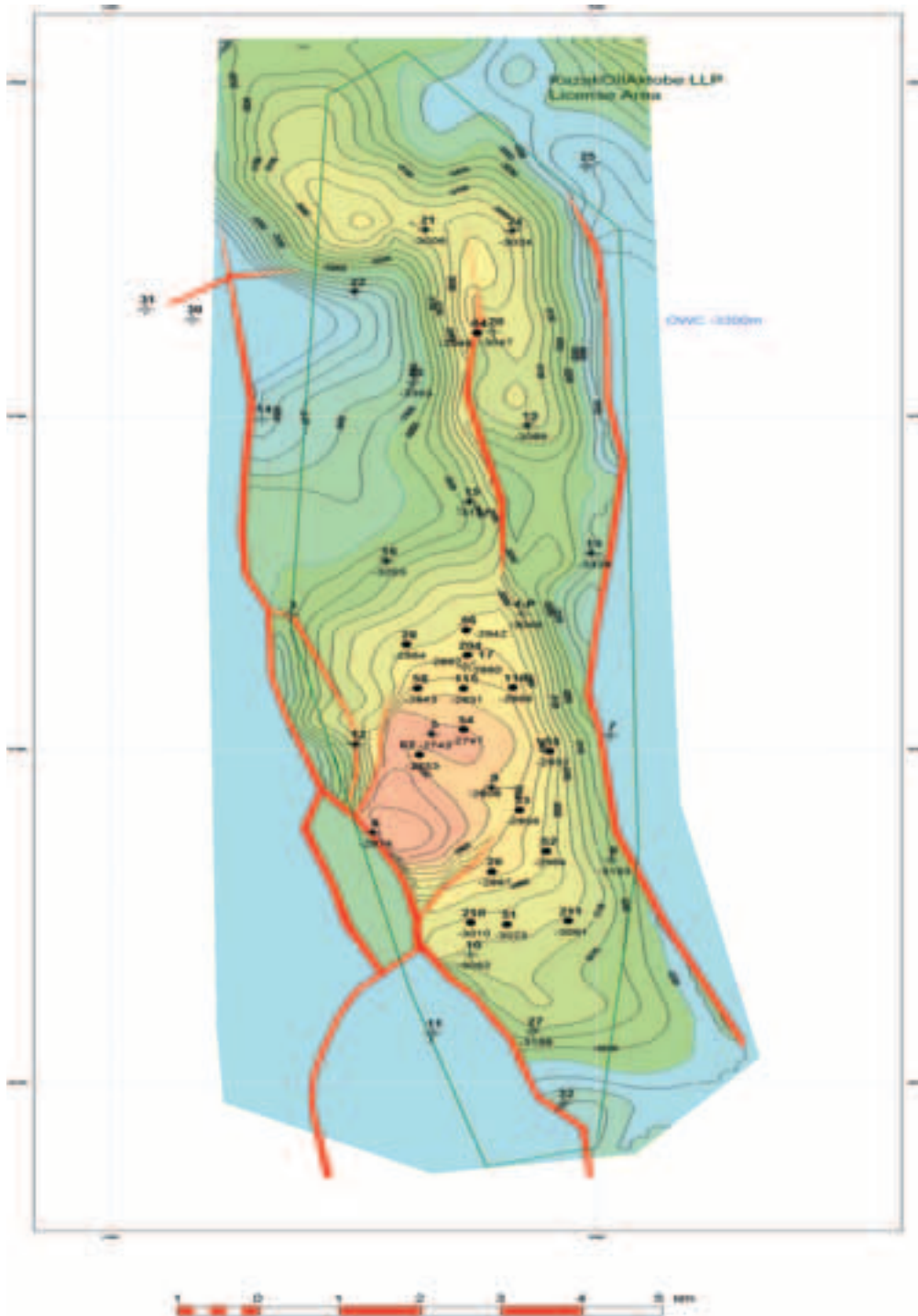


Figure 2 – Alibekmola Field – Structure Map on the Top of the KT-2-1 Zone

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

The field was discovered in 1987 by a state exploration company and was delineated by 24 exploration and appraisal wells within the licence area between 1985 and 1994. KOA shot 180 km² of 3D seismic in 2001 then drilled 12 new wells between late 2001 and December of 2003 and re-activated 2 older appraisal wells. Pilot production commenced in December 2001 and by late December 2003 there were a total of 12 wells producing at a combined rate of approximately 14,000 bopd. The location of all wells drilled to date in the field are shown in Figure 2.

A full field production plan was approved by the Central Development Committee (“CDC”) of the Republic of Kazakhstan in December 2002 which covers the majority of the central and southern areas of the field. Further delineation drilling is required over the northern area of the field before including the northern area in the development plan.

Most of the Alibekmola wells are flowlined to a central production facility (“CPF”) located in the central area of the field. This facility allows for basic crude oil stabilization and includes a de-mercaptanisation facility, which eliminates the mercaptans present in the crude oil enabling it to meet export requirements. The CPF currently has a capacity of about 19,000 bopd (2,500 tonnes per day) of crude oil but will be de-bottlenecked to raise the capacity to 25,000 bopd (3,300 tonnes per day) by mid-2004. A new CPF will be installed in early 2005 that is expected to increase the capacity to 60,000 bopd (7,900 tonnes per day). Water injection facilities are expected to be operational by mid-2004 and gas injection is expected to commence in late 2005.

Drilling was ongoing at the end of 2003 with 5 drilling rigs and 2 workover/completion rigs operating in the field. Future development forecast in this report will include 37 new production wells, 19 water injection wells and 8 workovers of older appraisal wells.

The future capital expenditures required for the Alibekmola field were estimated to be some \$406 million in the proved reserves case and \$426 million in the proved plus probable case. These costs are comprised of well drilling and equipping costs, oil production and water injection facility costs and capitalized maintenance costs.

All of the produced crude oil is currently sold to export markets in Eastern Europe. A pipeline connection from the Alibekmola field to the nearby pipeline linking the Zhanazhol and Kenkiyak fields located west of Alibekmola was completed in late 2002 and a new pipeline connecting Kenkiyak to Atyrau commenced operations in mid 2003. This line provides KOA with access to the CPC pipeline that delivers the crude to Novorossisk, as well as (if required) to the Kaztransoil – Transneft system.

4.1.2 Kozhasai Field

The Kozhasai field is a north-south trending anticlinal structure similar in size and shape to the Alibekmola field. There is one Carboniferous age zone in the field referred to as the KT-2 zone that ranges in depth from 9,700 feet to 11,300 feet (2,950 to 3,440 meters). The KT-2 zone consists of nodular, algal, oolitic, organogenic-fragmental and biomorphic limestone with primary and secondary porosity and contains a 37 degree crude oil pool with an overlying gas cap and an underlying aquifer. The average net pays in the KT-2 zone over the area of the field assigned proved and probable reserves is 233 feet and the porosity 8.2 per cent. A structure map on the top of the KT-2 zone is presented in Figure 3 below:

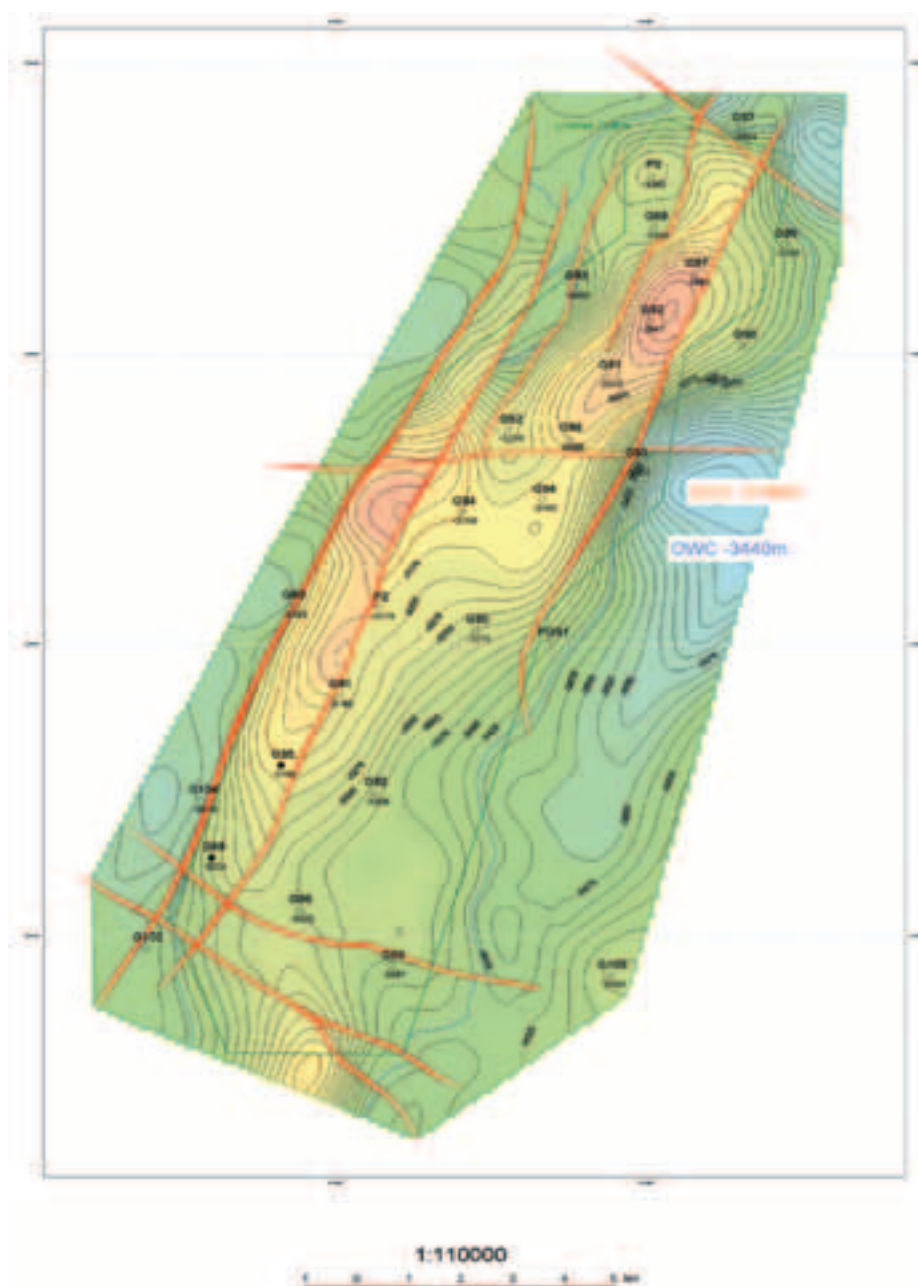


Figure 3 – Kozhasai Field – Structure Map on the Top of the KT-2 Zone

The Kozhasai field was discovered in 1979 and was delineated by 20 exploration and appraisal wells within the licence area between 1979 and 1990. KOA shot a 230-km² 3D program in 2002 and completed the interpretation in 2003. Pilot production commenced in this field in 2003 when two of the existing wells on the field were re-entered and put on production, well 98 in December 2003 and well 95 in January 2004. Production rates in January 2004 averaged 870 bopd from the two wells. The location of all wells drilled to date in the field are shown in Figure 3.

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

Production is currently stabilized in the field before being trucked a distance of 71 km to the Alibekmola field where it is treated before being transported via the Kenkiyak-Atyrau pipeline to export markets.

Future development plans at Kozhasai include continuation of pilot production and appraisal of the field, so that the full field development plan can be finalized, approved, and implemented by the end of 2006. Five appraisal wells are planned to be drilled by the end of 2005 as well as re-entries of old wells. The pilot production project anticipates production from the field rising from current rates to approximately 9,000 bopd by the end of 2005.

The future capital expenditures required for the Kozhasai field were estimated to be some \$6.5 million in the proved reserves case and \$29.5 million in the proved plus probable case. These costs are comprised of well drilling and equipping costs and oil production facility costs.

4.2 Reserves Estimates

4.2.1 Alibekmola Field Reserves Estimates

The Alibekmola full field development plan calls for commingled production from the KT-2-1 and KT-2-2 zones and a 600x600 meter, 9 spot waterflood pattern. KOA is seeking approval from the CDC to allow re-injection of the associated gas at the field at the top of the structure. Pilot water injection is expected to be operational by mid-2004 and gas injection, if approved, is expected to commence in late 2006.

Original oil in place estimates for the KT-2-1 and KT-2-2 zones were determined volumetrically based on net pay maps and the average interpreted petrophysical parameters. Proved plus probable reserves estimates for the KT-2-1 and KT-2-2 zones were based on a 30 per cent. recovery factor of the original oil in place. The proved reserves were based on a 20 per cent. recovery factor to account for the possibility of both a lower oil in place than currently estimated and a less successful waterflood. Approximately 96 per cent. of the Alibekmola field reserves are assigned to the KT-2-1 and KT-2-2 zones.

The KT-1 zone was assumed to be produced only under primary recovery due to the limited amount of geological and test data and the presence of an overlying gas cap. The proved plus probable reserves were based on a 10 per cent. recovery factor of the original oil in place and the proved reserves on a 5 per cent. recovery factor.

Proved producing reserves were assigned to the existing 13 producing wells at 31 December 2003. Although these wells are not currently exhibiting a definitive production decline, the reserves were based on an annual decline of 17.5 per cent. from their current production rates. The proved producing production forecast continued until the end of 2012 when the overall field net cash flow becomes negative.

A summary of the property gross share of the original oil in place (OOIP) and the remaining recoverable reserves at 31 December 2003 for each reserves category in the Alibekmola field is presented below:

	Proved Producing	Total Proved	Proved Plus Probable	Proved Plus Probable Plus Possible
OOIP, Mbbl.....	762,714	762,714	762,714	953,392
Recoverable Reserves, Mbbl	24,545	134,097	205,587	359,326

4.2.2 Kozhasai Field Reserves Estimates

The Kozhasai field is at a much earlier stage of development than the Alibekmola field thus a greater portion of the potential reserves in this field were classified as probable and possible. Many of the KT-2 reservoir and fluid characteristics are very similar in the two fields making Alibekmola a good analogy to predict the future performance of Kozhasai. There are two important differences however, historical test data on the Kozhasai field suggests the presence of a gas cap or volatile oil in the structurally higher areas of the field whereas the Alibekmola field is undersaturated and the Kozhasai field appears to have somewhat lower porosities and permeabilities. There also appears to be more significant faulting in the Kozhasai field although this may provide some productivity benefits through natural fracturing.

Original oil in place estimates for the KT-2 zone were determined volumetrically based on net pay maps and the average petrophysical parameters. The oil in place was categorized into proved and probable areas. Areas that contained at least 40 meters of net pay were classified as probable and areas around existing wells that tested at economic production rates were classified as proved.

Nelson Resources Limited – Competent Persons Report Based on Forecast Prices and Costs

Some form of pressure maintenance will likely be required since the underlying aquifer is unlikely to provide much pressure support, however, at this stage of development all of the proved and probable reserves were based on primary recovery.

The proved producing reserves were based on the current production rates from the one existing producing well and a 30 per cent. decline from current rates. Proved undeveloped reserves were assigned to re-activations of six of the older wells. The reserves were based on an initial rate of 75 per cent. of the maximum combined test rates exhibited for each of the wells when they were initially tested, estimated to average 300 bopd, and a 30 per cent. per year decline rate. The proved plus probable reserves for the one producing well were based on a slightly shallower decline rate of 25 per cent. per year and for the six recompletions on 100 per cent. of the maximum combined test rates, of 400 bopd, and a decline rate of 25 per cent. Probable reserves were also assigned for six new delineation wells, two wells per year from 2004 to 2006. The reserves for these new wells were based on an initial rate of 500 bopd per well and a decline of 25 per cent. per year.

A summary of the property gross share of the original oil in place (OOIP) and the remaining recoverable reserves at 31 December 2003 for each reserves category in the Kozhasai field is presented below:

	Proved Producing	Total Proved	Proved Plus Probable	Proved Plus Probable Plus Possible
OOIP, Mbbl.....	85,231	85,231	315,637	582,692
Recoverable Reserves, Mbbl	782	3,047	9,269	126,856

4.3 Net Present Value Estimates

The net present values of the proved and probable crude oil reserves assigned to the Alibekmola and Kozhasai fields were based on future production and revenue analyses and are presented in US dollars. Since the Alibekmola and Kozhasai fields are within the same production licence and hydrocarbon contract, the royalties and taxes are based on the combined production, revenues and costs for both fields.

The production forecast for each field was based on the productivity of the existing wells and the forecast number of future wells in each reserves case. The total proved production forecast for the Alibekmola field was based on a total of 56 production wells and was forecast to reach a peak rate of 44,000 bopd in 2007. The proved plus probable production forecast for the Alibekmola field was also based on a total of 56 production wells but was forecast to reach a peak rate of 62,000 bopd in 2007. The average production rates for the new wells were estimated to be 1,025 bopd in the proved case and 1,175 bopd in the proved plus probable case. Production was forecast to continue until 2020 in the proved case and 2023 in the proved plus probable case.

The total proved production forecast for the Kozhasai field was based on a total of 7 production wells and was forecast to reach a peak rate of 1,870 bopd in 2006. The proved plus probable production forecast for the Kozhasai field was based on a total of 13 production wells but was forecast to reach a peak rate of 4,750 bopd in 2006. The average production rates for the new wells were estimated to be 300 bopd in the proved case and 400 to 500 bopd in the proved plus probable case. Production was forecast to continue until 2011 in the proved case and 2015 in the proved plus probable case.

Future crude oil revenue was derived by employing the forecast production and the forecast Brent crude oil price less an estimate of the price differential between the Brent reference price and the field price. The price differential between the field price and Brent was estimated to be \$6.37 per barrel. All of the crude oil production was forecast to be exported in this evaluation. A summary of the calculation of the field price is presented in Table 2.

Crude oil production is subject to a sliding scale royalty consisting of 1 per cent. on the first 1,500,000 tonnes (11.25 mmbbls) of annual production, 1.5 per cent. on the next 1,500,000 tonnes and 2.5 per cent. over 3,000,000 tonnes (22.5 mmbbls).

Although there are no natural gas reserves included in the revenue forecasts, raw natural gas production is subject to royalties. The natural gas royalty was indicated to be 1 per cent. on the first 250 MM m³/yr (8.9 bcf) of annual deemed sales gas production, 2.0 per cent. on the next 250 MM m³/yr, 3.0 per cent. on the next 250 MM m³/yr and 4.0 per cent. over 750 MM m³/yr (26.6 bcf). The deemed sales gas production was based on the raw gas production and an estimated 20 per cent. shrinkage. The value of these royalties was based on the estimated market gas price presented in Table 2.

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The operating costs were based on the KOA 2004 budget. The operating costs include an allowance for all Kazakhstan G&A costs. Pipeline fees and trucking expenses were netted out of the sales prices in this evaluation and were not included in the operating costs. Capital cost forecasts were based on detailed analyses prepared by KOA. Abandonment costs were included at the end of the production forecast based on \$50,000 per well.

A summary of Nelson's share of the net present values for the Alibekmola and Kozhasai fields as of 31 December 2004 were estimated to be as follows:

	Net Present Value (\$1000) Discounted At				
	0%	5%	10%	15%	20%
Before Income Taxes					
Proved Developed Producing Reserves	118,496	108,779	100,665	93,802	87,932
Proved Undeveloped Reserves.....	522,026	376,595	279,268	211,590	162,980
Total Proved Reserves.....	640,521	485,374	379,933	305,392	250,912
Probable Additional Reserves	536,180	386,046	290,637	226,727	182,005
Total Proved & Probable Reserves	1,176,702	871,420	670,570	532,119	432,917
After Income Taxes					
Proved Developed Producing Reserves	82,280	75,916	70,569	66,021	62,111
Proved Undeveloped Reserves.....	250,792	169,391	116,110	79,797	54,201
Total Proved Reserves.....	333,072	245,307	186,679	145,818	116,312
Probable Additional Reserves	208,712	148,376	111,170	86,782	69,973
Total Proved & Probable Reserves	541,784	393,683	297,849	232,600	186,285

The revenue forecasts and net present value estimates for the proved undeveloped reserves were calculated by subtracting the proved producing forecasts from the total proved forecasts. The revenue forecasts and net present value estimates for the probable reserves were calculated by subtracting the total proved forecasts from the proved plus probable forecasts.

5. North Buzachi Field

5.1 Property Overview

The North Buzachi field is located in the North Ustyurt sedimentary basin approximately 260 kilometers north of the city of Aktau in the Mangistau Oblast. Nelson recently acquired a 50 per cent. interest in the Buzachi Operating B.V. Joint Operating Company that operates this field. The other 50 per cent. of the joint operating company is owned by the Chinese National Petroleum Company (CNPC).

The North Buzachi field was discovered in 1974 by a state exploration company but very little development occurred until the late 1990's. Nimir Petroleum Company Limited acquired the rights to develop the field and signed a 25-year production licence with the Republic of Kazakhstan on November 14, 1996 and negotiated a hydrocarbon contract on May 29, 1997. The hydrocarbon contract specifies the royalties, taxes, and other fiscal terms applicable to future production as well as the general rights and obligations of the joint venture. Texaco (later ChevronTexaco) acquired 65 per cent. of Nimir's interest in 1998 then both Nimir and ChevronTexaco sold their interests to CNPC and Nelson in 2003.

There were reported to be 134 exploration and appraisal wells drilled during Soviet times but none of those wells have been re-entered for production. Texaco drilled 2 vertical wells and 2 horizontal wells in 1998 and 1999 and commenced production in April 1999. A 3D seismic program was acquired over the central area of the field in 2000 as well as some 2D seismic in the west area of the field. An additional 30 delineation wells were drilled in September 2000 and June 2001 raising production to the 6,000 to 7,000 bopd range. An additional 10 wells were drilled in early 2003 raising production to close to 8,000 bopd.

The North Buzachi field contains a 19 degree crude oil in three Cretaceous and five Jurassic sandstone reservoirs located at depths ranging from 300 to 500 meters. The oil reservoirs are trapped in an anticlinal structure broken by a number of faults. These Cretaceous and Jurassic reservoirs consist of non-marine channel deposits to relatively continuous marine sands. The oil reservoirs are underlain by water and in some cases have small gas caps.

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Average net pays are 35 feet in the Cretaceous and 54 feet in the Jurassic. Porosities range from 26 to 30 per cent, and average permeabilities are in the order of 1.4 darcies. A structure map on the top of the Jurassic J-10AB, the zone containing approximately 60 per cent. of the total field crude oil reserves, is presented below in Figure 4.

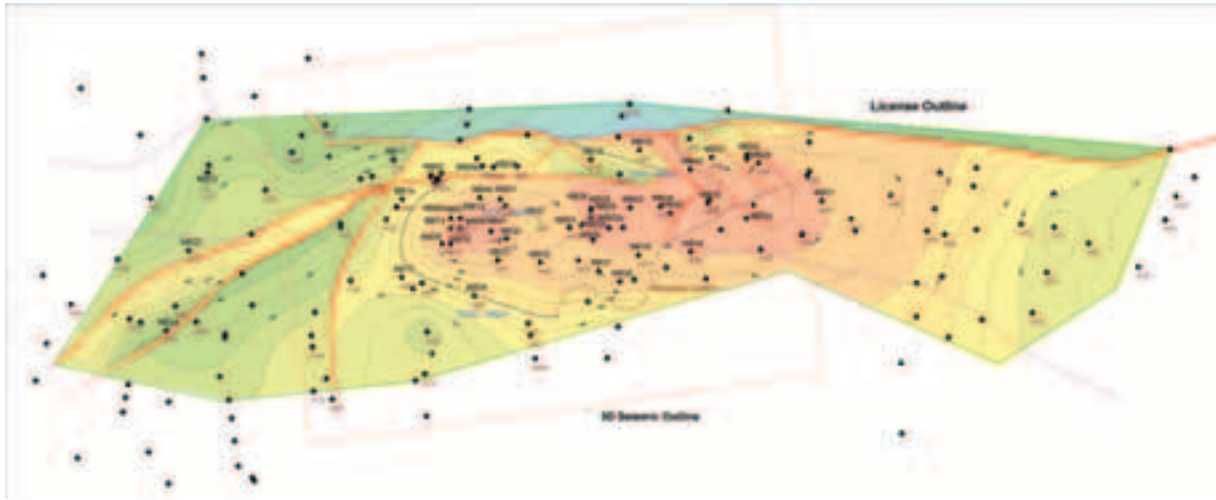


Figure 4 — North Buzachi Field — Structure Map on the Top of the J10AB Zone

Most of the wells are operated with pumps and are flowlined to a central production facility in the north central area of the field. The crude is then pipelined to the Arman field to be processed to pipeline quality specifications before entering the Kaztransoil export pipeline system. The crude is sold both domestically, to the Atyrau refinery, and to a variety of export markets.

Future development forecast in this report will include 264 new production wells and 83 water injection wells in the proved reserves case and 281 new production wells and 88 water injection wells in the proved plus probable reserves case.

The future capital expenditures required for the North Buzachi field were estimated to be some \$320 million in the proved reserves case and \$358 million in the proved plus probable case. These costs are comprised of well drilling and equipping costs, oil production and water injection facility costs and capitalized maintenance costs.

5.2 Reserves Estimates

Original oil in place estimates for each of the eight zones assigned reserves were based on the petrophysical parameters determined from an analysis of the well log and core data and the individual pool rock volume estimates planimetered from net pay maps.

The proved producing reserves estimates were based on well by well decline curve analyses. The total proved reserves were based on recovery factors up to 15 per cent. for the better quality reservoirs where waterflooding was expected to be successfully implemented to as low as 2.5 per cent. where poorer reservoir qualities suggested that waterflooding was unlikely to be successful. The overall field proved recovery factor was estimated to be 9.9 per cent. of the mapped original oil in place.

The total proved plus probable reserves were based on recovery factors as high as 20 per cent. for the better quality reservoirs and somewhat lower in other sands and other blocks. The overall field proved plus probable recovery factor on the mapped original oil in place was estimated to be 13.5 per cent.

A summary of the property gross share of the original oil in place (OOIP) and the remaining recoverable reserves at December 31, 2003 for each reserves category in the North Buzachi field, after economic cutoffs, is presented below.

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	Proved Producing	Total Proved	Proved Plus Probable	Proved Plus Probable Plus Possible
OOIP, Mbbl.....	1,181,011	1,181,011	1,237,906	1,485,487
Recoverable Reserves, Mbbl.....	8,531	109,597	159,515	260,272

5.3 Net Present Value Estimates

The net present values of the proved and probable crude oil reserves assigned to the North Buzachi field was based on future production and revenue analyses and are presented in US dollars.

The production forecast was based on the productivity of the existing wells and the forecast number of future wells in each reserves case. The total proved production forecast was based on a total 302 production wells and was forecast to reach a peak rate of 37,000 bopd in 2009. The proved plus probable production forecast was based on a total of 319 production wells but was forecast to reach a peak rate of 48,000 bopd in 2009. The average production rates for the new wells were estimated to be 190 bopd in the proved case and 215 bopd in the proved plus probable case. Production was forecast to continue until 2018 in the total proved case and 2021 in the proved plus probable case.

Crude oil revenue is derived from both domestic and export sales. Approximately 15 per cent. of the production is forecast to be sold to domestic refineries and 85 per cent. to export markets. A summary of the domestic and export price forecasts is presented in Table 2.

Crude oil production is subject to a sliding scale royalty consisting of 2.5 per cent. on the first 2,000,000 tonnes (13.38 mmbbls) of annual production, 5.0 per cent. on the next 2,000,000 tonnes, 7.0 per cent. on the next 1,000,000 tonnes and 9.0 per cent. over 5,000,000 tonnes (33.47 mmbbls).

The operating costs were based on the 2004 budget. The operating costs include an allowance for all Kazakhstan G&A costs. Pipeline fees and trucking expenses were netted out of the sales prices in this evaluation and were not included in the operating costs. Capital cost forecasts were based on detailed analyses prepared by Nelson. Abandonment costs were included at the end of the production forecast based on \$20,000 per well.

A summary of Nelson's share of the net present values for the North Buzachi field as of December 31, 2004 were estimated to be as follows:

	Net Present Value (\$1000) Discounted At				
	0%	5%	10%	15%	20%
Before Income Taxes					
Proved Developed Producing Reserves	22,124	20,883	19,800	18,848	18,003
Proved Undeveloped Reserves.....	292,516	205,504	146,876	106,281	77,481
Total Proved Reserves.....	314,639	226,387	166,676	125,128	95,484
Probable Additional Reserves	248,726	170,835	123,353	92,914	72,512
Total Proved & Probable Reserves	563,365	397,222	290,029	218,043	167,996
After Income Taxes					
Proved Developed Producing Reserves	22,124	20,883	19,800	18,848	18,003
Proved Undeveloped Reserves.....	205,755	139,118	94,905	64,771	43,736
Total Proved Reserves.....	227,879	160,001	114,706	83,619	61,739
Probable Additional Reserves	178,812	121,159	86,581	64,724	50,245
Total Proved & Probable Reserves	406,691	281,160	201,287	148,343	111,985

The revenue forecasts and net present value estimates for the proved undeveloped reserves were calculated by subtracting the proved producing forecasts from the total proved forecasts. The revenue forecasts and net present value estimates for the probable reserves were calculated by subtracting the total proved forecasts from the proved plus probable forecasts.

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6. Price Sensitivities

A calculation of the sensitivity of the net present values to crude oil prices has been prepared by varying the reference Brent Crude oil price by \$1.00 per barrel. The net present values using a crude oil price \$1.00 per barrel higher than the forecasts in this report are presented in Table 4 below:

	Net Present Value (\$1000) Discounted At				
	0%	5%	10%	15%	20%
Before Income Taxes					
Proved Developed Producing Reserves	156,601	143,516	132,683	123,582	115,837
Proved Undeveloped Reserves.....	910,656	653,080	480,760	361,315	275,965
Total Proved Reserves.....	1,067,257	796,596	613,443	484,897	391,802
Probable Additional Reserves	843,284	596,728	442,928	341,688	271,947
Total Proved & Probable Reserves	1,910,540	1,393,323	1,056,371	826,584	663,749
After Income Taxes					
Proved Developed Producing Reserves	113,003	104,326	97,094	90,977	85,734
Proved Undeveloped Reserves.....	502,001	341,538	236,191	164,523	114,264
Total Proved Reserves.....	615,004	445,864	333,285	255,499	199,998
Probable Additional Reserves	422,752	294,235	216,094	165,717	131,581
Total Proved & Probable Reserves	1,037,757	740,099	549,380	421,216	331,579

Table 4 – Company Share of Net Present Values as of 31 December 2003 – Price Sensitivity \$1.00/bbl Higher

The net present values using a crude oil price \$1.00 per barrel lower than the forecasts in this report are presented in Table 5 below:

	Net Present Value (\$1000) Discounted At				
	0%	5%	10%	15%	20%
Before Income Taxes					
Proved Developed Producing Reserves	124,639	115,809	108,247	101,718	96,035
Proved Undeveloped Reserves.....	718,426	511,117	371,527	274,426	204,956
Total Proved Reserves.....	843,065	626,926	479,775	376,144	300,990
Probable Additional Reserves	726,529	517,035	385,052	297,595	237,086
Total Proved & Probable Reserves	1,569,593	1,143,961	864,827	673,739	538,077
After Income Taxes					
Proved Developed Producing Reserves	94,361	88,065	82,623	77,888	73,741
Proved Undeveloped Reserves.....	409,986	274,396	184,754	123,537	80,557
Total Proved Reserves.....	504,346	362,461	267,377	201,425	154,298
Probable Additional Reserves	349,698	243,010	178,033	136,210	107,968
Total Proved & Probable Reserves	854,044	605,472	445,410	337,635	262,266

Table 5 – Company Share of Net Present Values as of 31 December 2003 – Price Sensitivity \$1.00/bbl Lower

7. Professional qualifications

McDaniel & Associates Consultants Ltd. has over 49 years of experience in the evaluation of oil and gas properties. McDaniel is registered with the Association of Professional Engineers, Geologists and Geophysicists of Alberta (APEGGA). All of the professionals involved in the preparation of this report have in excess of 5 years of experience in the evaluation of oil and gas properties. Mr. Bryan Emslie, Senior Vice President and partner of McDaniel & Associates was directly responsible for the preparation of this report. Mr. Emslie has in excess of 20 years of experience in the evaluation of oil and gas properties. All of the persons involved in the preparation of this report and McDaniel & Associates are independent of Nelson.

In preparing this report, we relied upon factual information including ownership, technical well data, production, prices, revenues, operating costs, capital costs, contracts, and other relevant data supplied by the Company. The extent and character of all factual information supplied were relied upon by us in

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preparing this report and has been accepted as represented without independent verification. We have relied upon representations made by the Company as to the completeness and accuracy of the data provided and that no material changes in the performance of the properties has occurred nor is expected to occur, from that which was projected in this report, the date that the data was obtained for this evaluation and the date of this report, and that no new data has come to light that may result in a material change to the evaluation of the reserves presented in this report.

This report was prepared by McDaniel & Associates Consultants Ltd. for the exclusive use of Nelson, Canaccord Capital (Europe) Limited and Hoare Govett Limited and is not to be reproduced, distributed or made available, in whole or in part, to any person, company or organization other than Nelson, Canaccord Capital (Europe) Limited and Hoare Govett Limited without the knowledge and consent of McDaniel & Associates Consultants Ltd. We reserve the right to revise any estimates provided herein if any relevant data existing prior to preparation of this report was not made available, if any data between the effective date of the evaluation and the date of this report were to vary significantly from that forecast, or if any data provided was found to be erroneous.

Sincerely,

**McDANIEL & ASSOCIATES
CONSULTANTS LTD.**

B. H. Emslie, P. Eng.

R. Ott, P. Geol.

SECTION 2

Karakuduk field



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13 July 2004

Reference: Competent Person's Report on Nelson Resources Limited ("Nelson")

Dear Sirs,

Ryder Scott Company, L.P. ("Ryder Scott") was asked by Nelson to present the reserves attributable to Karakuduk-Munay, JSC ("KKM") in the Karakuduk field, Republic of Kazakhstan. All reserves volumes and income shown in this report are attributable to KKM's 93.2 per cent. interest (after royalties) in the Karakuduk field.

The reserves presented herein were originally estimated for Chaparral Resources, Inc. ("Chaparral"), which holds a 60 per cent. interest in KKM, as part of their 31 December 2003 SEC 10-K reserves filing and are subject to the conditions and assumptions set forth in the original reserves report provided to Chaparral. Nelson, through 60 per cent. ownership in Chaparral, owns 36 per cent. of KKM.

For the purpose of this competent persons report, Nelson requested that Ryder Scott (i) employ a hydrocarbon pricing scenario different from the pricing used for the original SEC reserves study conducted for Chaparral, and (ii) provide reserves both before and after taxes. As a result, the proved reserves included herein conform to the definition approved by the Society of Petroleum Engineers (SPE) and the World Petroleum Congress (WPC), except that they are based on price and cost parameters which allow for future changes in current economic conditions, whereas the definition approved by the SPE/WPC assumes that no change in current economic conditions will occur in the future. The probable reserves included herein conform to definitions of probable reserves approved by the SPE/WPC using the deterministic methodology.

The escalated hydrocarbon pricing scenario employed was provided by McDaniel & Associates Consultants Ltd., (Nelson's reserves evaluation firm). The tax schedule for after tax reserves calculations was provided by Nelson and was not independently verified by Ryder Scott. As such, Ryder Scott assumes no responsibility for the accuracy of the tax schedule applied in this study.

The probable reserves are less certain to be recovered than the proved reserves. The reserves and income quantities attributable to the different reserve classifications that are included herein have not been adjusted to reflect the varying degrees of risk associated with them and thus are not comparable.

It should be noted that the estimated quantities of reserves presented in this report, which were based on escalated price and cost parameters, may differ from the quantities of reserves which would be estimated using constant current price and cost parameters. The format and content of this report also follows the guidelines set out in Chapter 19 of the Listing Rules of the UK Listing Authority.

The estimates of reserves presented herein are based upon a detailed study of the Karakuduk field; however, we have not made a field examination. No consideration was given in this report to potential environmental liabilities which may exist nor were any costs included for potential liability to restore and clean up damages, if any, caused by past operating practices. Chaparral, for whom the study was originally conducted has informed us that they have furnished us all of the accounts, records, geological and engineering data, and reports and other data required for this investigation. The ownership interests, prices, and other data furnished by Chaparral were accepted without independent verification. The estimates presented are based on data available through 31 December 2003.

The value of KKM lies primarily in its ownership of oil and gas in the ground and the production thereof rather than their interests in production or export facilities. The effective date for valuation reporting is 31 December 2003. The reserves included in this report are estimates only and should not be construed as being exact quantities. Estimates of reserves may increase or decrease as a result of future operations.

In addition, the estimated reserves and future income amounts presented in this report are related to hydrocarbon prices which may differ from prices assumed in the escalated model provided by McDaniel & Associates Consultants Ltd. Therefore, volumes of reserves actually recovered and amounts of income actually received may differ significantly from the estimated quantities presented in this report.

“The Property Overview” section was provided by Nelson and was not independently verified by Ryder Scott.

Property overview

The Karakuduk oil field is situated within the Aristanov Step of the North Ustyurt Basin located approximately 340 kilometers north east of the port of Aktau in the Mangistau Oblast of western Kazakhstan (Figure 1).

The field was discovered in 1971 by a state exploration organization and a total of 22 exploration and appraisal wells were drilled and then abandoned. The field was not developed due to its small size (relative to the larger fields in the Mangistau area such as Uzen, Zhetabai and Kalamkas). Development of the field began in 1996. By the end of 2001 there were 36 wells available for production, 24 of which were new drills. In 2002 the field was connected by pipeline to the Aktau–Atyrau regional trunk pipeline. Further drilling in 2003 and 2004 has increased the total well fund to 48 producing wells with gross daily production from the field of 8,500 bopd.

The Karakuduk field consists of a stacked sequence of sandstone, siltstone and shale of Triassic, Jurassic and Cretaceous age that form an anticline of about 13 x 8 km in area with a faulted eastern margin. Vertical closure at the top Jurassic is about 50 meters. The field is delineated by 50 wells and by a 3D seismic survey carried out in 2000. The structure was significantly refined following interpretation of the 3D and from the results of development drilling. The field is divided into two main compartments – a western block, which encompasses most of the reserves, and an eastern block. The Karakuduk field contains high-gravity oil. In the Middle Jurassic horizons the oil density is 0.808 g/cc (44° API). Lower gravity oil is found in the Upper Jurassic formations, i.e. 0.866.0 g/cc (32° API).

In the Jurassic sequence there are 9 horizons in the Middle and Upper Jurassic from a depth of 2,500 to 3200+ meters. Seven of the horizons are productive. Based on stratigraphy, horizons J-I and J-II are confined to the Callovian stage, J-IV and J-V – to the Bathonian stage and J-VI, J-VIII and J-IX – to the Bajocian stage. There are other horizons J-X and J-XIII for example that are just beginning to be appraised. Early testing of log anomalies in these horizons did not result in recovery of any hydrocarbons.

The majority of production from the field is obtained from the J-1 and J-II reservoirs. The fluvio-lacustrine system at Karakuduk provides good quality reservoirs where they are present. Reservoirs are porous with porosity varying from 7 to 22 per cent. and permeability from 0.1 to 300 mD. Average values of the reservoir gross thickness vary between 9.6 and 60 meters. Net oil pay sometimes reaches 35 meters.

Reserves

The following presents an estimate of the reserves, future production and before and after tax income attributable to leasehold interests of KKM in the Karakuduk field as of 31 December 2003. The tax schedule employed in this study was provided by Nelson and was not independently verified by Ryder Scott. As such, Ryder Scott assumes no responsibility for the accuracy of the tax schedule applied in this study. All reserves and income listed below are attributable to KKM's 93.2 per cent. interest (after royalties) in the field. Nelson, through ownership in Chaparral, owns a 36 per cent. interest in KKM.

Liquid hydrocarbons are expressed in standard 42 gallon barrels.

The deductions from future gross revenue after royalty (6.8 per cent. of gross volume) comprise the normal direct costs of operating the wells, Naftex Commission and export tariff (U.S.\$2.46 per stock tank barrel of oil), local sales tariff and transportation costs (U.S.\$4.44 per stock tank barrel of oil), recompletion costs, development costs, and abandonment costs.

ESCALATED PARAMETERS
Estimated Net Reserve and Income Data
Certain Leasehold Interests of
Karakuduk-Munay, JSC
As of 31 December 2003

	Proved			
	Developed		Undeveloped	Total Proved
	Producing	Non-Producing		
Net Remaining Reserves				
Oil/Condensate – Barrels	10,874,659	4,232,196	10,508,873	25,615,728
Income Data – \$'000s				
Future Gross Revenue.....	\$194,088	\$80,389	\$183,166	\$457,643
Deductions	\$88,209	\$47,131	\$118,379	\$253,719
Future Net Income (FNI)	\$105,879	\$33,258	\$64,787	\$203,924
Discounted FNI @ 10%.....	\$78,345	\$15,419	\$ 39,539	\$133,304
After Tax Future Net Income (ATFNI)	\$20,234	\$20,482	\$35,585	\$76,301
Discounted ATFNI @10%	\$10,721	\$8,763	\$20,412	\$39,896
			Probable	
		Developed Non-Producing	Undeveloped	Total Probable
Net Remaining Reserves				
Oil/Condensate – Barrels		524,075	36,896,441	37,420,516
Income Data – \$'000s				
Future Gross Revenue.....		\$9,996	\$684,660	\$694,656
Deductions.....		\$2,943	\$229,991	\$232,934
Future Net Income (FNI)		\$ 7,053	\$454,669	\$461,722
Discounted FNI @ 10%.....		\$ 2,759	\$191,054	\$193,813
After Tax Future Net Income (ATFNI)		\$4,819	\$245,904	\$250,722
Discounted ATFNI @10%.....		\$1,687	\$101,692	\$103,379

The discounted future net income shown above was calculated using a discount rate of 10 per cent. per annum compounded monthly. Future net income was discounted at four other discount rates which were also compounded monthly.

Discounted Future Net Income – U.S.\$'000s As of 31 December 2003				
Discount Rate Per cent.	Before Tax Proved	Before Tax Probable	After Tax Proved	After Tax Probable
8.....	144,432	227,209	45,265	121,375
12.....	123,359	166,499	35,253	88,699
15.....	110,358	134,284	29,429	71,398
20.....	92,834	96,909	22,081	51,263

The results shown above are presented for your information and should not be construed as our estimate of fair market value.

In general, the reserves included herein were estimated by a combination of the volumetric and performance methods. The performance method by itself was applied only in cases where the historically established decline trend was definitive. Reserves were estimated by the volumetric method in those cases where there was inadequate historical performance data to establish a definitive trend or where the exclusive use of production performance data as a basis for the reserve estimates was considered to be inappropriate.

An average drainage area per well was determined for each reservoir based on the estimated drainage area of existing producing wells. For the J-4, J-6A, J-6B, and J-10 zones, an average ultimate drainage area of 180 acres was estimated. An average ultimate drainage area of 90 acres per well was estimated for reservoirs J-2, J-7, and J-8/J-9. The original development plan for the Karakuduk field proposed 90-acre well spacing. Our review of the most recent performance data indicates that 150 to 180-acre well spacing may be more appropriate for the better sands. This was confirmed by a reservoir simulation model which indicated an average drainage area of 150 acres per well for the J-1 reservoir. Additional studies are planned to investigate benefits from horizontal wells.

No evidence of natural aquifer support has been observed to date. As a result, from 1998 through the latter parts of 2003 the field has, for all practical purpose, produced under primary depletion drive in all sands. A waterflood program was initiated in October 2003 with injection into well #103. A field wide pattern waterflood is planned for most producing horizons. All reserves attributed to the waterflood program are currently classified as probable reserves. A shallow aquifer sand serves as the water source for all injection water. As of 31 December 2003 one water supply well was on-line. A total of nine to ten water supply wells with a total estimated capacity of 22,000 to 30,000 bbl/day (sufficient to maintain pressure and waterflood operations) are scheduled to be operational by year-end 2005.

Competent Persons Credentials

Ryder Scott was founded in Bradford, Pennsylvania in 1937 by Harry M. Ryder, a registered professional engineer, and his partner, David Scott, Jr. Today the company maintains the high principles of its founding fathers and uniquely combines advanced technology with the judgment, experience, and high ethical standards of qualified professional engineers, geologists, and geophysicists to provide its clients the best work product possible.

The company's only source of revenue is the payment for services rendered and reimbursement of expenses. It is the company's policy to avoid any activity that would possibly result in a conflict of interest with any of our clients. The staff of Ryder Scott consists of 75 qualified professionals who combined have extensive experience in virtually every petroleum producing area of the world. Detailed biographies of each professional staff member are available upon request.

Reserves certifications and evaluations as well as other studies produced by Ryder Scott are accepted by major worldwide financial institutions and investors, and frequently become a basis for the sale or purchase of individual or company – wide oil and gas properties. Such reports, particularly those relating to estimates of oil and gas reserves, appraisals and studies forecasting the results to be obtained by primary and enhanced recovery operations, are also used for loans, mergers, privatization, registration with stock exchanges in the financial centers of the world, and other purposes.

Neither we nor any of our employees have any interest in the Karakuduk field and neither the employment to make this study nor the compensation was contingent on our estimates of reserves and future income for the Karakuduk field.

Very truly yours,

RYDER SCOTT COMPANY, L.P.

Thomas Wagenhofer, P.E.

Vice President

PART IV: FINANCIAL INFORMATION

SECTION 1

Accountants' report on Nelson Resources Limited

“**ERNST & YOUNG**”

Ernst & Young LLP
1 More London Place
London SE1 2AF

The Directors
Nelson Resources Limited
7th Floor
19 Berkeley Street
London W1J 8ED

The Directors
Canaccord Capital (Europe) Ltd.
27 Upper Brook Street
London W1K 7QF

13 July 2004

Dear Sirs

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 13 July 2004 of Nelson Resources Limited (the “Company” or “Nelson”).

Basis of preparation

The financial information set out on pages 48 to 72 is based on the audited consolidated financial statements of Nelson for the three years ended 31 December 2003, to which no adjustments were considered necessary, and has been prepared on the basis set out in Note 1 and excludes certain Unaudited Supplemental Information about oil and gas producing activities and the acquisition of the North Buzachi oil field which is set out in Part IV, Section 3 of the admission document referred to above.

Responsibility

Such financial statements are the responsibility of the directors of the Company who approved their issue.

The directors of Nelson are responsible for the contents of the admission document dated 13 July 2004 in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that previously obtained by us relating to the audit of the financial statements underlying the financial information for the years ended 31 December 2002 and 31 December 2003. The evidence also included that recorded by Arthur Andersen, Moscow who audited the financial statements underlying the financial information for the year ended 31 December 2001. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

Opinion

In our opinion, the financial information presents fairly, in all material respects, for the purposes of the admission document dated 13 July 2004, the financial position of Nelson as at the dates stated and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States, except for the inclusion of certain Unaudited Supplemental Information referred to in the basis of preparation paragraph above.

Consent

We consent to the inclusion in the admission document dated 13 July 2004 of this report and accept responsibility for this report for the purposes of paragraph 45(2)(b)(iii) of Schedule 1 to the Public Offers of Securities Regulations 1995.

Consolidated Balance Sheets

As at 31 December 2001, 2002 and 2003

Expressed in thousands of US dollars

	Note	2001	2002	2003
Assets				
Current assets				
Cash and cash equivalents.....		531	7,507	43,246
Assets of the discontinued segment		6,791	—	—
Accounts receivable and prepaid expenses		1,823	3,521	19,546
Inventory	6	283	557	2,242
Investments.....	7	—	6,311	—
Total current assets		9,428	17,896	65,034
Oil and gas properties, full cost	8	16,765	27,444	108,963
Property, plant and equipment	9	1,962	2,648	11,750
Advances to mining joint venture	4	5,389	—	—
Advances to oil and gas limited partnership	10	6,286	20,385	23,318
Other non-current assets.....		239	187	384
Total assets		40,069	68,560	209,449
Liabilities				
Current liabilities				
Accounts payable		1,835	3,798	18,765
Accrued liabilities.....		1,876	6,840	6,295
Current liabilities of the discontinued segment....		1,577	—	—
Income taxes payable		2	328	924
Derivative instruments		—	—	3,887
Bank loan.....	11	3,053	—	58,000
Current portion of long term debt	12	—	—	3,550
Total current liabilities		8,343	10,966	91,421
Long-term debt.....	13	12,121	50,380	67,115
Long-term liabilities of the discontinued segment.....		4,340	—	—
Total liabilities		24,804	61,346	158,536
Commitments and contingencies	23			
Shareholders' equity				
Share capital		4,346	4,467	7,392
Additional paid in capital		113,667	115,358	176,247
Other compensation costs.....		—	817	9,161
		118,013	120,642	192,800
Shareholders' equity advance.....	14	9,316	13,710	—
Accumulated deficit.....		(111,545)	(129,644)	(140,655)
Other comprehensive income/(loss).....	2	(519)	2,506	(1,232)
Total shareholders' equity		15,265	7,214	50,913
Total liabilities and shareholders' equity		40,069	68,560	209,449

Consolidated Statement of Operations

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars, except per share amounts

	Note	2001	2002	2003
Revenue				
Crude oil		—	6,911	40,591
Expenses				
Cost of production		—	1,779	4,452
Sales and transportation		—	2,292	10,227
Depreciation and amortization		56	1,017	5,537
General and administration		6,050	12,209	14,681
Derivative instruments		—	—	3,887
Other compensation costs		—	817	8,769
		<u>6,106</u>	<u>18,114</u>	<u>47,553</u>
Loss from operations		(6,106)	(11,203)	(6,962)
Other income/(expenses)				
Foreign exchange (loss)/gain		(528)	(1,394)	3,555
Interest and financing costs		(821)	(6,397)	(8,783)
Profit on sale of investment		—	—	2,731
Impairment provision		(2,010)	—	—
Interest and other income		360	2,191	2,683
		<u>(2,999)</u>	<u>(5,600)</u>	<u>186</u>
Loss from continuing operations before income taxes		(9,105)	(16,803)	(6,776)
Income taxes	16	(42)	(333)	(4,235)
Net loss from continuing operations		(9,147)	(17,136)	(11,011)
Net loss from discontinued operations	4	(2,446)	(963)	—
Net loss		<u>(11,593)</u>	<u>(18,099)</u>	<u>(11,011)</u>
Basic and diluted loss from continuing operations per common share (U.S.\$)	17	(0.020)	(0.039)	(0.019)
Basic and diluted loss from discontinued operations per common share (U.S.\$)	17	(0.010)	(0.002)	—
Basic and diluted loss per common share	17	<u>(0.030)</u>	<u>(0.041)</u>	<u>(0.019)</u>

Consolidated Statements of Cash Flows

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars

	2001	2002	2003
Cash flows from continuing operations			
Net loss from continuing operations	(9,147)	(17,136)	(11,011)
Adjustments to reconcile net loss to net cash provided by operating activities:			
Profit on sale of investments	—	—	(2,731)
Other compensation costs	—	817	8,769
Exchange rate (gain)/loss	378	13	(610)
Depreciation and amortization	56	1,017	5,537
Discount accretion	—	1,070	1,211
Impairment provision	2,010	—	—
Derivative instruments	—	—	3,887
Retirement obligation accretion	—	—	20
Interest on shareholders' equity advance	316	1,394	431
Loan arrangement fee amortised	—	—	177
Debenture cost amortised	—	90	117
Net effect on cash flows	(6,387)	(12,735)	5,797
(Increase)/decrease in working capital	465	5,281	(2,692)
Net cash provided by/(used in) operating activities	(5,922)	(7,454)	3,105
Cash flows from investing activities			
Capital expenditure on oil and gas properties	(6,085)	(11,627)	(28,876)
Acquisition of subsidiary	—	—	(58,348)
Proceeds from sale of discontinued operation	—	1,049	—
Proceeds from sale of investment	—	—	6,337
Purchase of property, plant and equipment	(1,949)	(877)	(7,294)
Advances to oil and gas limited partnership	(5,592)	(14,099)	(2,933)
Advances to mining joint venture	(88)	—	—
Net cash used in investing activities	(13,714)	(25,554)	(91,114)
Cash flows from financing activities			
Proceeds from exercise of stock options	161	1,667	2,505
Proceeds from private placement	5,521	—	—
Proceeds from rights offering	—	—	37,074
Net proceeds from exercise of warrants less shareholders' equity advance plus interest	—	—	6,661
Shareholders' equity advance	9,000	3,000	—
Bank loans received	6,049	55,653	78,000
Bank loans paid	(2,996)	(20,992)	—
Repayment of long term debt	(3,557)	—	—
Proceeds of convertible debenture	3,000	—	—
Other non-current assets	(239)	(38)	(492)
Net cash provided by financing activities	16,939	39,290	123,748
Cash flow used in discontinued operations	697	694	—
Net increase in cash and cash equivalents	(2,000)	6,976	35,739
Cash and cash equivalents at beginning of year	2,543	531	7,507
Cash and cash equivalents at end of year	543	7,507	43,246
Less cash of discontinued operations	(12)	—	—
	531	7,507	43,246
Changes in components of working capital			
Accounts receivable and prepaid expenses	(1,612)	(1,698)	(16,025)
Inventory	(280)	(274)	(1,685)
Accounts payable	1,670	1,963	14,967
Accrued liabilities	1,409	4,964	(545)
Income taxes payable	(56)	326	596
(Increase)/decrease in working capital	1,131	5,281	(2,692)
Supplemental information:			
Taxes paid during the year	(98)	(6)	(3,639)
Interest paid during the year	(359)	(3,045)	(6,287)

Consolidated Statements of Shareholders' Equity

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars

	Number of Common Shares	Common Shares	Additional Paid in Capital	Other Compensation costs	Total	Shareholders' Equity Advance	Accumulated Deficit	Other comprehensive income	Shareholders' Equity
Balance 31 December 2000	427,248,062	3,213	108,811		112,024	—	(99,952)	—	12,072
Exercise of stock options	4,135,000	41	120		161	—	—	—	161
Shares issued in payment of interest	3,173,526	32	275		307	—	—	—	307
Share subscription received	—	1,060	4,461		5,521	—	—	—	5,521
Shareholders' equity advance	—	—	—		—	9,000	—	—	9,000
Interest on shareholders' equity advance	—	—	—		—	316	—	—	316
Net loss for the year	—	—	—		—	—	(11,593)	—	(11,593)
Cumulative translation adjustments	—	—	—		—	—	—	(519)	(519)
Balance 31 December 2001	434,556,588	4,346	113,667		118,013	9,316	(111,545)	(519)	15,265
Exercise of stock options	11,549,567	115	1,552	—	1,667	—	—	—	1,667
Debentures converted	553,705	6	139	—	145	—	—	—	145
Other compensation costs	—	—	—	817	817	—	—	—	817
Shareholders' equity advance	—	—	—	—	—	3,000	—	—	3,000
Interest on shareholders' equity advance	—	—	—	—	—	1,394	—	—	1,394
Net loss for the year	—	—	—	—	—	—	(18,099)	—	(18,099)
Revaluation of investment held for sale ..	—	—	—	—	—	—	—	2,705	2,705
Cumulative translation adjustments	—	—	—	—	—	—	—	320	320
Balance 31 December 2002	446,659,860	4,467	115,358	817	120,642	13,710	(129,644)	2,506	7,214
Exercise of stock options	12,620,000	126	2,957	—	3,083	—	—	—	3,083
Debentures converted	9,979,558	100	2,755	—	2,855	—	—	—	2,855
Exercise of warrants	196,062,000	1,961	18,841	—	20,802	(14,141)	—	—	6,661
Rights offering	73,839,417	738	36,336	—	37,074	—	—	—	37,074
Movement in other compensation costs ..	—	—	—	8,344	8,344	—	—	—	8,344
Interest on shareholders' equity advance ..	—	—	—	—	—	431	—	—	431
Net loss for the year	—	—	—	—	—	—	(8,811)	—	(8,811)
Release of revaluation of investment held for sale	—	—	—	—	—	—	—	(2,705)	(2,705)
Cumulative translation adjustments	—	—	—	—	—	—	—	(1,033)	(1,033)
Balance 31 December 2003	739,160,835	7,392	176,247	9,161	192,800	—	(138,455)	(1,232)	53,113

Consolidated Statement of Comprehensive Income

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Components of Comprehensive Income			
Net loss	(11,593)	(18,099)	(11,011)
Change in foreign currency translation adjustment, net of income tax (U.S.\$ nil)	(519)	320	(1,033)
Unrealised gains or losses			
Revaluation of investment held for sale, net of income tax (U.S.\$ nil)	—	2,705	(2,705)
Comprehensive income	<u>(12,112)</u>	<u>(15,074)</u>	<u>(14,749)</u>

Notes to the Financial Information

31 December 2003, 2002 and 2001

(Tabular amounts are expressed in thousands of U.S. dollars, except share amounts)

1. Organization and basis of presentation

Nelson was incorporated as an exempted company under the laws of Bermuda on 31 March 1993. The Company is involved in oil development and production.

The financial information is prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") except for the exclusion of certain Unaudited Supplemental Information which is set out in Part IV, Section 3 of the admission document of the Company dated 13 July 2004. All amounts are stated in U.S. dollars unless otherwise indicated.

2. Significant accounting policies

(a) Principles of consolidation

The financial information of the Company includes the accounts of the Company and its wholly-owned subsidiaries, Aktobe Munai Services LLP ("AMS"), Commonwealth & British Services Limited ("CBS"), Nelson Petroleum Buzachi Holdings B.V. ("NPBH BV"), Nelson Petroleum Buzachi B.V. ("NPB BV"), Nelson Buzachi Holdings Limited ("NBHL") and Nelson Buzachi Limited ("NBL"). Interest in Kazakhoil Aktobe LLP ("KOA"), an oil and gas limited partnership, in which the Company has a 50 per cent. interest, is reported using the proportional consolidation method. All material intercompany balances and transactions are eliminated.

(b) Going concern

The Consolidated Financial Statements of the Company as at and for the years ended 31 December 2001, 31 December 2002 and 31 December 2003 were prepared on the basis of a going concern.

The directors stated in Note 2 to the financial statements for the years ended 31 December 2001 and 31 December 2002 that the Company's ability to continue as a going concern depended upon its ability to raise external financing, however, the Company has continued as a going concern for more than twelve months from the date of those financial statements.

The directors stated in Note 2 to the financial statements for the year ended 31 December 2003 that the Company's ability to continue as a going concern depended upon its ability to replace a bridging loan facility that was due to mature on 4 June 2004. As set out in Note 11, Bank loans, this was achieved on 28 May 2004 when a subsidiary of the Company entered into a Crude Oil Advance Payment Agreement with Vitol S.A., which was utilised, in conjunction with existing cash, to repay the bridge loan.

(c) Management estimates

The presentation of the financial information in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities in the consolidated balances as well as the revenues and expenses during the reporting periods. Actual results could differ from those estimates. Significant items subject to estimates and assumptions include inventory, deferred income tax assets and asset retirement obligations.

(d) Foreign currency translations

The financial information is presented in U.S. dollars.

The Company complies with Statement of Financial Accounting Standards (FAS) No. 52, "Foreign Currency Translation" for its subsidiaries in Kazakhstan.

Transactions in currencies other than the functional currency are translated at the exchange rate in effect at the date of each transaction. Differences in exchange rates during the period between the date a transaction denominated in a foreign currency is consummated and the date on which it is either settled or translated are recognised in the statement of operations.

The financial information of foreign subsidiaries is translated into U.S. dollars using the current-rate method. Accordingly, assets and liabilities denominated in foreign currencies are translated at rates of exchange in effect at the balance sheet date. Revenues and expenses are translated at average rates of exchange in effect during the year. The foreign exchange movement arising on consolidation is recorded as other comprehensive income/(loss).

The Company has not entered into any material transactions that are denominated in hyper-inflationary currencies.

The following table summarises the exchange rates of the different currencies to 1 U.S. dollar for the years ended 31 December 2001, 2002 and 2003:

As of 31 December	Canadian Dollar	British Pounds	Kazakh Tenge
2001.....	1.5775	1.4554	150.20
2002.....	1.5593	1.6099	155.60
2003.....	1.2946	1.7785	144.22

(e) *Recognition of revenue*

The Company recognises revenues from oil sales when crude oil is shipped to the buyers. Sales do not include indirect taxes (excises, VAT and royalty).

(f) *Inventory*

Oil and gas stock and operating supplies are stated at the lower of cost or net realizable value. Cost is determined using the *first-in-first-out* method.

(g) *Property, plant and equipment*

Property, plant and equipment are stated at cost, net of accumulated depreciation.

Maintenance repairs and minor renewals are charged to expense as incurred. Major renewals and betterments are capitalised and depreciated over their estimated useful lives. When assets are retired or otherwise disposed of, the cost is removed from the asset account and the corresponding accumulated depreciation is removed from the related reserve account. Any gain or loss resulting from such retirement or disposal is included in current income.

The recoverability of property, plant and equipment is assessed whenever events or circumstances indicate a potential impairment. This assessment involves comparing the carrying value of the assets with management's best estimate of the future undiscounted cash flows to be generated by using the asset. Where this calculation indicates an impairment the asset is written down to its fair value, which is estimated based upon management's best estimate of future discounted cash flows.

Depreciation is provided on a straight-line basis over the estimated useful lives of the property and equipment as follows:

	Years
Buildings and constructions.....	20
Machinery and equipment	10-12
Vehicles.....	4
Other	5-10

Assets under construction are not depreciated until construction has been completed and the fixed asset is fully operational.

(h) *Taxes based on income*

The Company records a provision for income taxes using the "liability" method as prescribed by FAS No. 109, "Accounting for Income Taxes". Under the liability method of FAS 109, deferred tax assets and liabilities are recognised for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets are recognised in full subject to a valuation allowance to reduce the amount of such assets to that amount which is more likely than not to be realised.

(i) *Oil and gas properties*

The Company follows the full cost method of accounting for oil and gas operations whereby all exploration and development expenditures are capitalised. Currently, the only cost pool relates to the Company's operations in Kazakhstan. Capitalised expenditures include land acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, gathering and production facilities and equipment and overhead expenses related to exploration and development activities.

All capitalised costs of oil and gas properties, including estimated future costs to develop proved reserves, will be amortised on the unit-of-production method using estimates of total proved reserves. Investments in unproved properties are not amortised until proved reserves associated with the projects can be determined.

The recoverability of oil and gas properties is assessed whenever events or circumstances indicate a potential impairment. This assessment involves comparing the carrying value of the assets with management's best estimate of the future undiscounted cash flows to be generated by using the cost pool. Where this calculation indicates an impairment the cost pool is written down to its fair value, which is estimated based upon management's best estimate of future discounted cash flows.

Unproved oil and gas properties are stated at cost and not depreciated until proved reserves can be determined or until impairment occurs.

(j) *Asset retirement obligations and environmental liabilities*

Estimated future restoration costs are provided for based on the number of wells drilled. Costs are based on independent engineering estimates of future site restoration in accordance with current contracts. Provision is being made for site restoration costs, where they are probable and can be reasonably estimated. Note 13 to the financial information summarises the environmental and restoration costs of the company under asset retirement obligations.

Environmental liabilities are recognised when environmental assessments or clean-ups are probable and the associated costs can be reasonably estimated.

(k) *Financial instruments*

The Company believes the amounts presented for financial instruments in the financial information, consisting of cash equivalents, accounts receivables and accounts payables are reasonable estimates of their fair value. For debt obligations' fair value, refer to Note 19 to the financial information.

The Company utilises derivative instruments to manage the Company's exposure to fluctuations in the price of oil as described in Note 19 to the financial information. Derivative financial instruments are recognised at fair value. Changes in the fair value of the derivative instruments are recognised periodically in income.

(l) *Statement of consolidated cash flows*

The Company prepares its consolidated statements of cash flows using the indirect method as permitted by FAS No. 95, "Statement of Cash Flows". For purposes of the consolidated statements of cash flows, the Company considers all highly liquid debt instruments purchased with maturity of three months or less to be cash equivalents.

(m) *Reclassifications*

Certain amounts in prior years have been reclassified to conform to current year presentation.

(n) *Stock options and warrants*

Employee stock options are accounted for under the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees". APB No. 25 requires the use of the intrinsic value method to measure compensation cost as the excess, if any, of the quoted market price of the stock at grant over the amount the employee must pay to acquire the stock.

The Company complies with the disclosure requirements of FAS No. 123 and FAS No. 148, "Accounting for Stock-Based Compensation," which uses a fair value-based method of accounting for stock options granted to employees. The fair value of 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. These disclosure requirements are included in Note 15 to the financial information.

(o) *Investments*

Investments held for sale are stated in accordance with FAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities". Under this standard, the equity securities held by the Company that have readily determinable fair values are measured at fair value. Unrealised gains and losses for these investments are reported as comprehensive income and included as a separate component of shareholders' equity.

(p) *New accounting pronouncements*

Between January and December 2003, the Financial Accounting Standards Board (FASB) issued the following standards that are relevant to the Company:

During January 2003, the FASB issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires the consolidation of certain entities that are determined to be variable interest entities ("VIEs"). An entity is considered to be a VIE when either: (i) the entity lacks sufficient equity to carry on its principal operations; (ii) the equity owners of the entity cannot make decisions about the entity's activities; or (iii) the entity's equity neither absorbs losses or benefits from gains.

The Company has reviewed its financial arrangements and has not identified any material VIEs that should be consolidated by the Company in accordance with FIN 46.

During April 2003, the FASB issued FAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which provides certain amendments for the impact of contracts entered into or modified after 30 June 2003 and hedging relationships designated after 30 June 2003. The adoption of FAS No. 149 is not considered to have a material effect on the Company's financial information.

In May 2003, the FASB issued FAS No. 150 "Accounting for certain Financial Instruments with Characteristics of both Liabilities and Equity". This statement establishes standards for how a company classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. The adoption of the FAS No. 150 is not considered to have a material effect on the Company's financial information.

3. Economic and operating environments

The Company's continued business activities are located in Kazakhstan. Kazakhstan continues to undergo substantial political, economic and social changes. As an emerging market, Kazakhstan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Furthermore, the Government of Kazakhstan has not yet fully implemented the reforms necessary to create banking, judicial, taxation and regulatory systems that usually exist in more developed markets. As a result, operations in this country involve risks that are not typically associated with those in developed markets. Although in recent years inflation has not been significant in Kazakhstan, certain risks persist in the current environment with results that include, but are not limited to, a currency that is not freely convertible outside of the country, certain currency controls, and young debt and equity markets characterised by low liquidity levels.

Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse changes in any of these factors, could significantly affect the Company's ability to operate commercially. It is difficult for management to estimate what changes may occur or the resulting effect of any such changes on the Company's financial position or future results of operations. The financial information does not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Company's consolidated financial statements in the period when they become known and estimable.

4. Discontinued segment

Due to the Company's change in its business model to focus on developing its oil and gas properties, the Company decided to dispose of its gold-mining business during the first quarter of 2002. The transaction was concluded on 11 November 2002, effective as of 31 October 2002.

The transaction involved the purchase by Avocet Mining plc (“Avocet”) of 100 per cent. of the Company’s subsidiary Commonwealth & British Minerals Limited (“CBML”) for a cash consideration of U.S.\$1.45 million (less assumption of loans worth U.S.\$0.40 million) and 14 million shares in Avocet. Through its acquisition of CBML, Avocet assumes the 44% ownership in Zervashan Gold Company (“ZGC”). Avocet is listed in the UK on the AIM. At the time of the disposal, Avocet’s shares traded at GBP 0.16.

The Company’s proportionate share of assets and liabilities of the discontinued segment at 31 December 2001 and 31 October 2002 comprised:

	31 December 2001	31 October 2002
Assets of the discontinued segment		
Cash.....	12	208
Receivables and prepaid expenses.....	797	259
Inventories.....	2,381	2,279
Property, plant and equipment.....	3,601	3,351
	<u>6,791</u>	<u>6,097</u>
Liabilities of the discontinued segment		
Current		
Accounts payable.....	(1,325)	(1,173)
Accrued liabilities.....	(252)	(1,056)
	<u>(1,577)</u>	<u>(2,229)</u>
Long-term		
Obligations of ZGC.....	(4,340)	(4,718)
Advances to mining joint venture.....	5,389	3,907
Net assets	<u>6,263</u>	<u>3,057</u>

Advances to ZGC bore interest at 10 per cent. per annum, compounded quarterly. Due to the uncertainty of the ultimate realisation of amounts due from ZGC the Company had provided a reserve against a significant portion of the total amount due from the joint venture.

Operating results of the discontinued gold-mining business for the 12 months to 31 December 2001 and 10 months to 31 October 2002, are as follows:

	12 months ended December 2001	10 months ended October 2002
Revenues		
Metal sales.....	10,100	6,618
Interest and management fees.....	434	334
	<u>10,534</u>	<u>6,952</u>
Expenses		
Mining.....	8,515	7,386
Depreciation and amortization.....	1,046	—
Impairment provision.....	3,000	1,700
Interest.....	419	378
	<u>12,980</u>	<u>9,464</u>
Loss from discontinued operations	<u>(2,446)</u>	<u>(2,512)</u>

The profit on sale of discontinued operations as of 31 October 2002, was calculated as follows:

Proceeds.....	4,606
Net assets as above.....	<u>3,057</u>
Profit.....	<u>1,549</u>

Following the decision to dispose of the gold mine, an impairment provision of U.S.\$3 million was reported in 2001 and a further U.S.\$1.70 million in 2002. If these impairment provisions were not recorded, the sale of discontinued operations would have resulted in a loss of U.S.\$3.15 million.

In July 2003, the Company sold its investment in Avocet for a net consideration of U.S.\$6.34 million. See Note 7 to the financial information.

5. Acquisition of North Buzachi Oil Field

On 17 December 2003, the Company acquired 100% of the issued and outstanding common shares of Nimir Petroleum Buzachi Holdings B.V. and its subsidiary Nimir Petroleum Buzachi B.V. from CNPC International, an affiliate of the China National Petroleum Corporation, for a consideration of U.S.\$1,000. All loans outstanding were also assumed for a consideration of U.S.\$58 million. After the year-end the names were changed to NPBH BV and NPB BV. NPB BV held a 35 per cent. interest in the hydrocarbon licence to the North Buzachi oil field in Western Kazakhstan.

NPB BV has arranged an interim financing facility with CSFB (see Note 11 to the financial information), secured against its assets to repay the U.S.\$58 million loan.

The purchase price allocations is as follows:

Purchase price	58,001,000
Transaction and other direct acquisition costs.....	347,107
	<u>58,348,107</u>

The total purchase price of U.S.\$58,348,107 was assigned to the net assets acquired as follows:

Oil and gas properties	56,042,467
Property, plant and equipment.....	2,305,640
	<u>58,348,107</u>

The above table summarises the estimated fair values of the net assets acquired and liabilities assumed at the date of acquisition. The fair value of the assets is preliminary and subject to refinement.

The acquisition of NPBH BV was accounted for under the purchase method with an effective date of 17 December 2003. The results of the operations of the acquired business are included in the financial information since the date of acquisition.

6. Inventory

At 31 December 2003, 2002 and 2001 inventories comprise the following:

	2001	2002	2003
Finished goods, metal	919	—	—
Mine operating supplies	1,462	—	—
Less assets of the discontinued segment.....	(2,381)	—	—
Materials and supplies.....	283	217	1,069
Crude oil	—	340	1,173
	<u>283</u>	<u>557</u>	<u>2,242</u>

7. Investments

As at 31 December 2001, 2002, 2003 investments held for sale comprise the following:

	2001	2002	2003
Investment in equity undertaking			
Listed investment	—	6,311	—

The investment comprised 14,000,000 ordinary shares, which represented a 17% holding in Avocet. The cost of the investment was U.S.\$3,558,000. The increase in 2002 was attributable to the increase in Avocet's share price and was recorded in other comprehensive income. In July 2003, the Company sold its investment in Avocet for a net consideration of U.S.\$6,336,680, resulting in a profit on sale of investment of U.S.\$2,731,000.

Investments in subsidiary undertakings as of 31 December 2003:

<u>Name</u>	<u>Country of incorporation</u>	<u>% Holding</u>
Aktobe Munai Services LLP (“AMS”).....	Republic of Kazakhstan	100
Commonwealth and British Services Limited (“CBS”).....	United Kingdom	100
Nelson Petroleum Buzachi Holdings B.V. (“NPBH BV”)	Netherlands	100
Nelson Petroleum Buzachi B.V. (“NPB BV”)*	Netherlands	100
Nelson Buzachi Holdings Limited (“NBHL”).....	Jersey	100
Nelson Buzachi Limited (“NBL”).....	United Kingdom	100

* NPB BV holds the 35% interest in the licence for the North Buzachi oil field that was subsequently increased to 50% in February 2004.

Investments in joint venture undertakings as of 31 December 2003:

<u>Name</u>	<u>Country of incorporation</u>	<u>% Holding</u>
Kazakhoil Aktobe LLP (“KOA”).....	Republic of Kazakhstan	50

8. Oil and gas properties

At 31 December 2003, 2002 and 2001 oil and gas properties comprise the following:

<u>Cost</u>	
At 1 January 2002.....	16,765
Additions.....	11,627
Exchange adjustment	(122)
At 1 January 2003.....	28,270
Additions.....	28,876
Acquisitions	56,042
Asset retirement obligation.....	171
Exchange adjustments.....	2,046
At 31 December 2003.....	<u>115,405</u>
 <u>Depreciation</u>	
At 1 January 2002.....	—
Charge for the year	839
Exchange adjustments.....	(13)
At 1 January 2003.....	826
Charge for the year	5,356
Exchange adjustments.....	260
At 31 December 2003.....	<u>6,442</u>
 <u>Net book value</u>	
At 31 December 2003.....	108,963
At 31 December 2002.....	27,444
At 31 December 2001.....	16,765

At 31 December 2002 U.S.\$7,159,000 of oil and gas properties had not been subject to depreciation.

KOA owns the licence to two oil and gas fields located in western Kazakhstan, the Alibekmola and Kozhasai fields. The licence extends over a 25 year period to develop, produce and market the hydrocarbon deposits. The hydrocarbon contract stipulates that KOA will pay the Government of the Republic of Kazakhstan U.S.\$69,619,840 for the past historical cost of discovering the two fields.

At the year end, NPB BV held a 35% interest in the hydrocarbon licence to North Buzachi oil field in Western Kazakhstan. After the year-end, a further 15% interest in the licence was registered. The licence was granted for a 25 year period from 14 November 1996. The licence covers an area of 125.77 km². All minimum capital expenditure requirements for North Buzachi have been met.

The capitalised interest for 2003 and 2002 was nil (2001 – U.S.\$934,000). The balance of capitalised interest brought forward in 2003, 2002 and 2001 was U.S.\$1,918,000.

9. Property, plant and equipment

A summary of the Company's share of ZGC, KOA, Buzachi and corporate fixed assets is as follows:

31 December 2001

	Cost	Accumulated Depreciation	Net
ZGC	11,731	8,130	3,601
KOA	1,798	28	1,770
Corporate	415	223	192
Less assets of the discontinued segment – ZGC (Note 4)	(11,731)	(8,130)	(3,601)
Total	<u>2,213</u>	<u>251</u>	<u>1,962</u>

31 December 2002

	Cost	Accumulated Depreciation	Net
KOA	2,562	165	2,397
Corporate	550	299	251
Total	<u>3,112</u>	<u>464</u>	<u>2,648</u>

31 December 2003

	Cost	Accumulated Depreciation	Net
KOA	9,687	557	9,130
Buzachi	2,326	20	2,306
Corporate	718	404	314
Total	<u>12,731</u>	<u>981</u>	<u>11,750</u>

ZGC's assets comprise mill and mill equipment, KOA's and Buzachi's fixed assets comprise buildings, machinery, equipment and vehicles. The corporate fixed assets comprise fixtures and fittings.

10. Advances to oil and gas limited partnership

The Company and certain of its subsidiaries provided financial support to KOA in the form of advances. The terms of the advances are included in a financing agreement between Nelson and KOA dated 12 June 2001. Under the terms of this agreement Nelson agreed to finance all expenses of KOA stipulated in the annual work program and the budget approved by the joint venture partners. Nelson Resources and its subsidiaries' proportionate share of such advances approximated to U.S.\$6,286,000, U.S.\$20,385,000 and U.S.\$23,318,000 at 31 December 2001, 2002 and 2003 respectively. The advances bear interest at the lower of LIBOR plus 6.5 per cent. or 12 per cent. per annum. Under the terms of the financing agreement, accrued but not paid interest is added to the principal amount (capitalised) every six months. During 2002, U.S.\$1,337,248 of interest was repaid. No interest was paid in 2003.

The financing provided by Nelson under the 12 June 2001 loan agreement is repayable only after KOA has sufficient available positive cash flow. All advances and loans, including the interest thereon, have to be paid in full before KOA can distribute any net profits to its owners. In addition, KOA may not pay any amounts due to Nelson prior to the payment of all outstanding amounts due under the BNP Paribas facility (see Note 13). This is subject to an exception that Nelson may provide short-term financing up to U.S.\$10 million to KOA, which may be repaid.

11. Bank loans

In 2001, KOA borrowed funds from Halyk Savings Bank ("HSBK") under a credit line with a total limit of U.S.\$10 million for the period of one year. As of 31 December 2001, the outstanding principal amount was U.S.\$3,053,000. During 2001, loans were granted in both Tenge and US Dollars. Loans in Tenge were granted at 16.5 per cent. per annum, in US Dollars at 15 per cent. and on the overdraft in US Dollars at 12 per cent. The credit line extended until 1 July 2002 but was fully repaid in February 2002.

On 15 December 2003, NPB BV entered into a credit facility agreement with CSFB. The maximum principal amount available under the facility is U.S.\$90 million, of which U.S.\$58 million was drawn down in connection with the purchase of NPBH BV and the first 35 per cent. interest in the licence to develop the North Buzachi field in Kazakhstan. The remaining U.S.\$32 million was drawn down in February 2004 when the transfer of the additional 15 per cent. interest in the licence to NPB BV was approved by the Kazakh government.

Loans under this facility bear an annual interest rate of 8 per cent. payable on the termination date. The facility terminated on 4 June 2004.

On 28 May 2004, NPB BV entered into a Crude Oil Advance Payment agreement with Vitol S.A., the proceeds from which together with other cash resources of the Company were used to repay the amounts due on the termination of the credit facility with CSFB.

The maximum principal amount available under this facility is U.S.\$70 million. The amount advanced represents a prepayment for crude oil products to be delivered to Vitol S.A. under an offtake contract between NBP BV and Vitol S.A. The amount advanced, is to be repaid by monthly instalments equal to $\frac{1}{42}$ nd (one forty second) of the amount advanced commencing six months from the date of the agreement.

The outstanding amount drawn under this agreement bears annual interest at a floating rate based upon LIBOR plus a 3.2 per cent. margin until the day falling one year after the date of the agreement and 4.25 per cent. thereafter. Interest is payable on the last day of each month.

The performance of NBP BV's obligations under this facility are guaranteed by Nelson.

12. Current portion of long term debt

At 31 December 2003, 2002 and 2001 short-term debt is comprised of:

	2001	2002	2003
BNP Paribas loan	—	—	3,333
Obligations of KOA	—	—	217
	<u>—</u>	<u>—</u>	<u>3,550</u>

Both these obligations represented KOA's pro rata portion of the current portion of long-term debt. See Note 13 (c) and (d).

13. Long-term liabilities

At 31 December 2003, 2002 and 2001 long-term debt is comprised of:

	2001	2002	2003
Due to the Republic of Kazakhstan (a)	8,524	9,594	10,805
Convertible debentures (b)	3,000	2,855	—
BNP Paribas loan (c)	—	—	16,667
Obligations of KOA (d)	597	217	—
Halyk Savings bank loan (e)	—	21,500	22,653
Kazkommerts bank loan (f)	—	16,214	16,798
Asset retirement obligations (g)	—	—	192
Obligations of ZGC (h)	4,340	—	—
	<u>16,461</u>	<u>50,380</u>	<u>67,115</u>
Less long term liabilities of the discontinued segment	<u>(4,340)</u>	<u>—</u>	<u>—</u>
	<u>12,121</u>	<u>50,380</u>	<u>67,115</u>

The long-term liabilities are repayable as follows:

	2001	2002	2003
Within one year	380	—	—
One to two years	—	2,855	—
Within two years	—	217	39,451
Two to three years	3,000	37,714	16,667
Within three years	217	—	—
Three to four years	—	—	4,351
Four to five years	—	4,351	4,351
More than five years	8,524	5,243	2,295
	<u>12,121</u>	<u>50,380</u>	<u>67,115</u>

(a) *Due to the Republic of Kazakhstan*

As discussed in Note 8, KOA has an obligation to pay U.S.\$69,619,840 to the Republic of Kazakhstan for exploration and development cost, referred to as “historical cost”, incurred by the Republic in discovering the Alibekmola and Kozhasai oil and gas fields. The historical cost obligation is payable in quarterly instalments of U.S.\$1,087,810 commencing 1 January 2007 through 1 October 2022. The obligation was discounted at acquisition using an interest rate of 12 per cent. per annum, which approximated the Company’s cost of borrowing at the date of signing the hydrocarbon production agreement. Discount accretion is being amortised using the interest method over the life of the obligation. At 31 December 2003 and 2002, the net present value of such future payments is comprised as follows:

	2001	2002	2003
Principal	13,067	13,067	13,067
Discount accretion.....	3,982	6,121	8,543
	17,049	19,188	21,610
	8,524	9,594	10,805

(b) *Convertible debentures*

In 2001, the Company issued U.S.\$3,000,000 in convertible debentures maturing in April 2004, bearing an annual interest rate of 13 per cent. These debentures were convertible in whole or in part at any time prior to maturity into common shares of the Company at a price of Cdn.\$0.40 (U.S.\$0.27). In August 2003, the Company exercised its right to repay the principal and all accrued and unpaid interest on the convertible debentures, as the price for Nelson’s common shares on the Toronto Stock Exchange was greater than Cdn.\$0.60 for at least 27 of the 30 consecutive trading days preceding notification. All debenture holders elected to convert the principal amount of the convertible debentures into a total of 9,979,558 common shares.

At 31 December 2002 accrued interest on the convertible debentures amounted to U.S.\$92,787. The liability for such accrued interest amounts was included in accrued liabilities in the consolidated balance sheet at 31 December 2002.

(c) *BNP Paribas loan*

On 27 August 2003, KOA entered into a term loan facility with a U.S.\$60 million maximum aggregate principal amount with BNP Paribas. The liability represented the 50 per cent. pro rata portion of KOA’s loan drawn down from BNP Paribas at 31 December 2003. The maximum amount was available until 29 February 2004, after which, provided that the initial maximum amount of U.S.\$60 million had been drawn down in full, KOA were entitled to request an increase of the initial commitment. KOA had drawn down the maximum amount of U.S.\$60 million under this facility as of 29 February 2004 and on 7 May 2004 the aggregate maximum principal amount available under the facility was increased to U.S.\$100 million.

Borrowings under the facility bear interest at a floating rate based upon LIBOR plus a 4 per cent. margin. Amounts drawn under the facility accrue interest from the date of the drawdown to the date when the amount is repaid. Interest is payable monthly.

Under a subordination agreement entered into between BNP Paribas, AMS and KOA on 27 August 2003, all existing and current finance agreements between AMS and KOA are subordinated to the BNP Paribas facility in priority of payment. Nelson has irrevocably and unconditionally guaranteed the repayment of amounts borrowed under the facility. In addition, the loans under the facility are secured by certain crude oil contracts between KOA and its off-takers (currently, 100 per cent. of KOA’s production is sold under an off-take agreement with Glencore), a zero cost collar pricing agreement with BNP Paribas, certain insurance policies as well as letters of credit, all of which may be assigned to the lender.

Loans under the facility will mature on 27 August 2006. KOA is obligated to repay the principal amount of loans drawn under the facility in 24 equal monthly instalments beginning on 27 September 2004. This repayment schedule may be accelerated if proven reserves of Alibekmola fall below 25 per cent. of the total proved reserves at the date of the facility agreement.

(d) *Obligations of KOA*

The pro rata long term obligations of KOA in 2002 consisted of a non-interest bearing obligation to Kazmunaigas in the amount of U.S.\$216,678 for expenses incurred in connection with KOA's operations since its inception. The U.S.\$216,678 obligation to Kazmunaigas is non-interest bearing and is repayable on or prior to 27 October 2004 (See Note 12).

(e) *HSBK loan*

On 7 June 2002, AMS entered into a revolving credit facility agreement with HSBK. The initial maximum principal amount of the facility of U.S.\$20 million was increased to U.S.\$27 million in November 2002. In April 2003, the currency of the loan granted under the facility was changed from being denominated in U.S. dollars to Kazakh Tenge. Pursuant to the terms of the facility, the amounts drawn down under the HSBK facility can only be used for the development of the Alibekmola and Kozhasai fields.

The loan bears interest at the rate of 15 per cent. per annum for Tenge denominated loans or 12.5 per cent. for loans in U.S. dollars. Interest is payable semi-annually. Nelson has irrevocably and unconditionally guaranteed the repayment of all the obligations of AMS under the facility.

The credit line is available until 7 June 2005 and all the loans drawn down under the facility will mature on 11 June 2005.

(f) *Kazkommertsbank loan*

On 4 June 2002, AMS entered into a revolving credit facility agreement with Kazkommerts bank. The maximum principal amount available under the facility is U.S.\$20 million. In June 2003, the currency of the loan granted under the facility was changed from being denominated in U.S. dollars to Kazakh Tenge. Pursuant to the terms of the facility, Kazkommerts has a unilateral right to suspend or terminate the credit facility.

The loan bears interest at the rate of 15 per cent. per annum for Tenge denominated loans or 12.5 per cent. for loans in U.S. dollars. Interest is payable semi-annually. Nelson has irrevocably and unconditionally guaranteed the repayment of all the obligations of AMS under the facility.

The credit line is available until 4 June 2005 when all loans under the facility will mature.

(g) *Asset retirement obligations*

Under FAS No. 143, the fair value of all legal obligations associated with the retirement of tangible long-lived assets that result from acquisition, construction or development, shall be recognised in the period in which it is incurred. The following represents the pro rata long-term asset retirement obligation of KOA and North Buzachi for site restoration at the end of the licence as follows:

	2003
At 1 January 2003.....	—
Initial liability	172
Accretion expense.....	20
At 31 December 2003.....	<u>192</u>

The pro forma effects of the application of FAS No.143 if the Statement had been adopted for the previous year are not material.

(h) *Obligations of ZGC*

The long term obligation of ZGC in 2001 represented the pro rata portion of the U.S.\$6,300,000 transfer of loans and advances to the International Finance Corporation ("IFC"), a member of the World Bank Group and accrued interest. The loan bore interest at the rate of 10 per cent. per annum and was payable on or prior to 31 December 2005.

Under the terms of the loan agreement between the IFC and ZGC, until the IFC loan was paid in full, management fees or other fees payable to the Company would be restricted to U.S.\$500,000.

14. Shareholders' equity

(a) Authorised share capital

Authorised share capital consists of 10,000,000 U.S.\$0.01 common shares and 500,000 U.S.\$0.01 preference shares in 2003 and 2002. All common shares carry equal voting rights. None of the preference shares have been issued as of 31 December 2003 and 2002.

(b) Issued common shares

	Number of Common Shares	Common Shares	Additional Paid in Capital	Other Compensation costs	Total
Balance 31 December 2000.....	427,248,062	3,213	108,811	—	112,024
Exercise of stock options.....	4,135,000	41	120	—	161
Shares issued in payment of interest	3,173,526	32	275	—	307
Share subscription received.....	—	1,060	4,461	—	5,521
Balance 31 December 2001.....	434,556,588	4,346	113,667	—	118,013
Exercise of stock options.....	11,549,567	115	1,552	—	1,667
Debentures converted (c).....	553,705	6	139	—	145
Other compensation costs.....	—	—	—	817	817
Balance 31 December 2002.....	446,659,860	4,467	115,358	817	120,642
Exercise of stock options.....	12,620,000	126	2,957	—	3,083
Debentures converted (c).....	9,979,558	100	2,755	—	2,855
Exercise of warrants (d)	196,062,000	1,961	18,841	—	20,802
Rights offering (e)	73,839,417	738	36,336	—	37,074
Movement in other compensation costs.....	—	—	—	8,344	8,344
Balance 31 December 2003.....	<u>739,160,835</u>	<u>7,392</u>	<u>176,247</u>	<u>9,161</u>	<u>192,800</u>

(c) In August 2003, the Company exercised its right to repay the principal and all accrued and unpaid interest on the convertible debentures. All debenture holders elected to convert the principal amount of the convertible debentures into a total of 9,979,558 common shares. During 2002, some debenture holders elected voluntarily to convert their principal amount into 553,705 common shares.

(d) The International Finance Corporation (a shareholder of the Company), was granted 31,062,000 warrants of which 22,378,000 could be exercised from October 2000 to July 2003 at a price of Cdn.\$0.16 (U.S.\$0.10) per share and thereafter through October 2004 at Cdn.\$0.37 (U.S.\$0.25). The remaining 8,684,000 warrants could be exercised only on a pro rata basis upon exercise of the investor warrants at a price of Cdn.\$0.16 from October 2000 through July 2003. The total warrants of 31,062,000 were exercised on 5 June 2003.

The Company's two major investors received warrants to acquire 15,000,000 common shares at a price of Cdn.\$0.08 per share (U.S.\$0.05) and warrants to acquire 150,000,000 common shares at a price of Cdn.\$0.16 (U.S.\$0.10). The aforementioned warrants were exercised in April 2003.

The two major shareholders entered into an agreement where the shareholders provided the Company with an unsecured credit line in the amount of U.S.\$6 million each at an interest rate of 12 per cent. per annum. The loan and accrued interest thereon was repaid from the conversion of the shareholders' existing warrants that were exercised into the Company's common stock in April 2003.

(e) On 31 December 2003, the rights offering for 73,839,417 million common shares of the Company closed and was fully subscribed at a price of Cdn.\$0.65 per share.

15. Stock options

The Company maintains a stock option plan (the "Plan") pursuant to which the Company may grant options to directors, officers and employees. Share options are exercisable at prices not less than the closing market value of the share on the date of grant and are permitted to have a maximum term of ten

years. The maximum number of shares reserved for issuance under the Plan is 42,000,000 common shares. The following table summarises stock option activity during 2002 and 2003 under the Plan:

	Number	Weighted Average Cost Cdn.\$	Weighted Average Cost U.S.\$
Outstanding at 31 December 2000.....	32,733,334	\$0.17	\$0.11
Options granted	15,598,699	\$0.35	\$0.23
Options exercised	(4,135,000)	\$0.06	\$0.04
Options lapsed	(5,300,000)	\$0.14	\$0.09
Outstanding at 31 December 2001.....	38,897,033	\$0.28	\$0.18
Options granted	8,500,000	\$0.42	\$0.27
Options exercised	(11,549,567)	\$0.23	\$0.15
Options lapsed	(18,577,466)	\$0.24	\$0.15
Outstanding at 31 December 2002.....	17,270,000	\$0.41	\$0.26
Options granted	13,286,465	\$0.67	\$0.52
Options exercised	(6,080,000)	\$0.36	\$0.28
Options lapsed	(450,000)	\$0.33	\$0.25
Outstanding at 31 December 2003.....	24,026,465	\$0.57	\$0.44
Exercisable at 31 December 2003	18,196,465	\$0.60	\$0.46

The following table summarises information about the Plan's stock options outstanding at 31 December 2003:

Exercise price Cdn.\$	Number of options Outstanding	Weighted average Remaining Life (years)	Number of options exercisable
0.30	250,000	2.29	250,000
0.35	2,166,667	4.00	—
0.40	2,330,000	3.83	2,330,000
0.45	2,330,000	3.83	2,330,000
0.50	2,330,000	3.83	—
0.63	1,333,333	4.63	—
0.66	3,786,465	2.65	3,786,465
0.67	9,500,000	4.32	9,500,000
	24,026,465		18,196,465

From 31 December 2003 to 30 April 2004 the Company did not grant options to key employees or directors of the Company.

The Company accounts for the stock options issued under the Plan under APB 25. Had compensation cost for these plans been determined consistent with FAS No. 123, net income attributable to common stock and earnings per share would have been reduced to the following pro forma amounts:

	2001	2002	2003
	(in thousands, except per share amounts)		
Net loss As reported	(11,593)	(18,099)	(11,011)
Reverse other compensation costs per the intrinsic method	—	817	8,769
Other compensation costs per the fair value method	(2,295)	(1,519)	(2,663)
Pro forma	(13,888)	(18,801)	(4,905)
Basic and diluted earnings per share As reported	(0.03)	(0.039)	(0.019)
Pro forma	(0.03)	(0.043)	(0.008)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants in 2003 and 2002, respectively: average risk-free interest rates of 1.29 and 4.01 percent; average expected lives of 1.02 and 3.57 years;

average expected volatility factors of 102.12 and 110.24 per cent.; and no dividend yield. The estimated weighted average fair value of options to purchase one share of common stock issued under the Plan was Cdn.\$0.26 in 2003 and Cdn.\$0.28 in 2002.

The exercise price of all stock options granted under the scheme is denominated in Canadian Dollars. Canadian dollars are neither the reporting currency of the Company nor the currency in which the employees are paid. As such, on the date of the grant the exercise price is not fixed and the plan is deemed to be a variable plan under APB No. 25. Compensation cost is re-measured for each reporting period using the intrinsic value method. The cost is reported as a charge in earnings over the periods the service is provided by the employee. The additional compensation cost, net of taxes, included in the net loss for 2003 and 2002 was U.S.\$8,768,567 and U.S.\$817,234 respectively.

In March 2003, as part of the settlement with Mr. Teck Soon Kong, a former director of Nelson, 13,080,000 options at Cdn.\$0.21 were granted to him outside the option plan. Mr. Kong exercised 6,540,000 options during 2003. As at 31 December 2003, the remaining options outside the plan were 6,540,000.

16. Income taxes

According to FAS 109, deferred tax assets are only reported if it is more likely than not that some portion or all of the deferred tax assets will be realised. After consideration of all the evidence, both positive and negative, management has determined that it is more likely than not that none of the deferred tax assets will be realised and accordingly no deferred tax assets have been recorded.

The total deferred tax assets at 31 December 2003, 2002 and 2001 were as follows:

	2001	2002	2003
Total deferred tax assets.....	—	1,212	708
Less valuation allowance	—	(1,212)	(708)
Net deferred tax assets	—	—	—

The Company has income tax expense relating to withholding tax paid in Kazakhstan on interest repayment and corporation tax paid in Kazakhstan and the United Kingdom.

A reconciliation of the Company's expected tax benefit to the income tax expense as reported in the consolidated statement of operations is as follows:

	2001	2002	2003
Loss from continuing operations before income taxes .	(9,105)	(16,803)	(6,776)
Statutory tax rate	0% and 30%	0% and 30%	0%, 30% and 34.5%
Income taxes computed at statutory rate per individual companies*	(658)	(2,436)	3,553
Foreign exchange differences	373	848	(582)
Non deductible expenses.....	330	801	353
Losses brought forward.....	—	—	76
Withholding tax.....	—	201	694
Unrecognised deferred tax asset	—	978	124
Adjustment in respect of prior year	(3)	(59)	17
	<u>42</u>	<u>333</u>	<u>4,235</u>
Income taxes comprise of:			
Withholding tax.....	—	201	694
Kazakh tax.....	—	189	3,275
UK tax charge/(refund)	42	(57)	266
Income tax expense.....	<u>42</u>	<u>333</u>	<u>4,235</u>

* The income taxes calculated on a statutory basis is a charge rather than a credit due to the taxable profits in Kazakhstan. These taxable profits cannot be offset against losses elsewhere in the group.

The Company operates in various tax jurisdictions having varying statutory tax rates. In Kazakhstan, the tax rate is 30 per cent. In the United Kingdom, the corporate tax rate is 30 per cent. (30 per cent. in 2002) and, in the Netherlands, the corporate tax rate is 34.5 per cent. By agreement with the Bermudian tax authorities the Company's Bermudian tax rate is nil on its reported results of operations.

According to the contract between the Kazakh tax authorities and KOA, the Company is liable to pay taxes under the tax regime existing as of the date of signing the contract, 10 August 1999.

The Company calculates its tax liabilities in accordance with the contract; however, Kazakhstan currently has a number of laws related to various taxes imposed by both state and regional tax authorities. Applicable taxes include value added tax, corporate income tax (profits tax), a number of turnover based taxes, and payroll (social) taxes, and other taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, regulations are often unclear or nonexistent. Accordingly, few precedents with regard to issues have been established.

Often, differing opinions regarding legal interpretation exist both among and within government ministries and organisations, thus creating uncertainties and areas of conflict. Tax declarations, together with other compliance areas (for examples customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Kazakhstan substantially more significant than typically found in countries with more developed tax systems.

The liability for income tax is provided for in the accrued liabilities in the financial information. Management believes that it has adequately provided for tax liabilities in the financial information. However, the risk remains that relevant government ministries and organisations could take differing positions with regard to interpretive issues and the application of the provisions contained in the contract and the resulting effect of such positions on the Company's tax liability could be significant.

17. Basic and diluted loss per share

The loss per share calculations are based on the weighted average common shares outstanding during the periods as follows:

	2001	2002	2003
Weighted average number of common shares outstanding.....	432,525,719	444,027,810	589,703,797

The diluted loss per common share has not been disclosed as the inclusion of unexercised options and warrants would be anti-dilutive in 2003, 2002 and 2001.

18. Pension plans

The Company operates a defined contribution pension plan for its UK based employees. For the years ended 31 December 2003, 2002 and 2001, the amount recognised as an expense was U.S.\$62,099, U.S.\$11,256 and U.S.\$7,739 respectively.

19. Financial instruments, hedging and trading activities

The Company accounts for derivative financial instruments in accordance with FAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This statement requires that the Company recognize all derivatives on the balance sheet at fair value and those derivatives not accounted for as hedges, are reported in the statement of operations.

Commodity trading

KOA has entered into a risk management program where it is utilizing derivative instruments to manage the exposure to fluctuations in the price of crude oil. KOA has entered into the following contracts with BNP Paribas:

Contract amount (bbls per month)	Contract period	Contract Type	Price Floor (\$/bbl)*	Price Ceiling (\$/bbl)*
120,000	September 2003 to August 2006	Zero cost collar	18.00	30.00
150,000	December 2003 to August 2006	Zero cost collar	18.00	29.50

* Brent price

Financial Instruments

The Company does not use foreign currency contracts.

Fair Value Disclosure

The carrying amounts of cash and cash equivalents approximate fair value. The Company estimates the fair value of its short-term and long-term debt generally using discounted cash flow analysis based on current interest rates for instruments with similar maturities.

The year-end fair values of short-term and long-term debt were as follows:

	2001	2002	2003
<i>Short-term debt</i>			
CSFB bank loan	—	—	58,000
BNP Paribas bank loan	—	—	3,333
<i>Long-term debt</i>			
Halyk Savings bank loan.....	—	22,800	22,653
Kazkommerts bank loan.....	—	17,194	16,798
Convertible debentures.....	2,965	3,126	—
BNP Paribas bank loan	—	—	16,667

Market and Credit Risks

The Company's financial instruments expose it to market and credit risks and may at times be concentrated with certain counterparties or groups of counterparties. The Company uses oil trading companies to market its production. The capabilities of these oil trading companies are assessed on a regular basis and the contractual arrangements can be changed as required.

The Company's oil operations are exposed to oil price fluctuations. The Company has begun to use price risk management contracts to limit its exposure to oil price fluctuations, by protecting against the potential down side in oil prices.

In 2003, KOA has been able to export all of its crude oil to international markets. Due to Kazakh regulations, there is a possibility that the Company may be required to sell some portion of its crude oil production to local markets at prices lower than those achieved on the international market. Government directed deliveries may disrupt customer relationships, lead to delays in payments for crude oil or result in sale at below market prices.

At the North Buzachi field, the Ministry of Energy assigned the licence holders a quota of approximately 15 per cent. to supply to the Atyrau refinery for domestic use. There is no requirement to make such sales to the local market, but the Ministry of Energy may impose them artificially by controlling export pipeline access quotas. The price realised for these sales was substantially lower than world market prices.

20. Operating leases

The Company's future minimum annual lease payments through the term of the lease are as follows:

	2001	2002	2003
Within one year	182	219	96
One to two years	—	—	361
Two to three years.....	—	361	78
Three to four years.....	—	78	—
Four to five years.....	—	—	168
More than five years.....	—	—	—
	<u>182</u>	<u>658</u>	<u>703</u>

21. Related party transactions

For the period ended 30 November 2002, the Company incurred legal fees of U.S.\$109,524 payable to Gowling Lafleur Henderson LLP, a firm in which an officer of the Company was a partner until November 2002.

Central Asian Industrial Holdings N.V. ("CAIH") currently owns approximately 23.3 per cent. of the voting shares of the Company. CAIH is owned by Meridian Capital CIS Fund which is, in turn, controlled by certain shareholders of Kazkommerts bank, who have an indirect control of CAIH. Mr. Subkhanberdin, who is a member of the Board of Directors of the Company, is also a major shareholder of the beneficial

owner of Central Asian Investment Company and Chairman of the Board of Directors of Kazkommerts bank. In addition, Mr. Alshinbayev is a member of the Board of Directors of Kazkommerts bank and a Chief Executive Officer of CAIH.

As more fully described in Note 13, the Company obtained a U.S.\$20 million loan from Kazkommerts bank of Kazakhstan, an organization which is related to CAIH. The loan was obtained on reasonable commercial terms applicable to arms-length transactions in Kazakhstan.

As at 31 December 2003, another principal shareholder of the Company is Energy Investments International Ltd (“EII”), which owns approximately 23.3 per cent. of the voting shares of the Company. Mr. Abuov, who is a member of the Board of Directors of the Company, is also a major shareholder of EII. In addition, Mr. Tiku, also a member of the Board of Directors of the Company, is associated with EII as Mr. Tiku is a Managing Director and shareholder of EII.

As more fully described in Note 13, the Company obtained a U.S.\$27 million loan from HSBK, an organization which is related to one of the Company’s major shareholders. The loan was obtained on reasonable commercial terms applicable to arms-length transactions in Kazakhstan. As more fully described in Note 11, HSBK has guaranteed the obligations of NPB BV to CSFB up to U.S.\$45 million.

As described in Note 14, in August 2003, the Company entered a loan agreement with CAIH and with EII pursuant to which CAIH and EII provided the Company with an unsecured credit line in the amount of U.S.\$6,000,000 each at an interest rate of 12 per cent. Independent verification was obtained that the loan agreement is on commercially reasonable terms that are not less advantageous to the Company if obtained from an arm’s length party.

During 2002 and 2003, KOA entered into crude oil off-take agreements and pre-export credit agreements with Euro-Asian Oil and UniOil, companies that are affiliated with EII. Mr. Tiku, a member of the Board of Directors of the Company, is a beneficial owner of UniOil A.G. Mr. Abuov, a member of the Board of Directors of the Company, is a beneficial owner of Euro-Asian Oil A.G. These contracts relate to activities in the ordinary course of business of KOA and were entered into on an arm’s length basis.

During 2003 and 2002, CBS provided technical and administrations services to KOA in the amount of U.S.\$413,000 and U.S.\$677,000 respectively.

22. Segment financial information

The Company has two reportable segments. The oil and gas segment is engaged in exploratory drilling and production of crude oil in Kazakhstan. Corporate and other are mostly head office and branch office costs and include general expenses, financing cost and other non-operating items. There are inter-segment transactions included in Corporate and other revenues.

Year ended 31 December 2001

	Oil and Gas	Corporate and Other	Total
Revenues			
Crude oil.....	—	—	—
Expenses			
Cost of production.....	—	—	—
Sales and transportation	—	—	—
Depreciation and amortization	(28)	(28)	(56)
General and administration	(1,123)	(4,927)	(6,050)
Income/(loss) from operations	(1,151)	(4,955)	(6,106)
Other income/(expenses)			
Foreign exchange loss	(505)	(23)	(528)
Interest and financing costs	(30)	(791)	(821)
Impairment provision	—	(2,010)	(2,010)
Interest and other income	11	349	360
Loss before income taxes and extraordinary item	(1,675)	(7,430)	(9,105)
Income taxes.....	—	(42)	(42)
Net loss from continuing operations	(1,675)	(7,472)	(9,147)
Segment assets	27,024	6,254	33,278
Capital expenditures.....	7,841	193	8,034

Geographic information

	Revenues	Long-lived assets
Kazakhstan	—	25,056
Tajikstan	—	5,389
Other countries	360	196
	<u>360</u>	<u>30,641</u>

Year ended 31 December 2002

	Oil and Gas	Corporate and Other	Total
Revenues			
Crude oil	6,911	—	6,911
Expenses			
Cost of production	1,779	—	1,779
Sales and transportation	2,292	—	2,292
Depreciation and amortisation	963	54	1,017
General and administration	2,320	9,889	12,209
Other compensation costs	—	817	817
	<u>7,354</u>	<u>10,760</u>	<u>18,114</u>
Loss from operations	(443)	(10,760)	(11,203)
Other income/(expenses)			
Foreign exchange loss	(655)	(739)	(1,394)
Interest and financing costs	(1,222)	(5,175)	(6,397)
Interest and other income	67	2,124	2,191
	<u>(1,810)</u>	<u>(3,790)</u>	<u>(5,600)</u>
Loss from continuing operations before income taxes	(2,253)	(14,550)	(16,803)
Income taxes	—	(333)	(333)
Net loss from continuing operations	<u>(2,253)</u>	<u>(14,883)</u>	<u>(17,136)</u>
Segment assets	53,939	14,621	68,560
Capital expenditure	<u>12,394</u>	<u>110</u>	<u>12,504</u>

Geographic information

	Revenues	Long-lived assets
Kazakhstan	6,911	50,549
Other countries	—	115
	<u>6,911</u>	<u>50,664</u>

Year ended 31 December 2003

	Oil and Gas	Corporate and Other	Total
Revenues			
Crude oil	40,591	—	40,591
Expenses			
Cost of production	4,452	—	4,452
Sales and transportation	10,227	—	10,227
Depreciation and amortisation	5,460	77	5,537
General and administration	2,776	9,705	12,481
Derivative instruments	3,887	—	3,887
Other compensation costs	—	8,769	8,769
	<u>26,802</u>	<u>18,551</u>	<u>43,077</u>
Income/(loss) from operations	13,789	(18,551)	(4,762)
Other income/(expenses)			
Foreign exchange gain	1,500	2,055	3,555
Interest and financing costs	(2,366)	(6,417)	(8,783)
Profit on sale of investment	—	2,731	2,731
Interest and other income	235	2,448	2,683
	<u>(631)</u>	<u>817</u>	<u>186</u>
Profit/(loss) from continuing operations before income taxes...	13,158	(17,734)	(4,576)
Income taxes	(3,275)	(960)	(4,235)
Net profit/(loss)	<u>9,883</u>	<u>(18,694)</u>	<u>(8,811)</u>
Segment Assets	140,780	68,669	209,449
Capital Expenditure	<u>94,396</u>	<u>142</u>	<u>94,538</u>

Geographic information

	Revenues	Segment Assets	Long-lived assets
Kazakhstan	40,591	163,319	140,755
Other countries	—	46,130	3,660
	<u>40,591</u>	<u>209,449</u>	<u>144,415</u>

23. Commitments and contingencies

- (a) Under the licence for the Alibekmola and Kozhasai fields, KOA is required to invest a minimum of U.S.\$47.50 million and U.S.\$24.50 million over the term of the licence, respectively. The licence expires on 19 October 2023. As at 31 December 2003 the minimum investment requirement for Alibekmola has been met. All minimum investment requirements under the licence for the North Buzachi field have been met.
- (b) A claim has been received from the Company's former chief operating officer, Mr. Roy Meade. Mr. Meade is demanding that the Company make a payment of U.S.\$2.80 million to him pursuant to a stock option agreement concluded between the Company and Mr. Meade on or about 1 December 1999. The Company's position is that no monies are due and owing to Mr. Meade. Mr. Meade has not commenced proceedings in pursuit of his claim. If any proceedings are commenced by Mr. Meade, they will be vigorously defended by the Company.
- (c) Extensive national, regional and local environmental laws and regulations affect all of the oil operations conducted through the Company's joint ventures in Kazakhstan. These laws and regulations set various standards regulating certain aspects of health and environmental quality, provide for user fees, penalties and other liabilities for the violation of those standards and establish in some circumstances obligations to remediate current and former facilities and off-site locations.

The Company believes it is currently in compliance with all existing Kazakhstan environmental laws and regulations. However, in the future, compliance with more stringent laws or regulations, or more vigorous enforcement policies of any regulatory agency, could require material expenditures for the installation and operations of systems and equipment for remedial measures, any or all of which could have a material adverse affect on its business, financial condition and results of operations.

24. Subsequent events

- (a) After the year-end, the Company acquired a further 15% participatory interest in the licence of the hydrocarbon agreement of the North Buzachi field from CNPC International for U.S.\$32 million. A definitive Joint Operating Agreement was executed by the parties allowing for the operation of the field through a joint operating company, in which both parties will share, on a 50/50 basis, decision making authority and funding responsibility. The further 15% acquisition was funded through the interim financing facility arranged through CSFB (see Note 11).
- (b) On 17 May 2004, pursuant to the Chaparral Share Purchase Agreement, NRL Acquisition Corp., a newly-incorporated wholly-owned subsidiary of the Company, acquired from CASH, a 60% interest in Chaparral Resources Inc., (“Chaparral”) for a consideration of U.S.\$20 million. Chaparral is an oil and gas exploration and production company. The only operating asset of Chaparral is its participation in the development of the Karakuduk field through Closed Joint Stock Company Karakudukmunai (“KKM”), a closed joint stock company organised under the laws of Kazakhstan. Chaparral owns a 60% ownership interest in KKM with the other 40% ownership interest being held by Kazmunaigas.

25. Reconciliation of results from U.S. GAAP to Canadian GAAP

The financial information has been prepared in accordance with accounting principles generally accepted in the U.S. (U.S. GAAP), which conform in all material respects with those applicable in Canada (Canadian GAAP).

26. Independent auditors’ reports on financial statements

The Consolidated Financial Statements of the Company as at and for the years ended 31 December 2001, 31 December 2002 and 31 December 2003 were prepared on the basis of a going concern.

The independent auditors’ reports on the financial statements for the years ended 31 December 2001 and 31 December 2002 contain an explanatory paragraph which refers to “substantial doubt” as to the Company’s ability to continue as a going concern, however, the Company has continued as a going concern for more than twelve months from the date of those reports.

The independent auditors’ report on the financial statements for the year ended 31 December 2003 contains an explanatory paragraph which refers to “substantial doubt” as to the Company’s ability to continue as a going concern due to the fact that the bridging loan facility that was due to mature on 4 June 2004 had not been replaced. As set out in Note 11, Bank loans, this was achieved on 28 May 2004 when a subsidiary of the Company entered into a Crude Oil Advance Payment Agreement with Vitol S.A., which was utilised in conjunction with existing cash to repay the bridge loan. As a result, our opinion in this report is not modified in relation to going concern.

Yours faithfully
Ernst & Young”

SECTION 2

Unaudited report for the three months ended 31 March 2004

Set out below is the full text of the report for the three months ended 31 March 2004 which was published on 14 May 2004.

“Interim Report to Shareholders

Following a successful year in 2003, our results for the first quarter of 2004 demonstrate that we continue to make substantial progress on both strategic and operational levels.

The completion in February of the acquisition of a 50 per cent. interest in the North Buzachi field was the first tangible demonstration of our strategy of growth through acquisitions, achieved in a very competitive environment and with bank financing of the full acquisition cost. Nelson plans to be the partner of choice to international oil companies, as it is with the Chinese National Petroleum Company (“CNPC”) and Kazmunaigas. We are pleased with the evolution of our partnership with CNPC as we work together to advance the field development and work programs for the North Buzachi field.

On the operational level, we continued with our aggressive development of the existing assets, resulting in dramatic increases in production, revenue and operating cash flow. Quarter for quarter, total revenue, net to Nelson, increased by 767 per cent. to \$26 million at March 31, 2004, from \$3 million at March 31, 2003. Of this, over 500 per cent. of the increase was from our joint venture, Kazakhoil Aktobe LLP (“KOA”), which saw revenue climb to \$19 million at March 31, 2004 from \$3 million at March 31, 2003. North Buzachi contributed \$7 million to total revenue. We had net production of 725,683 barrels of oil at KOA and 309,388 barrels of oil at North Buzachi in the quarter, representing a dramatic 437 per cent. increase as compared to 192,922 barrels of oil for the same period last year. Net loss for the quarter increased to \$4.7 million against a loss of \$1.7 million for the same period in 2003; however, the current 2004 quarter includes \$11.8 million of non-cash expense associated with oil price hedges and stock option compensation costs. Operating cash flow continued to improve dramatically, generating in the quarter \$10.9 million in positive cash flow, compared with a deficit in the same quarter last year and nearly twice the amount of cash flow generated during the full year in 2003.

I am pleased with the progress we have made with operational improvements at KOA. Our efforts to expand production through the de-bottlenecking of the pilot production facilities at our central processing facility at Alibekmola were completed in May 2004. This brings the processing capacity to approximately 25,000 barrels of oil per day. The significance of this is not only in its economic efficiency but equally, in demonstrating KOA’s organizational competence in carrying out such a complex project to a successful completion.

Your company continues to benefit from its competitive strengths. One such strength is to recognize and quickly adapt to the ever-changing business environment. We made the decision to accelerate the development of our fields to benefit from higher oil prices and continued to lower our cost of capital by taking advantage of favorable capital markets.

We are mindful of challenges in managing rapid growth. We are continuing to recruit talented employees to add breadth and depth to organisational competence, while utilizing overhead more efficiently through spreading its costs over a larger asset base.

Our ongoing focus is to become a world-class, independent exploration and production company. By continuing to expand upon our operating record and our experience of successfully doing business in the region, we intend to continue to build shareholder value and to become the partner of choice both for western and Kazakh companies.

I would like to thank, once again, all of our employees for their hard work and dedication, and would like to take this opportunity to welcome the new team at North Buzachi. I feel a very special thanks is owed to your Board for their dedication and commitment to serve. They have devoted much time and effort to support your company’s growth by assisting and guiding your management.

Nick Zana
Chairman
May 12, 2004

Operational Highlights

During the first quarter of 2004, Nelson continued the successful growth it experienced the previous year. Net production from its joint venture partner KOA continued to increase and a further 15 per cent. participatory interest in the license to the North Buzachi oil field was acquired on February 3, 2004. According to McDaniel's estimates, Nelson's 50 per cent. share of remaining recoverable proved plus probable reserves went from 119.599 million barrels in January 2003 to 187.186 million barrels in January 2004. Equally during this period, Nelson's 50 per cent. share of remaining recoverable proved, probable and possible reserves increased from 203.785 million barrels in January 2003 to 424.676 million barrels in January 2004.

Key operational events for the quarter included:

North Buzachi

- Acquisition of a further 15 per cent. participatory interest in the license to the field.
- Jointly prepared and agreed the personnel secondment plan into the joint venture.
- North Buzachi issued drilling, completion, work over and logging tenders for 2004 drilling program.
- North Buzachi initiated a study with Nipineftegaz to revise the full field development plan.
- Tendered an engineering procurement and construction contract for the central processing facility ("CPF"), gathering stations and flow lines.

KOA

- Drilled and completed 4 new wells and drilled a total of 15,507 meters.
- Re-entered and worked over 1 historical well.
- Started re-appraisal of the northern part of Alibekmola field with the drilling and completing of wells 64 and 61.
- Conducted a complete geophysical survey of the northern part of Alibekmola field.
- Procured and prepared for start-up the pilot water injection system for two Alibekmola wells.
- Completed the 25,000 bopd (3,300 MT/d) CPF de-bottleneck project to 75 per cent.
- Constructed and commissioned a 3,500 bopd (450 MT/d) CPF in Kozhasai field.

During the quarter, KOA showed continued performance improvement. On March 31, 2004 there were 19 producing wells in Alibekmola and Kozhasai with an average daily production of 2,128 MT/d or 16,000 bopd, compared to 6 producing wells with 1,311 MT/d or 9,830 bopd during the corresponding period in 2003. Comparably on March 31, 2004 there were 44 producing wells in North Buzachi with an average daily production of 1,102 MT/d or 7,540 bopd.

During this quarter, there were 320 people employed by KOA, composed of 157 office and 163 field employees, while North Buzachi employed 75 people (plus 141 contract employees), composed of 43 office and 32 field employees. For the same period, Nelson Resources had 62 people, with 36 working out of Almaty, 12 out of Aktau, 8 out of Aktobe and 6 out of London. None of the operations reported a lost time incident during the first quarter of 2004.

The following table sets out the production in barrels for the quarter at KOA 50 per cent. and for Buzachi (35 per cent. in January and 50 per cent. from February 3, 2004):

	Q1 — 2004			Q1 — 2003 ¹		
	Jan	Feb	Mar	Jan	Feb	Mar
KOA	215,243	249,149	261,291	48,915	70,359	73,648
North Buzachi	80,670	110,973	117,745	106,872	95,858	91,745
Total	295,913	360,122	379,036	155,787	166,217	165,393

1 Nelson had no interest in North Buzachi during Q1 of 2003. These numbers have been provided for comparison only at 50 per cent. for the quarter.

The following table sets out the sales in barrels for the quarter at KOA 50 per cent. and for Buzachi (35 per cent. in January and 50 per cent. from February 3, 2004):

	Q1 — 2004			Q1 — 2003 ¹		
	Jan	Feb	Mar	Jan	Feb	Mar
KOA.....	—	433,618	222,765	53,902	50,424	—
North Buzachi	60,837	94,567	164,305	77,628	135,690	85,180
Total	60,837	528,185	387,070	131,530	186,114	85,180

1 Nelson had no interest in North Buzachi during Q1 of 2003. These numbers have been provided for comparison only at 50 per cent. for the quarter.

Management's Discussion and Analysis as of May 12, 2004.

The following Management's Discussion and Analysis ("MD&A") of the financial condition and results of our operations should be read in conjunction with the unaudited consolidated financial statements of Nelson Resources Limited (the Company or Nelson) included in this report and our MD&A and audited consolidated financial statements for the year ended December 31, 2003.

The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries, Aktobe Munai Services LLP ("AMS"), Commonwealth & British Services Limited ("CBS"), Nelson Petroleum Buzachi Holdings B.V. ("NPBH BV"), Nelson Petroleum Buzachi B.V. ("NPB BV"), Nelson Buzachi Holdings Limited ("NBHL") and Nelson Buzachi Limited ("NBL"). Interest in Kazakhoil Aktobe LLP ("KOA"), an oil and gas limited partnership, in which the Company has a 50 per cent. interest, is reported using the proportional consolidation method. NPB BV holds a 50 per cent. participatory interest in the license to the North Buzachi field. All material intercompany balances and transactions are eliminated.

Certain data contained herein is noted to be either 100 per cent. KOA or North Buzachi or 50 per cent. net to Nelson.

Forward-Looking Information

Certain information in this MD&A is forward-looking and is subject to important risks and uncertainties. The results or events predicted in this information may differ from actual results or events. Factors which could cause actual results or events to differ materially from current expectations include, among other things, the ability of Nelson to successfully implement its strategic initiatives and whether such strategic initiatives will yield the expected benefits, the availability and price of oil, results of capital raising initiatives, regulatory decisions, competitive factors in the oil exploration and production sector, and the current economic and political conditions in Kazakhstan. For additional information on those and other factors, see "Business Risks" below, and the reports filed by Nelson with Canadian securities regulators. Nelson disclaims any intentions or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Results of operations

The Company recorded a net loss of \$4.725 million (\$0.0064 per share) for the quarter ended March 31, 2004, compared to a net loss of \$1.669 million (\$0.0037 per share) for the quarter ended March 31, 2003. The Company acquired a further 15 per cent. participatory interest in the North Buzachi oil field as of February 3, 2004. The results reflect the inclusion of the additional 15 per cent. interest of North Buzachi since that date.

Exclusion of the non-cash flow charges for derivative instruments and other compensation costs, of \$4.019 million and \$7.814 million, respectively, would result in a net profit of \$7.108 compared to the net loss recorded of \$4.725 million.

Revenue, Production and Sales

Total revenue was \$26.398 million for the three months ended March 31, 2004 which represented an increase of \$23.490 million over total revenue of \$2.908 million for the three months ended March 31, 2003. Crude oil revenue increased because of increased production and higher crude oil export prices.

The following table sets out total production figures for 50 per cent. of KOA operations and of North Buzachi (35 per cent. in January and 50 per cent. from February 3, 2004):

Field	Three months ended March 31	
	2004 (bbls)	2003 (bbls)
KOA	725,683	192,922
North Buzachi	309,388	—
Total	<u>1,035,071</u>	<u>192,922</u>

Total crude oil revenue can be analyzed as follows:

KOA	Three months ended March 31	
	2004	2003
Quantity sold in bbls (50%) net to Nelson	656,383	104,326
Average price in \$ per barrel	29.38	27.87
Oil and gas revenue 50% (\$'000) net to Nelson.....	<u>19,287,078</u>	<u>2,907,816</u>

Buzachi	Three months ended March 31	
	2004	2003
Quantity sold in bbls net to Nelson	319,709	—
Average price in \$ per barrel	22.24	—
Oil and gas revenue (\$'000) net to Nelson.....	<u>7,110,811</u>	<u>—</u>

Other income

	Three months ended March 31	
	2004 \$'000	2003 \$'000
Foreign exchange gain/(loss)	1,538	1,246
Interest and other income.....	750	462
Total	<u>2,288</u>	<u>1,708</u>

For the quarter ended March 31, 2004, the Company recognized a foreign exchange profit of \$1.538 million, compared to a profit of \$1.246 million for the quarter ended March 31, 2003. The foreign exchange gain recognized was due to the strengthening of the Kazakh Tenge to the U.S. dollar.

Interest and other income represented the Company's 50 per cent. interest received on advances to KOA, bank interest and other income. The main reason for the increase of \$0.288 million is bank interest received due to higher cash balances in the group.

Cost of Production

Cost of production relates to the cost of producing crude oil and was \$3.471 million for the three months ended March 31, 2004 compared to \$0.198 million for the same period in 2003 and can be analyzed as follows:

	Three months ended March 31			
	2004		2003	
	\$'000	\$/bbl	\$'000	\$/bbl
KOA	1,999	2.75	198	1.03
North Buzachi.....	1,472	4.76	—	—
Total.....	<u>3,471</u>		<u>198</u>	

For the year ended December 31, 2003 the cost of production at KOA was \$2.68 per barrel which is comparable to the \$2.75/bbl for the first quarter of 2004. The cost of production cannot be compared on a per barrel basis for the three months ended March 31, 2004 with March 31, 2003 due to timing differences.

Sales and transportation

Sales and transportation costs can be analyzed as follows and on a per barrel basis (based on barrels of oil sold):

	Three months ended March 31			
	2004		2003	
	\$'000	\$/bbl	\$'000	\$/bbl
KOA	4,283	6.53	1,507	14.45
North Buzachi.....	934	2.92	—	—
Total.....	<u>5,217</u>		<u>1,507</u>	

Sales and transportation costs at KOA are the costs of shipping crude oil from our central processing facility located at Alibekmola via the Kaztransoil pipeline system to Atyrau and further via Caspian Pipeline Consortium (CPC) to Novorossisk. For the first quarter 2003, crude oil was transported by a combination of truck, rail and/or pipelines to Atyrau, where it was transshipped into the Kaztransoil pipeline system for transport via Symara to the port of Odessa for export sale.

The reduction in 2004 is due to KOA having direct pipeline access to export markets. Until May 2003, KOA relied on a combination of trucking, rail and pipeline transportation as described above.

Production from the North Buzachi field can be exported via the following routes:

- the Kalamkas-Aktau-Atyrau-Samara pipeline to Samara and then by pipeline through Russia to the Black Sea port of Odessa, Ukraine, or
- the Kalamkas-Aktau-Atyrau-Samara pipeline to Samara and then by pipeline through Russia and Belarus directly to Germany, Poland and the Czech Republic, or
- the Kalamkas-Aktau pipeline to the Caspian Sea port of Aktau then via tankers to Makhachkala and onward to Novorossisk, or
- the Kalamkas-Aktau pipeline to the Caspian Sea port of Aktau then via tankers to Baku, Azerbaijan and onward by rail to the Black Sea port of Batumi, Georgia.

Depreciation and Amortization

Depreciation and amortization expense increased by \$2.956 million to \$3.490 million. The increase is due to an increase in production as compared to the first quarter 2003. Additionally, the amount subject to depreciation or amortization has increased as a result of increased future costs on the cost pool and the acquisition of North Buzachi.

Depreciation and amortization can be analysed as follows:

	Three months ended March 31			
	2004		2003	
	\$'000	\$/bbl	\$'000	\$/bbl
Oil and gas properties.....	3,422	3.31	507	2.62
Property, plant and equipment	68		27	
Total.....	<u>3,490</u>		<u>534</u>	

For the year ended December 31, 2003 the depreciation rate was \$3.41 per barrel.

General and administration

The table below analyses total general and administration costs between oil and gas operations and corporate. For oil and gas operations, the general and administrative costs are also reflected on a per barrel basis.

	Three months ended March 31			
	2004		2003	
	\$'000	\$/bbl	\$'000	\$/bbl
Oil and gas KOA	919	1.26	483	2.50
Oil and gas North Buzachi	371	1.20	—	—
Corporate	1,926		1,880	
Total.....	<u>3,216</u>		<u>2,363</u>	

For the year ended December 31, 2003 KOA's general and administration costs were \$1.63 per barrel. The general and administration costs at KOA have decreased from \$2.50 per barrel to \$1.26 per barrel for the quarter ended March 31, 2004 due to significant increases in production. The amounts of general and administration expenses are relatively constant and the costs are spread over a larger volume of production.

Derivative instruments

In 2003, KOA has entered into a risk management program where it is utilizing derivative instruments to manage the exposure to fluctuations in the price of crude oil. KOA has entered into the following contracts with BNP Paribas:

Contract amount (bbls per month)	Contract period	Contract Type	Price Floor (\$/bbl)*	Price Ceiling (\$/bbl)*
120,000	September 2003 to August 2006	Zero cost collar	18.00	30.00
150,000	December 2003 to August 2006	Zero cost collar	18.00	29.50

* Brent price

Statement of Financial Accounting Standards (FAS) No. 133 "Accounting for Derivative Instruments and Hedging Activities", requires that the Company recognize all derivatives on the balance sheet at fair value. The \$4.019 million expense for the three months ended March 31, 2004 represented the increased marked to market liability of the above derivative instruments.

Other compensation costs

Other compensation costs relate to the changes in the value of stock options granted to employees. Other compensation costs amounted to \$7.814 million for the quarter ended March 31, 2004, compared to \$0.462 million for the same period in 2003. The reason for the increase is due to share price movements affecting option valuation and the strengthening of the Canadian dollar. The share price has increased from Cdn\$0.50 at March 31, 2003 to Cdn\$1.62 at March 31, 2004. At December 31, 2003 the share price was Cdn\$1.09.

Interest and financing costs

The following table sets out the interest expense and the amortisation of debt issue costs:

	Three months ended March 31	
	2004 \$'000	2003 \$'000
Government debt accretion	327	288
Pre-export financing	—	40
Interest on BNP Paribas loan	400	—
Amortization of arrangement fee of BNP Paribas loan	60	—
Interest on HSBK and KKB loans	1,542	1,320
Debenture interest	—	93
Shareholders' equity advance interest	—	360
Debenture issue cost amortized/written off	—	23
Interest on CSFB loan	1,579	—
Amortization of arrangement fee of CSFB loan	592	—
Other	—	21
Total	<u>4,500</u>	<u>2,145</u>

As can be seen from the above table, the increase of \$2.355 is mainly due to the interest and amortization of the arrangement fee of the Credit Suisse First Boston (CSFB) loan.

Income taxes

The following table sets out the income taxes:

	Three months ended March 31	
	2004 \$'000	2003 \$'000
Oil and gas KOA.....	1,681	—
Corporate.....	3	—
Total	<u>1,684</u>	<u>—</u>

The increase of \$1.684 million is mainly due to KOA reporting a profit for the quarter ended March 31, 2004.

Capital expenditures

The table below provides a breakdown of capital expenditures:

	Three months ended March 31	
	2004 \$'000	2003 \$'000
Oil and gas properties	4,287	289
Acquisition of participatory interest in North Buzachi	32,250	—
Purchase of property, plant and equipment	5,555	2,842
Total	<u>42,092</u>	<u>3,131</u>

The majority of the oil and gas properties and property, plant and equipment expenditure was on KOA. The increased capital expenditure for the three months ended March 31, 2004 is because of the development of the Alibekmola and Kozhasai fields. The \$32.250 million represent the cost of the 15 per cent. participatory interest in the license to the North Buzachi oil field.

KOA's capital expenditure budget for 2004 is \$124 million. The capital expenditure is expected to be financed with an increase in the current BNP Paribas loan and through cash from current operations. Funding for Nelson's share of the projected capital expenditure budget at North Buzachi is expected to be funded from operating cash flow and existing cash resources.

Liquidity and Capital Resources

The following table sets out the levels of cash, working capital and cash used:

	March 31, 2004 \$'000	December 31, 2003 \$'000
Cash and cash equivalents.....	45,539	43,246
Cash flow	10,863	5,797
Working capital ⁽¹⁾	(3,017)	(8,083)

(1) Working capital is net of cash and short-term debt

As of March 31, 2004 the Company had negative working capital of \$3.017 million compared to negative working capital of \$8.083 million at the end of 2003. The increase is mainly due to higher accounts receivable and inventory levels.

The cash flow from operating activities increased from \$5.797 million for the year ended December 31, 2003 to \$10.863 million in the first quarter of 2004. In 2003, the most significant use of cash were the losses from operations of \$11.011 million compared to a smaller loss of \$2.241 million in 2004.

Net cash used in investing activities was \$43.409 million for the three months ended March 31, 2004 compared to \$4.011 million for the same period in 2003. The acquisition of the 15 per cent. participatory interest in North Buzachi is responsible for \$32.250 million of the increase. The remaining increase is explained by the increases in acquisition of oil and gas properties and purchase of property, plant and equipment.

Net cash provided by financing activities amounted to \$44.448 million for the quarter ended March 31, 2004 compared to \$1.019 million for the same period in 2003. The Company received a total of \$42 million from new loans during the first quarter in 2004; \$32 million from a short-term facility with CSFB and \$10 million from the Company's pro rata portion of KOA's loan from BNP Paribas.

The short-term loan of \$90 million matures on June 4, 2004. The Company is in the process of re-structuring the interim financing to a long term financing and is confident that the signing of the new term loan can be achieved before the expiry of the interim facility.

The following table sets out the Company contractual obligations as of March 31, 2004:

Contractual obligations	Total	Payments due by period \$'000			
		Less than 1 year	1 to 3 years	4 to 5 years	After 5 years
Long Term Debt	73,350	—	66,569	4,351	2,430
Capital Lease Obligations.....	—	—	—	—	—
Operating Leases	607	—	439	168	—
Purchase Obligations	4,077	—	4,077	—	—
Other Long Term Obligations	24,910	—	—	24,635	275
Total.....	102,944	—	71,085	29,154	2,705

Off-Balance Sheet Arrangements

The Company did not engage in off-balance sheet accounting to structure any of its financial arrangements for the three month period ended March 31, 2004.

Summary of Quarterly results

The tables below set out selected quarterly information:

\$'000	Total Revenue	Net income/(loss)*	Net income/(loss) (\$/share)*	
			Basic	Diluted
2004, Quarter Ended March 31	26,398	(4,725)	(0.0064)	(0.0064)
2003, Quarter Ended March 31	2,908	(1,669)	(0.0037)	(0.0037)
June 30.....	8,921	(154)	(0.0003)	(0.0003)
September 30	15,451	5,499	0.0083	0.0080
December 31.....	13,311	(14,687)	(0.0221)	(0.0221)

* The net income/(loss) and the per share data is also the net income/(loss) from continuing operations.

\$'000	Total Revenue	Net loss from continuing operations	Basic and diluted loss per share \$	Net income/ (loss)	Net profit/(loss)(\$/share)	
					Basic	Diluted
2002, Quarter Ended March 31	328	(2,948)	(0.0071)	(2,888)	(0.0070)	(0.0070)
June 30	2,030	(3,828)	(0.0087)	(5,321)	(0.0121)	(0.0121)
September 30	4,290	(2,707)	(0.0061)	(3,259)	(0.0073)	(0.0073)
December 31	263	(7,653)	(0.0171)	(6,631)	(0.0148)	(0.0148)

For the quarter ended September 30, 2003 the Company recorded a profit of \$5.499 million, due to a one-off profit on sale of investment of \$2.731 million. The loss of \$14.687 million recorded in the fourth quarter 2003 is due to the increase in fair value of derivative instruments of \$3.887 million and other compensation costs increase of \$7.366 million. These costs had no cash flow impact. On December 17, 2003, the Company acquired a 35 per cent. interest in the hydrocarbon license to the North Buzachi oil field.

The total revenue has increased steadily due to increased production and higher oil prices during 2003. Up to November 2002, the Company had an interest in a gold mining operation.

Selected Annual Information

\$'000	Total Revenue	Net loss from continuing operations	Basic and diluted loss per share \$	Net loss	Basic and diluted loss per share \$	Total Assets	Total Long-Term Liabilities
Year ended December 31							
2003	40,591	11,011	0.019	11,011	0.019	209,449	158,536
2002	6,911	17,136	0.039	18,099	0.041	68,560	61,346
2001	—	9,147	0.021	11,593	0.027	40,069	24,804

No dividends have been declared during 2001 to 2003.

No revenue was reported during 2001 as the Company was not yet producing oil. The increase in revenue between 2002 and 2003 is due to increased production and higher crude oil prices. The decrease of \$6.125 million in the net loss from continuing operations between 2003 and 2002, is the result of higher revenues recognized during 2003, a one-off profit on sale of investment of \$2.731 and foreign exchange gains. In November 2002, the Company disposed off its gold mining assets.

Total assets have increased year on year mainly due to increased capital expenditure at the oil and gas level. These were mainly funded through long term loans.

Transactions with related parties

Central Asian Industrial Holdings N.V. (“CAIH”) currently owns approximately 23.3 per cent. of the voting shares of the Company. Mr. Subkhanberdin, who is a member of the Board of Directors of the Company, is also a major shareholder of the beneficial owner of CAIH and Chairman of the Board of Directors of Kazkommerts bank. In addition, Mr. Alshinbayev, also a member of the Board of Directors of the Company, is a member of the Board of Directors of Kazkommerts bank and Chief Executive Officer of CAIH.

The Company obtained a \$20 million loan from Kazkommerts bank of Kazakhstan, an organization which is related to CAIH. The loan was obtained on reasonable commercial terms applicable to arms-length transactions in Kazakhstan.

Another principal shareholder of the Company is Energy Investments International Ltd (“EII”), which owns approximately 23.3 per cent. of the voting shares of the Company. Mr. Abuov, who is a member of the Board of Directors of the Company, is also a major shareholder of EII. In addition, Mr. Tiku, also a member of the Board of Directors of the Company, is associated with EII as Mr. Tiku is a Managing Director and shareholder of EII.

The Company obtained a \$27 million loan from Halyk Savings Bank of Kazakhstan (HSBK), an organization which is related to one of the Company’s major shareholders. The loan was obtained on reasonable commercial terms applicable to arms-length transactions in Kazakhstan. HSBK has guaranteed the obligations of NPB BV to CSFB up to \$45 million.

During 2002 and 2003, KOA entered into crude oil off-take agreements and pre-export credit agreements with Euro-Asian Oil and UniOil, companies that are affiliated with EII. Mr. Tiku, a member of the Board of Directors of the Company, is a beneficial owner of UniOil A.G. Mr. Abuov, a member of the Board of Directors of the Company, is a beneficial owner of Euro-Asian Oil A.G. These contracts relate to ordinary course activities of KOA and were completed on an arm’s length basis.

During 2003 and 2002, CBS provided technical and administrative services to KOA in the amount of \$413,000 and \$677,000 respectively and for the three months ended March 31, 2004 the amount was \$57,000.

Critical accounting policies and estimates

The Company prepares its financial statements in accordance with U.S generally accepted accounting principles (U.S. GAAP). Inherent in the application of generally accepted accounting principles in the preparation of financial statements is the need for the Company to make 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. As such, differential financial results can occur as circumstances change and additional information becomes available.

The following summary provides further information about the critical accounting policies that could have a significant impact on the results of the group. The areas that require the most significant judgments and estimates are in relation to oil and gas accounting, including the estimation of reserves, impairments, provisions for income taxes, asset retirement obligations, legal, environmental and other liabilities and the application of standards of accounting for derivative financial instruments require management to make numerous estimates and judgments.

The Company has not materially changed the use of its methodology for the estimates described below for the financial statements presented and actual results compared to estimates made have not had a material effect on the Company’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.

Oil and gas properties (Full cost method)

The Company follows the full cost method of accounting for oil and gas properties. Currently, the only cost pool relates to the Company's operations in Kazakhstan. Accordingly, all costs associated with acquisition, exploration, and development are capitalized. Capitalized expenditures include land acquisition costs, geological and geophysical expenses, costs of drilling both productive and non-productive wells, gathering and production facilities and equipment and overhead expenses related to exploration and development activities.

Effective with the adoption of FAS No. 143 "Accounting for Asset Retirement Obligations" 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.

All capitalized costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortized on the unit-of-production method using estimated proved reserves. Investments in unproved properties are not amortized until proved reserves associated with the projects can be determined or until impairment occurs. Unproved oil and gas properties are stated at cost pending the determination of reserves.

The recoverability of oil and gas properties is assessed whenever events or circumstances indicate a potential impairment. This assessment involves comparing the carrying value of the assets with management's best estimate of the future undiscounted cash flows to be generated by using the asset. Where this calculation indicates an impairment the asset is written down to its fair value, which is estimated based upon management's best estimate of future discounted cash flows.

Reserves

Estimates of our proved oil and gas reserves are prepared by McDaniel & Associates Consultants Ltd. in accordance with guidelines established by the Toronto Stock Exchange. 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 depreciation, depletion and amortization rate calculation and the financial statements.

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 FAS 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.

Asset retirement obligations

Estimated future restoration costs are provided for based on the number of wells drilled. Costs are based on independent engineering estimates of future site restoration in accordance with current contracts. Provision is being made for site restoration costs, where they are probable and can be reasonably estimated.

Legal, environmental and other liabilities

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. Management closely monitors known and potential legal, environmental and other contingencies and periodically determines when losses should be recorded for these items based on information available.

Derivative financial instruments

Derivative financial instruments are recognized in accordance with FAS 133, "Accounting for Derivative Financial Instruments and Hedging Activities", as amended. As a result, all derivative financial instruments are recognized 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.

Principles of consolidation

The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries. KOA, in which the Company has a 50 per cent. interest, is reported using the proportional consolidation method. All material intercompany balances and transactions are eliminated.

Foreign currency translations

The functional currency, as defined in U.S. GAAP, is the local currency for the Company's operations in the Republic of Kazakhstan. For all other operations, the functional currency is considered to be U.S. dollars.

U.S. GAAP does not require a company to prepare and report its financial statements in the same currency as its functional currency. Accordingly, the Company has elected to use the U.S. dollar as its reporting currency as a significant portion of its business is conducted in U.S. dollars and management uses the U.S. dollar to manage business risk and exposures and measure performance. The translation of the Consolidated Financial Statements into U.S. dollars is in accordance with the method prescribed by U.S. GAAP.

Because of exchange restrictions relating to converting Tenge into other currencies and because the Tenge is not a convertible currency outside Kazakhstan the translation of U.S. dollars should not be construed as a representation that such Tenge amounts have been, could be or will in the future be converted into U.S. dollars at the exchanges rates disclosed in the notes to the Consolidated Financial Statements.

Recognition of revenue

The Company recognizes revenues from oil sales when crude oil is delivered to the buyers. Sales do not include indirect taxes (excises, VAT and royalty).

Inventories

Oil stocks are stated at the lower of the cost of production or net realizable value. Cost is determined using the first-in-first-out method.

Stock options

Employee stock options are accounted for under the provisions of Accounting Principles Board Opinion (APB) No. 25, "Accounting for Stock Issued to Employees". APB No. 25 requires the use of the intrinsic value method to measure compensation cost as the excess, if any, of the quoted market price of the stock at grant over the amount the employee must pay to acquire the stock.

The Company complies with the disclosure requirements of FAS No. 123 and FAS No. 148, "Accounting for Stock-Based Compensation," which uses a fair value-based method of accounting for stock options granted to employees. The fair value of 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.

Other critical accounting policies

The above assessment of critical accounting policies is not meant to be an all inclusive discussion of the uncertainties to financial results that can occur from the application of the full range of the Company's accounting policies. Materially different results could occur in the application of the accounting policies as well. In addition, materially different results can occur upon the adoption of the new accounting standards promulgated by the various rule-making bodies.

New accounting pronouncements

During January 2003, the Financial Accounting Standards Board ("FASB") issued Financial Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"), which requires the consolidation of certain entities that are determined to be variable interest entities ("VIEs"). An entity is considered to be a VIE when either (i) the entity lacks sufficient equity to carry on its principal operations, (ii) the equity owners of the entity cannot make decisions about the entity's activities or (iii) the entity's equity neither absorbs losses or benefits from gains.

The Company has reviewed its financial arrangements and has not identified any material VIEs that should be consolidated by the Company in accordance with FIN 46.

During April 2003, the FASB issued FAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities", which provides certain amendments for the impact of contracts entered into or modified after 30 June 2003 and hedging relationships designated after 30 June 2003. The adoption of FAS No. 149 is not considered to have a material effect on the Company's financial statements.

In May 2003, the FASB issued FAS No. 150 "Accounting for certain Financial Instruments with Characteristics of both Liabilities and Equity". This statement establishes standards for how a company classifies and measures on its balance sheet certain financial instruments with characteristics of both liabilities and equity. The adoption of the FAS No. 150 is not considered to have a material effect on the Company's financial statements.

Business Risks

Commodity price risk

Commodity price risk related to crude oil prices is the Company's most significant market risk exposure. Crude oil prices are influenced by such worldwide factors as OPEC actions, political events and supply and demand fundamentals. The Company entered into a risk management program at KOA, where it is utilizing derivative instruments to manage the exposure to fluctuations in the price of crude oil. Please refer to note 19 of the 2003 consolidated financial statements.

Financial instrument risk

By utilizing derivative instruments to manage exposure to fluctuations in the price of crude oil, KOA is exposed to credit-related losses in the event of non-performance by counterparties to the derivative instruments. Additionally, if crude oil prices increased above the crude oil price collar ceiling specified in the derivative instruments, a fixed price could limit KOA's ability to receive the full benefit of commodity price increases. The use of derivative instruments combined with the current historically high crude oil prices may have a negative impact on the Company's results of operations and financial condition. Please refer to note 19 of the 2003 consolidated financial statements.

Economic and operating environments

Please refer to note 3 of the 2003 consolidated financial statements.

Income taxes

Please refer to note 16 of the 2003 consolidated financial statements.

Foreign currency exchange rate risk

Export revenues in KOA are mostly denominated in U.S. dollars. Substantial portions of the Company's operating costs are denominated in Kazakh Tenge. There is therefore an exposure when the Company converts between these currencies. There is no significant forward market for the Tenge and the Company does not hedge this exposure.

Insurance

The Company maintains insurance against risks that are typical in the oil and gas industry. Although the Company maintains insurance in amounts that it believes to be adequate, the insurance coverage maintained may not be adequate in the event of unforeseen circumstances.

Reserve estimates

Estimates of economically recoverable oil reserves and the future net cash flows therefrom are based upon a number of variable factors and assumptions, such as commodity prices, projected production from the property, the assumed effects of regulation by government agencies and future operating costs. All of these estimates may vary from actual results. Estimates of the recoverable oil reserves, classifications of such reserves based on risk of recovery and estimates of future net revenues expected therefrom, may vary. The Company's actual production, revenues, taxes, development and operating expenditures with respect to its reserves may vary from such estimates, and such variances could be material.

Financial and liquidity risks

Nelson relies on various sources of funding to support its growing capital expenditure program. Until internally generated cash flow can provide the funding from which the Company's annual capital expenditures program can be met, debt or equity will be utilized to expand capital programs. Accordingly, changes in interest rates may have a material effect on the cost of borrowing. New equity, if available and if on favourable terms, may also be utilized to expand exploration programs.

Cash flow is influenced by factors, which the Company cannot control, such as commodity prices, the U.S. dollar/Tenge exchange rate, interest rates and changes to existing government regulations and tax policies.

Inflation risks

Inflation risks subject the Company to potential erosion of crude oil netbacks. For example, increasing domestic prices for oil production equipment and services can inflate the costs of operations.

Transportation risks

Kazakhstan is a land-locked country and the Company is dependent upon pipeline, truck and rail transport for the transportation of its production to export markets. These routes cross multiple national and regional jurisdictions and can be subject to operational and regulatory disruption. The Company is striving to create several alternative routes to reduce its dependency on any one carrier and to reduce transportation costs.

Other

In addition to the risk of fluctuating oil prices, the Company will face the risk of possible government regulation limiting, from time-to-time, oil exports. During 2003, KOA has been able to export all of its crude oil to international markets. However, there can be no assurance that KOA will continue to export all of its oil in future, which could adversely affect the Company's revenues and relationship with other customers.

The Company, as part of the development plans for the Alibekmola and Kozhasai fields, will be required to implement an environmental management plan, which future costs may be significant.

These and other risks are discussed in detail in Nelson's annual information form.

Disclosure of outstanding share data

As of May 14, 2004 the Company had 745,113,967 common shares outstanding. As of such date, the Company had 24,613,333 common share options outstanding with an average exercise price of Cdn.\$0.48.

Other

Additional information, including the quarterly and annual consolidated financial statements, annual information form, management proxy circular and other disclosure documents may be examined by accessing the SEDAR web site at www.sedar.com.

Consolidated Balance Sheets

Expressed in thousands of U.S. dollars, except share amounts

	March 31 2004 (unaudited)	December 31 2003 (audited)
Assets		
Current assets		
Cash and cash equivalents	\$ 45,539	\$43,246
Accounts receivable and prepaid expenses.....	24,802	19,546
Inventories.....	7,953	2,242
Total current assets	78,294	65,034
Oil and gas properties, full cost	144,161	108,963
Property, plant and equipment	17,242	11,750
Advances to oil and gas limited partnership.....	24,635	23,318
Other non-current assets	339	384
Total assets	<u>\$ 264,671</u>	<u>\$ 209,449</u>
Liabilities		
Current liabilities		
Accounts payable	\$ 18,520	\$18,765
Accrued liabilities	9,132	6,295
Income taxes payable	282	924
Derivative instruments	7,838	3,887
Bank loan	90,000	58,000
Current portion of long-term debt.....	8,967	3,550
Total current liabilities	134,739	91,421
Long-term liabilities	73,626	67,115
Total liabilities	<u>208,365</u>	<u>158,536</u>
Shareholders' equity		
Common Shares, par value \$0.01 per share. Authorized 1,000,000,000 Issued and outstanding 745,113,967 at March 31, 2004 and 739,160,835 at December 31, 2003		
Preference Shares, par value \$0.01. Authorized 50,000,000 with none outstanding.....	7,452	7,392
Additional paid in capital.....	181,862	176,247
Other compensation costs	13,744	9,161
	203,058	192,800
Accumulated deficit	(145,380)	(140,655)
Other comprehensive income/(loss)	(1,372)	(1,232)
Total shareholders' equity	<u>56,306</u>	<u>50,913</u>
Total liabilities and shareholders' equity	<u>\$ 264,671</u>	<u>\$ 209,449</u>

Unaudited Consolidated Statements of Operations
Expressed in thousands of U.S. dollars, except share amounts

	Three Months Ended March 31	
	2004	2003
Revenue		
Crude oil.....	\$26,398	\$2,908
Expenses		
Cost of production.....	3,471	198
Sales and transportation	5,217	1,507
Depreciation and amortization.....	3,490	534
General and administration	3,216	2,363
Derivative instruments	4,019	—
Other compensation costs	7,814	(462)
	<u>27,227</u>	<u>4,140</u>
Loss from operations.....	(829)	(1,232)
Other income/(expenses)		
Foreign exchange gain/(loss)	1,538	1,246
Interest and financing costs.....	(4,500)	(2,145)
Interest and other income.....	750	462
	<u>(2,212)</u>	<u>(437)</u>
Loss before income taxes	(3,041)	(1,669)
Income taxes	(1,684)	—
Net loss	<u>\$ (4,725)</u>	<u>\$ (1,669)</u>
Basic and diluted loss per share	(0.0064)	(0.0037)
Weighted average common shares outstanding	742,758,882	448,243,897

Unaudited Consolidated Statements of Cash Flows
Expressed in thousands of U.S. dollars

	Three Months Ended March 31	
	2004	2003
Cash Flows from continuing operating activities		
Net loss.....	\$ (4,725)	\$ (1,669)
Adjustments to reconcile net loss to net cash provided by/(used in) operating activities:		
Other compensation costs	7,814	(462)
Exchange rate (gain)/loss	(644)	(606)
Depreciation and amortization	3,490	534
Discount accretion	327	288
Debenture cost amortized	—	23
Derivative instruments	3,943	—
Asset retirement obligation accretion	6	—
Interest on shareholders' equity advance.....	—	360
Loan arrangement fee amortized	652	—
Net effect on cash flows.....	10,863	(1,532)
(Decrease)/Increase in working capital.....	(9,609)	9,265
Net cash used in operating activities	1,254	7,733
Cash flows from investing activities		
Capital expenditure on oil and gas properties	(4,287)	(289)
Acquisition of participatory interest in North Buzachi	(32,250)	—
Purchase of property, plant and equipment	(5,555)	(2,842)
Advances to oil and gas limited partnership.....	(1,317)	(880)
Net cash used in investing activities	(43,409)	(4,011)
Cash flows from financing activities		
Proceeds from exercise of stock options	2,448	1,105
Bank loans received	42,000	—
Other non-current assets	—	(86)
Net cash provided by financial activities	44,448	1,019
Net increase in cash and cash equivalents	2,293	4,741
Cash and cash equivalents at beginning of period	43,246	7,507
Cash and cash equivalents at end of period	\$ 45,539	\$ 12,248

Notes to First Quarter 2004

Interim Unaudited Consolidated Financial Statements

Note 1 Basis of Presentation and Significant Accounting Policies

The accompanying consolidated financial statements as of March 31, 2004 and for the three month periods ended March 31, 2004 and 2003 are unaudited but include all adjustments (consisting of normal recurring adjustments) that the Company considers necessary for a fair presentation of the consolidated financial information set forth therein and in accordance with generally accepted accounting principles. The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and have not been reviewed by an auditor. All amounts are stated in U.S. dollars unless otherwise indicated.

The accounting policies followed are consistent with those outlined in the annual audited financial statements. These unaudited consolidated financial statements do not include all disclosures normally provided in annual financial statements and should be read in conjunction with the Company's audited annual consolidated financial statements for the year ended December 31, 2003.

The consolidated financial statements of the Company include the accounts of the Company and its wholly owned subsidiaries, Aktobe Munai Services LLP ("AMS"), Commonwealth & British Services Limited ("CBS"), Nelson Petroleum Buzachi Holdings B.V. ("NPBH BV"), Nelson Petroleum Buzachi B.V. ("NPB BV"), Nelson Buzachi Holdings Limited ("NBHL") and Nelson Buzachi Limited ("NBL"). Interest in Kazakhoil Aktobe LLP ("KOA"), an oil and gas limited partnership, in which the Company has a 50 per cent. interest, is reported using the proportional consolidation method. All material intercompany balances and transactions are eliminated.

Note 2 Economic and Operating Environments

The Company's continued business activities are located in Kazakhstan. As an emerging market, Kazakhstan does not possess a well-developed business and regulatory infrastructure that would generally exist in a more mature market economy. Furthermore, the Government of Kazakhstan has not yet fully implemented the reforms necessary to create judicial, taxation and regulatory systems that function with the effectiveness often achieved in more developed markets. As a result, operations in transitional countries involve risks that are not typically associated with those in developed markets.

Uncertainties regarding the political, legal, tax or regulatory environment, including the potential for adverse changes in any of these factors could significantly affect the Company's ability to operate commercially. It is difficult for management to estimate what changes may occur or the resulting effect of any such changes on the Company's financial position or future results of operations.

The accompanying consolidated financial statements do not include any adjustments that may result from the future clarification of these uncertainties. Such adjustments, if any, will be reported in the Company's consolidated financial statements in the period when they become known and estimable.

Note 3 Shareholders' Equity

As of March 31, 2004 the Company had 745,113,967 shares outstanding. As of such date, the Company had the following contingently issuable shares.

	Number	Exercise Price
Share options outstanding	24,613,333	Average exercise price Cdn \$0.48

Note 4 Commitments and Contingencies

Under the license for the Alibekmola and Kozhasai oil and gas fields, KOA is required to invest a minimum of \$47.5 million and \$24.5 million, respectively, during the term of the licenses. The minimum investment requirement for Alibekmola has been met. The licenses expire on October 19, 2023."

SECTION 3

Unaudited Supplemental Information relating to Nelson Resources Limited

(a) Oil Producing Activities

The following supplemental information regarding the oil and gas activities of the Company is presented pursuant to FAS 69, "Disclosures about Oil and Gas Producing Activities". All the oil and gas activities are located in Kazakhstan.

The following estimates of reserve quantities and related standardised 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 emphasises 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.

Proved oil reserves consist of those estimated quantities of crude oil 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 oil reserves are reserves that can be expected to be recovered through existing wells with existing equipment and operating methods.

The standardised measure of discounted future net cash flows is computed by applying year-end prices of oil to the estimated future production of proved oil reserves, less estimated future expenditures (based on year-end costs) to be incurred in developing and producing the proved reserves, less estimated future income tax expenses. The estimated future net cash flows are then discounted using a rate of 10 per cent. per annum to reflect the estimated timing of the future cash flows.

Estimates of petroleum reserves have been made by independent engineers and Company employees. These estimates include reserves in which the Company holds an economic interest under joint venture agreements. These estimates do not include probable or possible reserves. The estimated net interests in proved reserves are based upon subjective engineering judgments and may be affected by the limitations inherent in such estimation. The process of estimating reserves is subject to continual revision as additional information becomes available as a result of drilling, testing, reservoir studies and production history. There can be no assurance that such estimates will not be materially revised in subsequent periods.

Estimated quantities of proved oil reserves of the Company's 50 per cent. share in KOA and 35 per cent. interest in North Buzachi, were as follows:

	Oil (Barrels)
Reserves at 1 September 2002	79,499,000
Production	(304,063)
Reserves at 31 December 2002	79,194,937
Revision of previous estimates	(9,052,530)
Acquisitions	38,401,196
Production	(1,611,303)
Reserves at 31 December 2003	<u>106,932,300</u>

The aggregate amounts of capitalised costs relating to oil producing activities and the related accumulated, depreciation and impairment relating to the Company's 50 per cent. share in KOA and 35 per cent. in North Buzachi were as follows:

	2002	2003
Unproved oil and gas properties	7,159	—
Proved properties	21,111	115,405
Gross Capitalised Costs	28,270	115,405
Accumulated depreciation	(826)	(6,442)
Net Capitalised Costs	<u>27,444</u>	<u>108,963</u>

Costs incurred in oil and gas producing activities, both capitalised and expenses relating to the 50 per cent. share in KOA and 35 per cent. interest in North Buzachi were as follows:

	2002	2003
Acquisition costs	—	56,042
Exploration costs	—	—
Development costs	11,627	28,876
Total costs incurred.....	<u>11,627</u>	<u>84,918</u>

Results of operations from oil producing activities relating to the 50 per cent. share in KOA and 35 per cent. interest in North Buzachi were as follows:

	2002	2003
Oil and gas production revenue	6,911	40,591
Production costs	(4,071)	(14,679)
Depreciation	(963)	(5,460)
Income taxes	—	(3,275)
Results of Operations for Producing Activities	<u>1,877</u>	<u>17,177</u>

Standardised measure of discounted future net cash flows and changes therein relating to proven oil reserves relating to the 50 per cent. share in KOA and 35 per cent. interest in North Buzachi were as follows:

	2002	2003
Future cash inflows	1,160,053	2,333,788
Future development costs	(255,426)	(318,278)
Future production costs.....	(274,888)	(416,789)
Future income tax expenses.....	(315,261)	(728,483)
Others	(2,075)	(25,407)
Future net cash flows	312,403	844,831
10% annual discount for estimated timing of cash flows.....	(173,083)	(376,511)
Standardised measure of discounted net cash flows.....	<u>139,320</u>	<u>468,320</u>

Principal sources of change in the standardised measure of discounted future net cash flows relating to the 50 per cent. share in KOA and 35 per cent. interest in North Buzachi were as follows:

	2002	2003
Beginning balance	—	139,320
Sales and transfers of oil produced, net of production and transportation costs.....	—	(32,820)
Net changes in prices, production costs and royalties related to future production.....	—	307,766
Net changes due to revisions in previous quantity estimates	—	28,876
Net changes in estimated future developments costs.....	—	5,946
Net changes in extensions and improved recovery	139,320	4,133
Changes from acquisitions of reserves.....	—	175,948
Net changes resulting from revisions in quantity estimates	—	(1,870)
Accretion of discount	—	7,533
Net changes in income taxes	—	(166,512)
Ending balance	<u>139,320</u>	<u>468,320</u>

(b) *Acquisition of North Buzachi*

The following selected unaudited pro forma combined results of operations for the years ended 31 December 2002 and 2003 have been prepared assuming that the acquisition occurred at the beginning of each period. This information is not necessarily indicative of the results that would have occurred had the acquisitions been completed at the beginning of the period indicated nor is it indicative of future operating results:

	2002	2003
Revenue.....	21,767	64,814
Depreciation	1,017	5,537
Interest expense	8,381	9,617
Income taxes.....	333	4,235
Net loss	20,565	7,268
Net loss per share	0.046	0.012
Shares used in calculation of net loss per share.....	444,027,810	589,703,797

SECTION 4

Accountants' Report on Chaparral Resources, Inc.



Ernst & Young LLP
1 More London Place
London SE1 2AF

The Directors
Nelson Resources Limited
7th Floor
19 Berkeley Street
London W1J 8ED

The Directors
Canaccord Capital (Europe) Ltd.
27 Upper Brook Street
London W1K 7QF

13 July 2004

Dear Sirs

Introduction

We report on the financial information set out below. This financial information has been prepared for inclusion in the admission document dated 13 July 2004 of Nelson Resources Limited ("Nelson").

Basis of preparation

The financial information set out on pages 94 to 118 is based on the audited consolidated financial statements of Chaparral Resources, Inc. ("Chaparral") for the three years ended 31 December 2003 to which no adjustments were considered necessary, and has been prepared on the basis set out in Note 1 and excludes certain Unaudited Supplemental Information about oil and gas activities which is set out in Part IV, Section 5 of the admission document referred to above.

Responsibility

Such financial statements are the responsibility of the directors of Chaparral who approved their issue.

The directors of Nelson are responsible for the contents of the admission document dated 13 July 2004 in which this report is included.

It is our responsibility to compile the financial information set out in our report from the financial statements, to form an opinion on the financial information and to report our opinion to you.

Basis of opinion

We conducted our work in accordance with the Statements of Investment Circular Reporting Standards issued by the Auditing Practices Board. Our work included an assessment of evidence relevant to the amounts and disclosures in the financial information. The evidence included that previously obtained by us relating to the audit of the financial statements underlying the financial information. It also included an assessment of significant estimates and judgements made by those responsible for the preparation of the financial statements underlying the financial information and whether the accounting policies are appropriate to the entity's circumstances, consistently applied and adequately disclosed.

Opinion

In our opinion, the financial information presents fairly, in all material respects, for the purposes of the admission document dated 13 July 2004, the financial position of Chaparral as at the dates stated and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States except for the exclusion of certain Unaudited Supplemental Information referred to in the basis of preparation paragraph above.

Consent

We consent to the inclusion in the admission document dated 13 July 2004 of this report and accept responsibility for this report for the purposes of paragraph 45(2)(b)(iii) of Schedule 1 to the Public Offers of Securities Regulations 1995.

CHAPARRAL RESOURCES, INC.
Consolidated Balance Sheets
As at 31 December 2001, 2002 and 2003
Expressed in thousands of US dollars

	Note	2001	2002	2003
Assets				
Current assets:				
Cash and cash equivalents		174	4,295	2,639
Accounts receivable:				
Oil sales receivable		—	1,993	215
VAT receivable	3	—	1,999	2,907
Prepaid expenses	4	245	1,872	1,940
Prepaid expenses to affiliates	4	—	584	1,296
Crude oil inventory		—	548	544
Total current assets.....		419	11,291	9,541
Materials and supplies.....		—	2,457	3,188
Hedge agreement.....		762	—	—
Other.....		5	5	—
Property, plant and equipment:				
Oil and gas properties, full cost:	5	—	84,833	118,347
Properties subject to depletion		—	8,814	2,942
Properties not subject to depletion.....		—	—	—
Investment in KKM and other oil and gas property costs — full cost method Republic of Kazakhstan.....		68,948	—	—
		68,948	93,647	121,289
Other property, plant and equipment	6	109	8,210	9,408
		69,057	101,857	130,697
Less — accumulated depreciation, depletion, and amortisation.....		(1,206)	(28,302)	(44,758)
Property, plant and equipment, net		67,851	73,555	85,939
Total assets		<u>69,037</u>	<u>87,308</u>	<u>98,668</u>

CHAPARRAL RESOURCES, INC.**Consolidated Balance Sheets**

As at 31 December 2001, 2002 and 2003

Expressed in thousands of US dollars

	Note	2001	2002	2003
Liabilities and stockholders' equity				
Current liabilities:				
Accounts payable		536	2,772	6,086
Accounts payable to affiliates	18	—	37	1,143
Accrued liabilities:				
Accrued compensation		449	227	949
Other accrued liabilities	8	144	2,432	1,571
Accrued interest payable	11	1,745	250	776
Current income tax liability	13	—	1,939	3
Shell capital loan		34,902	—	—
Current portion of loans payable to affiliates	11	—	6,000	12,000
Redeemable preferred stock, current portion		2,000	—	—
Total current liabilities		39,776	13,657	22,528
Accrued production bonus	9	—	477	190
Loans payable to affiliates	11	—	27,998	21,284
Deferred tax liability	13	—	746	3,057
Minority interest		—	321	4,635
Asset retirement obligation	10	—	—	804
Commitments and contingencies	16	—	—	—
Redeemable preferred stock — cumulative, convertible, Series A 75,000 designated, issued and outstanding — none and 50,000 shares as of 31 December 2002 and 31 December 2001, respectively		3,900	—	—
Stockholders' equity:				
Common stock — authorised, 100,000,000 shares of U.S.\$0.0001 par value; issued and outstanding, 38,209,502 and 38,209,502 shares as of 31 December 2003 and 31 December 2002, respectively	12	1	4	4
Capital in excess of par value		94,061	107,226	107,226
Preferred stock — 1,000,000 shares authorised, 925,000 shares undesignated. Issued and outstanding — none		—	—	—
Accumulated deficit		(68,701)	(63,121)	(61,060)
Total stockholders' equity		25,361	44,109	46,170
Total liabilities and stockholders' equity		69,037	87,308	98,668

CHAPARRAL RESOURCES, INC.**Consolidated Statements of Operations**

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars, except per share amounts

	Note	2001	2002	2003
Revenue.....		—	45,133	57,615
Costs and expenses:				
Transportation costs		—	9,427	11,474
Operating expenses		—	7,678	5,915
Impairment of materials inventory.....		—	203	—
Depreciation, depletion, and amortisation		753	12,804	18,038
Advisory fee.....	18	—	—	300
Hedge losses.....	7	237	762	—
General and administrative		4,330	6,811	7,762
		<u>5,320</u>	<u>37,685</u>	<u>43,489</u>
Income/(loss) from operations		(5,320)	7,448	14,126
Other income/(expense):				
Interest income		1,454	8	24
Interest expense.....		(14,446)	(5,605)	(4,526)
Equity income from investment.....	20	4,616	—	—
Accretion expense		—	—	(73)
Currency exchange gain/(loss).....		—	(131)	(62)
Minority interest.....		—	(241)	(4,314)
Other.....		—	(15)	(11)
		<u>(8,376)</u>	<u>(5,984)</u>	<u>(8,962)</u>
Income/(loss) before income taxes, extraordinary gain, and cumulative effect of change in accounting principle.....		(13,696)	1,464	5,164
Income tax expense.....	13	—	(2,685)	(4,121)
Income/(loss) before extraordinary gain and cumulative effect of change in accounting principle....		(13,696)	(1,221)	1,043
Extraordinary gain.....	11	—	5,338	—
Cumulative effect of change in accounting principle, net of taxes of U.S.\$436,000 for 2003 and U.S.\$0 for 2001.....	7 & 10	(2,519)	—	1,018
Net income/(loss)		<u>(16,215)</u>	<u>4,117</u>	<u>2,061</u>

CHAPARRAL RESOURCES, INC.**Consolidated Statements of Operations**

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars, except per share amounts

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Net income/(loss)	(16,215)	4,117	2,061
Cumulative annual dividend accrued Series A Redeemable Preferred Stock	(250)	—	—
Discount accretion Series A Redeemable Preferred Stock	(100)	—	—
Net income/(loss) available to common Stockholders	<u>(16,565)</u>	<u>4,117</u>	<u>2,061</u>
Basic and diluted earnings per share:			
Income/(loss) per share before extraordinary gain and cumulative effect of change in accounting principle	(0.98)	(0.04)	0.03
Extraordinary gain	—	0.18	—
Cumulative effect of change in accounting principle	(0.18)	—	0.02
Net income/(loss) per share	(1.16)	0.14	0.05
Weighted average number of shares outstanding (basic and diluted)	14,283,788	29,753,569	38,209,502

CHAPARRAL RESOURCES, INC.**Consolidated Statements of Cash Flows**

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cash flows from operating activities:			
Net income/(loss)	(16,215)	4,117	2,061
Adjustments to reconcile net income/(loss) to net cash provided in operating activities:			
Equity income from investment.....	(4,616)	—	—
Depreciation, depletion, and amortisation	1,333	12,804	18,038
Loss on disposition of assets.....	—	15	11
Deferred Income taxes	—	746	2,311
Cumulative effect of change in accounting principle	2,519	—	(1,018)
Hedge losses.....	237	762	—
Accretion expense on ARO.....	—	—	73
Amortisation of debt issuance cost	3,102	—	—
Amortisation of note discount.....	—	234	286
Extraordinary gain on restructuring of debt.....	—	(5,338)	—
Interest expense from transfer of net profits interest	4,369	—	—
Non-cash interest expense.....	—	2,753	—
Minority interest.....	—	241	4,314
Changes in assets and liabilities:			
(Increase)/decrease in:			
Accounts receivable	295	(1,960)	870
Prepaid expenses	(43)	(614)	(775)
Crude oil inventory	—	(240)	55
Accrued interest income on advances to KKM	(1,452)	—	—
Interest payments from KKM	5,799	—	—
Increase/(decrease) in:			
Accounts payable and accrued liabilities	396	(5,560)	(2,094)
Accrued interest payable	1,676	261	526
Other liabilities.....	—	288	213
Interest expense reclassified as principal on the Shell Capital loan	4,272	—	—
Net cash provided by operating activities.....	<u>1,672</u>	<u>8,509</u>	<u>24,871</u>

CHAPARRAL RESOURCES, INC.**Consolidated Statements of Cash Flows**

For the Years Ended 31 December 2001, 2002 and 2003

Expressed in thousands of U.S. dollars

	<u>2001</u>	<u>2002</u>	<u>2003</u>
Cash flows from investing activities			
Additions to property, plant, and equipment	(18)	(11,834)	(24,800)
Investment in and advances to KKM.....	(7,734)	—	—
Acquisition of 10% interest in KKM, net of cash acquired	—	(644)	—
Materials and supplies inventory	—	353	(732)
Proceeds from disposition of assets	—	5	5
Net cash used in investing activities	<u>(7,752)</u>	<u>(12,120)</u>	<u>(25,527)</u>
Cash flows from financing activities			
Net proceeds from Shell Capital loan	5,650	—	—
Proceeds from sale of stock	—	8,000	—
Proceeds from loans from affiliates	—	40,000	6,500
Payments on Shell Capital loan	—	(30,450)	—
Debt restructuring and issuance costs	—	(2,518)	—
Payments on loans from affiliates	—	(5,000)	(7,500)
Redemption of Series A Preferred Stock	—	(2,300)	—
Net cash provided/(used) by financing activities	<u>5,650</u>	<u>7,732</u>	<u>(1,000)</u>
Net increase/(decrease) in cash and cash equivalents.....	(430)	4,121	(1,656)
Cash and cash equivalents at beginning of year	<u>604</u>	<u>174</u>	<u>4,295</u>
Cash and cash equivalents at end of year	<u>174</u>	<u>4,295</u>	<u>2,639</u>
Supplemental cash flow disclosure			
Interest paid	986	3,019	4,282
Income taxes paid.....	—	—	5,019
Supplemental schedule of non-cash investing and financing activities			
Non-cash additions to oil and gas properties	—	—	3,939
Common stock issued for 10% interest in KKM.....	—	2,701	—
Discount recognised for note issued with stock warrants.....	—	2,466	—

CHAPARRAL RESOURCES, INC.
Consolidated Statements of Changes in Stockholders' equity

	Common Stock Shares	Amount	Capital in Excess of Par Value	Unearned Restricted Stock Awards	Accumulated Deficit	Total
Balance at						
31 December 2000	14,283,634	1	94,061	—	(52,136)	41,926
Capital stock issued for services.....	167	—	—	—	—	—
Cumulative dividend Series A redeemable Preferred Stock	—	—	—	—	(250)	(250)
Discount accretion on redeemable preferred stock	—	—	—	—	(100)	(100)
Net loss for the year 2001	—	—	—	—	(16,215)	(16,215)
Balance at						
31 December 2001....	14,283,801	1	94,061	—	(68,701)	25,361
Capital stock issued in private placement..	22,925,701	3	7,998	—	—	8,001
Capital stock issued for 10% interest in KKM	1,000,000	—	2,701	—	—	2,701
CAIH warrants issued	—	—	2,466	—	—	2,466
Discount accretion on redeemable preferred stock	—	—	—	—	(36)	(36)
Cumulative dividend Series A Redeemable Preferred Stock	—	—	—	—	(90)	(90)
Redemption of Series A Redeemable Preferred Stock	—	—	—	—	3,726	3,726
Adjustment due to full consolidation of KKM	—	—	—	—	(2,137)	(2,137)
Net income for the year 2002	—	—	—	—	4,117	4,117
Balance at						
31 December 2002....	38,209,502	4	107,226	—	(63,121)	44,109
Net income for the year 2003	—	—	—	—	2,061	2,061
Balance at						
31 December 2003....	38,209,502	4	107,226	—	(61,060)	46,170

Notes to the Financial Information
31 December 2001, 2002 and 2003

(Tabular amounts are expressed in thousands of U.S. dollars, except share amounts)

1. Organisation and basis of preparation

Chaparral Resources, Inc. ("Chaparral") was incorporated in the state of Colorado on 13 January 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 Republic of Kazakhstan. In 1999, Chaparral reincorporated from Colorado to Delaware.

The financial information is prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") except for the exclusion of certain Unaudited Supplemental Information which is set out in Part IV, Section 5 of the admission document of the Company dated 13 July 2004. All amounts are stated in U.S. dollars unless otherwise indicated.

2. Significant accounting policies

The principal accounting policies followed by Chaparral are described below:

(a) Principles of consolidation

The consolidated financial information includes the accounts of Chaparral and its greater than 50 per cent. owned subsidiaries, Closed Type JSC Karakudukmunay ("KKM"), Central Asian Petroleum (Guernsey) Limited ("CAP-G"), Korporatsiya Mangistau Terra International ("MTI"), Road Runner Services Company ("RRSC"), Chaparral Acquisition Corporation ("CAC"), and Central Asian Petroleum, Inc. ("CAP-D"). Chaparral owns 80 per cent. of the common stock of CAP-G directly and 20 per cent. indirectly through CAP-D. Hereinafter, Chaparral and its subsidiaries are collectively referred to as the "Company." All significant intercompany transactions have been eliminated.

As of 31 December 2003, Chaparral owns a 60 per cent. interest in KKM, a Kazakhstan Joint Stock Company of Closed Type. KKM was formed to engage in the exploration, development, and production of oil and gas properties in the Republic of Kazakhstan. KKM's only significant investment is in the Karakuduk Field, an onshore oil field in the Mangistau Region of the Republic of Kazakhstan. On 30 August 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 per cent.), MTI (10 per cent.), and KazMunayGaz JSC ("Kazmunaigas") (40 per cent.). In May 2002, Chaparral increased its ownership in KKM from 50 per cent. to 60 per cent. through the acquisition of 100 per cent. of the outstanding stock of MTI, a Kazakhstan company. Kazmunaigas, the national petroleum company of Kazakhstan, is owned by the government of the Republic of Kazakhstan.

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

(b) Acquisition

In May 2002, the Company acquired 100 per cent. of the outstanding shares of MTI from Dardana Limited. MTI's only asset was its 10 per cent. 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 U.S.\$3.9 million, including U.S.\$1.2 million of cash and common stock valued at U.S.\$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 to and announced. As a result, the total purchase price of U.S.\$3.9 million was recorded as an addition to the Company's oil and gas properties.

At the date of this report, Canaccord Capital (Europe) Ltd. and Hoare Govett Limited have received irrevocable signed placing letters from placees in the amount of U.S.\$200 million (being the gross amount of the fundraising).

(c) Going concern

The Consolidated Financial Statements of Chaparral as at and for the year ended 31 December 2001, 31 December 2002 and 31 December 2003 were prepared on the basis of a going concern.

The directors stated in Note 2 to the financial statements for the years ended 31 December 2001 and 31 December 2002 that Chaparral's ability to continue as a going concern depended upon its ability to raise external financing, however, Chaparral has continued as a going concern for more than twelve months from the date of those financial statements.

The directors stated in Note 2 to the financial statements for the year ended 31 December 2003 that due to uncertainties relating to Chaparral's ability to meet all expenditure and cash flow requirements through the next twelve months that substantial doubt existed as to Chaparral's ability to continue as a going concern. Chaparral has now been acquired by Nelson Resources Limited and the Group has sufficient funds to continue as a going concern.

(d) Cash and cash equivalents

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

(e) Revenue recognition

Revenue and related costs are recognised upon delivery of commercial quantities of oil production produced 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.

(f) 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. 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 recognised 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 U.S.\$3.7 million of net monetary liabilities denominated in Tenge as of 31 December 2003.

(g) Interest capitalisation

The Company capitalises interest on significant construction projects. Statement of Financial Accounting Standards ("SFAS") 34, Capitalisation of Interest Costs, provides standards for the capitalisation of interest costs as part of the historical cost of acquiring assets. FASB-Interpretation ("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 amortisation ("DD&A") expense is not currently taken and on which exploration or development activities are in progress, qualify for capitalisation of interest. Capitalised interest is calculated by multiplying the weighted-average interest rate on debt by the amount of costs excluded. Capitalised interest cannot exceed gross interest expense. The Company incurred interest costs of U.S.\$5.19 million and U.S.\$6.24 million for the years ended 31 December 2003 and 2002, respectively. For the same periods, the Company capitalised interest totaling U.S.\$662,000, and U.S.\$631,000, respectively.

(h) 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 capitalised.

All capitalised costs of proved oil and gas properties, including the estimated future costs to develop proved reserves, are amortised on the unit-of-production method using estimated proved reserves. Investments in unproved properties and major development projects are not amortised 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 capitalised cost to be amortised.

In addition, the capitalised 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 capitalised costs with no gain or loss recognised, unless such adjustments would significantly alter the relationship between capitalised costs and proved reserves of oil and gas, in which case the gain or loss is recognised in income. Abandonment of properties is accounted for as adjustments of capitalised costs with no loss recognised.

(i) Other property, plant and equipment

Other property, plant and equipment are valued at historical cost and are 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

(j) Inventory

Crude oil inventory is valued using the *first-in, first-out* method, at the lower of cost or net realisable value. Crude oil inventory 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 31 December 2003 and 2002 represented approximately 74,000 barrels and 87,000 barrels of crude oil, respectively.

Materials and supplies inventory is valued using the first-in, first-out method and is recorded at the lower of cost or net realisable 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, tangible drilling costs (drill bits, tubing, casing, wellheads, etc.) required for development drilling operations, spare parts, diesel fuel, and various materials for use in oil field operations.

(k) Earnings per common share

Basic Earnings Per Share (“EPS”) is computed by dividing income (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 years ended 31 December 2003, 2002 and 2001 are the same, as the assumed conversion of all potentially dilutive securities would be anti-dilutive.

(l) New accounting standards

In December 2003, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 104 Revenue Recognition (“SAB 104”), which codifies, revises and rescinds certain sections of SAB No. 101, Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The changes noted in SAB 104 did not have a material effect on the Company’s consolidated financial information.

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 30 June 2003 (with a few exceptions) and for hedging relationships designated after 30 June 2003. The guidance is to be applied prospectively only. The adoption of SFAS No. 149 as of 1 July 2003 had no effect on the Company’s consolidated financial information.

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 31 May 2003, and was otherwise effective for the Company as of 1 July 2003. The adoption of the applicable provisions of this statement as of the indicated dates has no effect on the Company’s financial information.

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 when and which business enterprise (the “primary beneficiary”) should consolidate the variable interest entity. 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 31 January 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 1 February 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 15 December 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 15 March 2004.
- (iii) All entities, regardless of whether a SPE, that were created subsequent to 31 January 2003. The provisions of FIN 46 were applicable for variable interests in entities obtained after 31 January 2003. The company is required to adopt FIN 46-R at the end of the first interim or annual reporting period ending after 15 March 2004.

The adoption of the provisions applicable to SPEs and all other variable interests obtained after 31 January 2003 did not have a material impact on the Company’s financial information.

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 15 June 2002. The Company adopted SFAS 143 on 1 January 2003. See Note 10 for the effect of the adoption of SFAS 143.

The EITF currently is deliberating on EITF No. 04-2 “Whether Mineral Rights Are Tangible or Intangible Assets” and EITF No. 03-S “Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Oil and Gas Companies.” These proposed statements will determine whether contract-based oil and gas mineral rights are classified as tangible or intangible assets based on the EITF’s interpretation of SFAS No. 141 and SFAS No.142. Historically, the Company has classified all of its contract-based mineral rights within property, plant, and equipment and has generally not identified these amounts separately. If the EITF determines that these minerals rights should be presented as intangible assets, Chaparral would have to reclassify its contract-based oil and gas minerals rights acquired after 30 June 2001 to intangible assets and make additional disclosures in accordance with SFAS No. 142. The Company has not acquired any contract-based mineral rights after 30 June 2001. Therefore, the adoption of this change will not have an effect on the Company’s financial information.

(m) 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.

(n) 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.

(o) Risks and uncertainties

The ability of the Company to realise 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.

3. 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 Company’s 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 31 December 2003 and 2002, the Company utilised its VAT receivable to offset fiscal obligations for approximately U.S.\$2.58 million and U.S.\$1.6 million against other fiscal obligations respectively.

4. Prepaid Expenses

The breakdown of Prepaid expenses at 31 December, 2001, 2002 and 2003 is as follows:

	Year ended 31 December		
	2001	2002	2003
Description			
Prepaid transportation costs to KTO.....	—	584	1,296
Advanced payments for materials and supplies.....	—	1,352	1,616
Prepaid insurance	245	104	210
Other prepaid expenses	—	416	114
Total prepaid expenses	245	2,456	3,236

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

5. Oil and Gas Properties — Full Cost

The Company has capitalised 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 capitalisable costs allowed under the full cost method of accounting. Overhead and general and administrative costs have been expensed as incurred.

The Company calculates depreciation, depletion, and amortisation of oil and gas properties using the units-of-production method. The provision is computed by multiplying the unamortised costs of proved oil and gas properties by a production rate calculated by dividing the physical units of oil and gas produced during the relevant period by the total estimated proved reserves. The unamortised costs of proved oil and gas properties include all capitalised costs net of accumulated amortisation, estimated future costs to develop proved reserves, and estimated dismantlement 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 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 recognised total amortisation expense of U.S.\$17.30 million and U.S.\$12.08 million for the years ended 31 December 2003 and 2002, respectively. For the same periods, the Company has an effective amortisation rate of U.S.\$6.42 and U.S.\$4.90 per barrel, respectively. The Company's amortisation expense during 2001 was U.S.\$730,000. Amortisation expense from KKM of U.S.\$8.67 million during 2001 was accounted for under the equity method.

In accordance with SFAS 19, Financial Accounting and Reporting by Oil and Gas Producing Companies, the Company accounts for amortisation of crude oil production as a component of crude oil inventory until the related crude oil is sold. For the years ended 31 December 2003 and 2002, the Company had U.S.\$423,000 and U.S.\$372,000 of amortisation expense allocated to crude oil inventory, respectively.

Costs capitalised to oil and gas properties consist of:

	Year ended 31 December	
	2002	2003
Description		
Acquisition costs	10,633	10,633
Exploration and appraisal costs	22,277	22,277
Development cost	54,920	81,366
Other capitalised cost	1,097	1,097
Capitalised interest	4,720	5,275
Asset Retirement Obligation	—	641
Total oil and gas properties at cost	93,647	121,289
Total costs not subject to amortisation	8,814	2,942
Total costs subject to amortisation	84,833	118,347
Accumulated amortisation	(25,105)	(40,915)
Net properties subject to amortisation	59,728	77,432

The Company's oil and gas properties and investments for the year ended 31 December 2001 include investments in KKM's common stock, advances to KKM, acquisition costs for CAP-G, and other capitalisable costs allowed under the full cost method of accounting. Accumulated equity losses in KKM and accumulated depletion have been netted against the gross capitalised costs.

Cost capitalised to oil and gas properties and investments for the year ended 31 December 2001 is as follows:

	Year ended 31 December 2001
Description	
Investment in KKM and other oil and gas Property costs — full cost method Republic of Kazakhstan	
Investments in KKM common stock.....	100
Advances to and interest due from KKM	58,674
Acquisition costs	6,244
Other capitalisable costs	1,097
Equity income.....	2,833
Total gross oil and gas investments	68,948
Accumulated amortisation.....	(1,142)
Total oil and gas properties and investment.....	67,806

The condensed financial statements of KKM are as follows:

	Year ended 31 December 2001	2002	2003
Description			
Condensed balance sheet			
Current assets	4,331	10,874	9,109
Non-current assets (primarily oil and gas properties, full cost method).....	67,117	66,949	81,551
Current liabilities.....	15,589	15,834	24,544
Non-current liabilities			
Loan payable to related party.....	58,438	31,809	29,977
Loans payable to affiliates.....	—	27,000	20,000
Other non-current liabilities	1,496	2,376	4,551
Charter capital	200	200	200
Retained earnings/ (accumulated deficit)	(4,275)	604	11,388
Condensed income statement			
Revenues	36,575	45,133	57,615
Other costs and expenses	(30,248)	(40,255)	(46,830)
Net income.....	6,327	4,878	10,785

6. Other Property, Plant and Equipment

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

	Year ended 31 December 2001	2002	2003
Description			
Office buildings and apartments	—	326	879
Office equipment and furniture	109	917	1,026
Vehicles.....	—	1,419	1,435
Land.....	—	25	25
Field buildings.....	—	4,948	5,413
Field equipment and furniture.....	—	575	630
Total cost	109	8,210	9,408
Accumulated depreciation.....	(64)	(3,197)	(3,843)
Property, plant and equipment, net	45	5,013	5,565

Depreciation expense for property, plant, and equipment was U.S.\$734,000, U.S.\$724,000, and U.S.\$23,000 for the years ending 31 December 2003, 2002 and 2001, respectively.

7. Hedge Agreement

During 2000, the Company paid U.S.\$4 million for put contracts to sell approximately 1.56 million barrels of North Sea Brent crude (the “Hedge Agreement”) to hedge price risk of future sales of oil production from the Karakuduk Field. The exercise prices of the various put contracts in the Hedge Agreement range from U.S.\$22.35 to U.S.\$17.25 per barrel, with monthly expiration dates beginning in October 2000 and ending in December 2002. The contracts were evenly spread between October 2000 to December 2001 (62,750 barrels per month) and between January 2002 to December 2002 (51,750 barrels per month).

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 15 June 2000. The Company adopted SFAS 133 on 1 January 2001. As a result of adoption of SFAS 133, the Company recognises 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 recognised 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. Accordingly, the Company recognised a U.S.\$2.52 million loss from the cumulative effect of change in accounting principle upon adoption. In addition and in accordance with SFAS 133, the Company recognised U.S.\$762,000 loss for the year ended 31 December 2002 to record the Hedge Agreement at its fair value as of that date. The Hedge Agreement expired in December 2002 and the Company did not enter into any hedge agreements during 2003.

8. Other Accrued Liabilities

Description	Year ended 31 December		
	2001	2002	2003
Accrued taxes payable	—	2,238	910
Production bonus.....	—	—	500
Other accrued liabilities	144	194	161
Total accrued liabilities	144	2,432	1,571

9. Accrued Production Bonus

Accrued production bonus represents production based bonuses, which will be payable to the Government of Kazakhstan, amounting to U.S.\$500,000 when cumulative production reaches 10 million barrels and U.S.\$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 U.S.\$213,000 and U.S.\$201,000 in production bonuses for the years ended 31 December 2003 and 2002, respectively. In addition, the first production bonus is expected to be paid during the second quarter 2004.

10. Asset Retirement Obligation

As discussed in Note 1, effective 1 January 2003, the Company changed its method of accounting for asset retirement obligations in accordance with SFAS 143, Accounting for Asset Retirement Obligations. Previously, the Company used an amount equal to the undiscounted cash flows associated with the asset retirement obligation (“ARO”) in determining depreciation, depletion, and amortisation (“DD&A”) rates. Under the new accounting method, the Company now recognises 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 capitalised 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 U.S.\$1.02 million, net of tax of U.S.\$436,000, or U.S.\$0.02 per share, which is included in income for the year ended 31 December 2003.

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

On 12 February 2003, the Company commenced a new drilling campaign to further develop and commercially produce the oil reserves in the Karakuduk Field. As a result of the new drilling campaign, the Company revised its estimate of retirement costs to include expected additions to the Karakuduk Field during 2003. This change in estimate did not result in a direct charge to income for the year ended 31 December 2003.

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

	Year ended 31 December 2003
Description	
Asset retirement obligation at beginning of year	—
Liability recognised in transition	516
Accretion expense	73
Revision in estimated cash flows	215
Asset retirement obligation at end of year	804

The pro forma effects of the application of SFAS 143 as if the Statement had been adopted for periods prior to 1 January 2003 are presented below:

The pro forma asset retirement obligation liability balances as if Statement 143 had been adopted on 1 January 2001 (rather than 1 January 2003) are as follows (in thousands);

	Year ended 31 December 2001	2002	2003
Description			
Pro forma amounts of liability for asset retirement obligation at beginning of year	426	467	516
Pro forma amounts of liability for asset retirement obligation at end of year	467	516	804

The Pro forma amounts assuming the accounting change is applied retroactively (in thousands, except share data);

Pro forma amounts assuming the accounting change is applied retroactively net-of-tax:

	Year ended 31 December 2001	2002	2003
Description			
Income/(loss) before extraordinary gain and cumulative effect of change in accounting principle	(13,643)	(708)	1,043
Net income/(loss)	(16,162)	4,630	2,061
Income/(loss) per share before extraordinary gain and cumulative effect of change in accounting principle	(0.96)	(0.02)	0.03
Net income/(loss) per share	(1.13)	0.16	0.05

11. Loans Payable to Affiliates

CAIH Note

In May 2002, the Company received a total equity and debt capital infusion of U.S.\$45 million, which was partially utilised 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 U.S.\$12 million from Central Asian Industrial Holdings, N.V. ("CAIH"), including U.S.\$8 million in exchange for 22,925,701 shares,

or 60 per cent., of the Company's outstanding common stock, and U.S.\$4 million in exchange for a three year note bearing interest at 12 per cent. per annum (the "CAIH Note"). Along with the CAIH Note, CAIH received a warrant to purchase 3,076,923 shares of the Company's common stock at U.S.\$1.30 per share (the "CAIH Warrant"). Additionally, JSC Kazkommertsbank ("Kazkommertsbank"), an affiliate of CAIH, provided KKM with a credit facility totaling U.S.\$33 million (the "KKM Credit Facility"), consisting of U.S.\$28 million that was used to repay a portion of the Shell Capital Loan and U.S.\$5 million that was made available for KKM's working capital requirements. The Company paid CAIH U.S.\$1.79 million as a related restructuring fee.

The CAIH Note was recorded net of a U.S.\$2.47 million discount, based on the fair market value of the CAIH Warrant issued in conjunction with the CAIH Note. The discount is amortised using the effective interest rate over the life of the CAIH Note. The principal balance of the CAIH Note is due on 10 May 2005 and accrued interest is payable quarterly. The CAIH Warrant is fully discussed in Note 12.

In June 2002, the Company prepaid U.S.\$2 million of the U.S.\$4 million outstanding principal balance of the CAIH Note. As a result, the Company recognised an extraordinary loss on the early extinguishment of debt of U.S.\$1.22 million from the write-off of 50 per cent. of the unamortised discount on the CAIH Note. The extraordinary loss was netted against the extraordinary gain from the restructuring of the Shell Capital Loan. The Company recognised U.S.\$423,000 in interest expense on the CAIH Note for the year ended 31 December 2002 and U.S.\$526,000 for the year ended 31 December 2003. The CAIH Note is presented net of U.S.\$716,000 remaining discount as of 31 December 2003.

In addition, as a result of the restructuring of the Shell Capital Loan, the Company recognised a U.S.\$6.56 million extraordinary gain on the extinguishment of debt due to the restructuring of the Shell Capital Loan. The extraordinary gain reflects the forgiveness of U.S.\$9.07 million in principal, interest, and fees previously owed to Shell Capital, less U.S.\$1.79 million in restructuring fees paid to CAIH, U.S.\$509,000 in professional fees, and U.S.\$220,000 in other costs and expenses. The Company recognised U.S.\$2.75 million and U.S.\$10.01 million in interest expense on the Shell Capital loan during 2002 and 2001, respectively. As of May 2002, the Company has no further commitments or obligation under the Shell Capital Loan.

KKM Credit Facility

In May 2002, KKM established a five-year, U.S.\$33 million credit line with Kazkommertsbank. The KKM Credit Facility consists of a U.S.\$30 million non-revolving line and a U.S.\$3 million revolving line, both of which were fully borrowed by KKM in May 2002. The Company recognised U.S.\$4.0 million and U.S.\$3.08 million of interest expense on the KKM Credit Facility for the years ended 31 December 2003 and 2002, respectively. Accrued interest payable as of 31 December 2003 on the KKM Credit Facility amounts to U.S.\$776,000.

The non-revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14 per cent. and is repayable over a five-year period with final maturity in May 2007. Accrued interest is payable quarterly, beginning in December 2002; KKM started making quarterly principal payments in May 2003. As of 31 December 2003, the Company has repaid U.S.\$3 million in principal and is in compliance with all the terms of the KKM Credit Facility.

The revolving portion of the KKM Credit Facility accrues simple interest at an annual rate of 14 per cent. The revolver is loaned to KKM for short-term periods of up to one year, but KKM has the right to re-borrow the funds through May 2006 with final repayment due in May 2007. The initial U.S.\$3 million revolving loan to KKM was subject to a three-month term. The principal balance was repaid in July 2002 and KKM immediately re-borrowed another U.S.\$3 million with a maturity date of 31 July 2003. KKM repaid the U.S.\$3 million due on 31 July 2003 and exercised its right to re-borrow another U.S.\$3 million with a maturity date of 31 July 2004. In addition, on 30 December 2003, Kazkommertsbank increased the revolving portion of the KKM Credit Facility from U.S.\$3 million to U.S.\$5 million. On the same date, KKM borrowed the additional U.S.\$2 million to finance ongoing operations. The additional U.S.\$2 million accrued interest at 14 per cent. and principal and interest is due in full on 30 June 2004. All amounts due in 2004 under the revolving portion of the KKM Credit Facility are classified as current as of 31 December 2003.

The original KKM Credit Facility included repayment terms of three years and four years for the non-revolving and revolving portions of the KKM Credit Facility, respectively, with an option to extend the final maturity date for repayment of the entire KKM Credit Facility to five years. In May 2002, KKM exercised the option to extend the repayment term to five years with final maturity in May 2007 for the entire KKM Credit Facility.

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

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

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

The maturity schedule of the Company's indebtedness as of 31 December 2003 is as follows:

Date	Principal Amount Due
2004	12,000
2005	10,000
2006	8,000
2007	4,000
Total principal due.....	34,000
Less:	
Principal due within one year.....	(12,000)
Unamortized debt issue cost.....	(716)
Net long-term principal due	21,284

Line of Credit

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

12. Common Stock

General

1998 Incentive and Non-statutory Stock Option Plan

On 26 June 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 nonstatutory stock options. The 1998 Plan has an effective term of ten years, commencing on 20 May 1998. The Company has not granted any options under the 1998 Plan as of 31 December 2003.

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 31 December 2003.

Non-Qualified Stock Options

During 2003, stock options to purchase 2,817 shares of the Company's common stock granted in 1997 to various employees and consultants of the Company expired. The expired options had exercise prices ranging between U.S.\$43.20 and U.S.\$142.50 per share.

Common Stock Offerings and Common Stock Warrant Issuances

In 1996, the Company sold 233,334 shares of common stock in a private placement at a price of U.S.\$30 per share. In connection with the private placement, the Company issued warrants to purchase 17,033 shares of the Company's common stock for a total of U.S.\$10 to the sales agent as a commission. In April 2002, the 17,033 warrants expired.

During February 1997, the Company entered into a severance agreement with Paul V. Hoovler, a former Chief Executive Officer and President of the Company, pursuant to which Mr. Hoovler received warrants to purchase 1,667 shares of the Company's common stock at an exercise price of U.S.\$51 per share and warrants to purchase 1,667 shares of the Company's common stock at an exercise price of U.S.\$75 per share. The 3,334 warrants expired in February 2001.

In January 1998, the Company granted 500 shares of the Company's common stock to an employee of the Company, which vested rateably on 30 January 1999, 2000, and 2001, respectively. The Company recognized U.S.\$45,000 as compensation expense, amortized over the vesting period of the grants.

As discussed in Note 11, Shell Capital's warrant for 1,785,455 shares of the Company's common stock was canceled on May 2002 as part of the restructuring of the Shell Capital Loan. The warrants had an exercise price of U.S.\$9.79.

In November 1997, the Company entered into a subscription agreement with an unaffiliated investor to purchase 225,000 shares of the Company's designated Series A, B, and C Redeemable Preferred Stock, for U.S.\$100 per share. As of 31 December 1997, the investor had purchased 50,000 shares of the Company's Series A Redeemable Preferred Stock for U.S.\$5 million. The Company issued a warrant for 15,000 shares at an exercise price of U.S.\$0.60 per share as compensation to the placement agent in connection with the subscription agreement. On 24 November 2002, the 15,000 share warrant expired.

On 5 August 1998, the Company retired two outstanding loans, totalling U.S.\$1,000,000. The Company borrowed the U.S.\$1,000,000 on 3 June 1998, subject to a 7 per cent. interest rate. In conjunction with the loans, the Company issued warrants to purchase 16,667 shares of the Company's common stock, at an exercise price of U.S.\$210 per share. On 25 November 2002, the 16,667 warrants expired.

In May 2002, the Company issued 1 million shares of its outstanding common stock valued at U.S.\$2.7 million and U.S.\$1.2 million in cash to Dardana Limited, in exchange for 100 per cent. of the stock of MTI, which owns a 10 per cent. interest in KKM.

As discussed in Note 11, the Company issued to CAIH a warrant to purchase 3,076,923 shares of the Company's common stock at an exercise price of U.S.\$1.30 per share, subject to certain anti-dilution provisions. The CAIH Warrant is exercisable for five years from 10 May 2002, the date of grant. The fair market value of the CAIH Warrant of U.S.\$2.47 million was recorded as a discount on the CAIH Note. The fair market value of the CAIH 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 per cent., dividend yield of 0 per cent., 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.

As discussed in Note 11, the Company received a total investment of U.S.\$12 million from CAIH, including U.S.\$8 million in exchange for 22,925,701 shares, or 60 per cent., of the Company's outstanding common stock.

In May 2002, the Company repurchased 50,000 shares of its Series A Redeemable Preferred Stock from an unrelated party for U.S.\$2.3 million. The Series A Redeemable Preferred Stock had a carrying value of approximately U.S.\$6 million, including U.S.\$1.1 million in accrued dividends. The U.S.\$3.7 million difference between the redemption price and the carrying value was recorded directly to retained earnings.

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 2000, 2001, 2002 and 2003 and all outstanding options were fully vested as of 31 December 1999, therefore pro-forma information is not presented.

A summary of the Company's stock option activity and related information for the periods ended follows:

	Shares Under Option	Weighted Average Exercise Price	Weighted Average Fair Value
Unexercised options outstanding — 31 December 2000	57,516	67.73	—
Options Cancelled	—	—	—
Unexercised options outstanding — 31 December 2001	57,516	67.73	—
Options Cancelled	(54,700)	66.32	—
Unexercised options outstanding — 31 December 2002	2,816	95.10	—
Options Cancelled	(2,816)	95.10	—
Unexercised options outstanding — 31 December 2003	—	—	—
Exercisable options			
31 December 2001	57,516	67.73	—
31 December 2002	2,816	95.10	—
31 December 2003	0	—	—

The following table summarizes all common stock purchase warrant activity:

	Number of Stock Warrants	Exercise Price Range
Outstanding, 31 December 2000	1,837,822	\$0.0006 – \$210
Expired	(3,334)	\$51 – \$75
Outstanding, 31 December 2001	1,834,488	\$0.0006 – \$210
Granted	3,076,923	\$1.30
Expired	(48,700)	\$0 – \$210
Cancelled	(1,785,455)	\$9.79
Outstanding as of 31 December 2002	3,077,256	\$0.60 – \$1.30
Expired	(333)	\$0.60
Outstanding as of 31 December 2003	3,076,923	\$1.30

13. 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 31 December		
Description	2001	2002	2003
Domestic	(13,696)	(5,923)	(3,883)
Foreign	—	7,387	9,047
	<u>(13,696)</u>	<u>1,464</u>	<u>5,164</u>

The components of the income tax provision (benefit) are as follows:

Description	Year ended 31 December		
	2001	2002	2003
Income tax provision:			
Current.....			
Domestic.....	—	—	—
Foreign	—	1,939	2,246
Total current.....	—	1,939	2,246
Deferred.....			
Domestic.....	—	—	—
Foreign	—	746	1,875
Total deferred.....	—	746	1,875
Total provision for income taxes	—	2,685	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:

Description	Year ended 31 December		
	2001	2002	2003
Deferred tax assets:			
Oil and gas assets	400	660	983
Sales of assets.....	—	28	23
Obsolete inventory	—	48	52
Amortisation of derivatives.....	1,133	1,400	1,400
Compensation and accrued expenses.....	786	41	1,022
Capital loss on transfer of net profits interest	1,529	1,529	1,529
Net operating loss carry-forwards.....	10,550	9,231	8,645
Deferred tax assets	14,398	12,937	13,654
Valuation allowance.....	(14,398)	(12,751)	(13,046)
Total deferred tax assets.....	—	186	608
Deferred tax liabilities:			
Depreciation and other basis differences	—	(932)	(3,665)
Net deferred tax liabilities	—	(746)	(3,057)

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 realised. After consideration of all the evidence, both positive and negative, management has determined that a U.S.\$13,046 valuation allowance at 31 December 2003 is necessary to reduce the deferred tax assets to the amount that will more likely than not be realised. The change in the valuation allowance for the current year is U.S.\$295,000. The increase in valuation allowance is mainly due to domestic operating losses realised during 2003 less expiration of net operating losses from prior years and prior year return to provision adjustments.

As of 31 December 2003, the Company has estimated domestic tax loss carry-forwards of U.S.\$24.7 million. These carry-forwards will expire at various times between 2004 and 2021.

	Expiration of domestic tax loss carry-forward				Total
	1 Year	2-3 Years	4-5 Years	Later Years	
Tax loss carry-forward	913	704	741	22,342	24,700

During 2000 and 2002, 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. During 2003 no such ownership change took place.

Undistributed earnings associated with the Company's interest in KKM amounted to approximately U.S.\$6.83 million at 31 December 2003. 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 unrecognised deferred U.S. income tax liability is not practical because of the complexities associated with the hypothetical calculation; however, unrecognised foreign tax credit forwards would be available to reduce some portion of the U.S. liability. Withholding taxes of approximately U.S.\$1.02 million would be payable upon remittance of all previously unremitted earnings at 31 December 2003.

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

	Year ended 31 December		
	2001	2002	2003
Description			
Income/(loss) before minority interest, income taxes, extraordinary gain, and cumulative effect of change in accounting principle	(13,696)	1,705	9,478
Statutory tax rate	35%	35%	35%
Income taxes (benefit) computed at statutory rate	(4,794)	597	3,317
Losses and expenses with no tax benefit	7	840	1,919
Expiration of NOL carry forwards	663	597	320
Difference in foreign tax rate	—	(378)	(694)
Valuation allowance	4,124	221	295
Reversal of provision for tax claim	—	—	(899)
Additional foreign taxes/(benefit)	—	808	(137)
Income tax provision	—	2,685	4,121

Foreign taxes applicable to the Company are specified under the Agreement with the Government of the Republic of Kazakhstan. As of 31 December 2003, the Company has utilised 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 U.S.\$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 favour of KKM with the exception of U.S.\$255,000 which was upheld. As a result, KKM reversed U.S.\$899,000 of income taxes accrued during 2002 for the Tax Claim net of U.S.\$255,000 which was settled in January 2004.

The Company has used the best estimates available to determine the Company's deferred tax assets and liabilities. Refer to Note 15 regarding the uncertainties of taxation in the Republic of Kazakhstan.

14. Operating Leases

The Company entered into a sublease agreement extending from March 2000 through November 2003. At the expiration date of the lease, the Company moved its registered office from Houston to New York. In addition, the Company entered into a new 6 month lease agreement for reduced office space at a new location in Houston. The Company also maintains an executive office in Almaty, Kazakhstan. The Almaty office is subleased from Nasikhat, an affiliate of Kazkommertsbank, for approximately U.S.\$3,000 per month renewable at the Company's option on 1 September 2004. As of 31 December 2003, the Company's future minimum annual lease payments through the contractual term of these leases are U.S.\$29,000, all due in 2004.

The Company's rental expense for 2003, 2002 and 2001, was approximately U.S.\$144,000, U.S.\$83,000 and U.S.\$77,000, respectively.

15. Commitments and Contingencies

Taxation

As part of the process of preparing the Company's consolidated financial statements, the Company is 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. 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 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 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 stabilisation of taxes and clarification on tax laws applicable to KKM. The amendment increased the KKM royalty rate from 8 per cent. to 8.14 per cent. 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 per cent. from 8.14 per cent. The effect of these changes is reflected on the Company's financial statements as of 31 December 2003.

The Ministry of State Revenues of the Republic of Kazakhstan is currently considering penalties with respect to the Tax Claim in the amount of U.S.\$970,000 (see Note 13). Due to the success of the appeal on the Tax Claim, we expect that the liability with regards to penalties will be reduced to approximately U.S.\$55,000. The date for the court hearing in respect of this claim is anticipated to be decided in March 2004, with the actual hearing to be conducted at a subsequent date. It is our opinion that the ultimate resolution of this claim will not have a material adverse effect on the financial position and operating results of Chaparral.

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 30 August 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.

16. Local Oil Sales Requirements and Export Quotas

The ability of the Company to realise 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 finalising access routes through the KazTransOil pipeline and onward through the Russian pipeline system. The Company has a right to export and receive export quota for 100 per cent. of the production from the Karakuduk Field under the terms of the Agreement.

During 2003, the Company sold crude oil to the following major customers: Vitol Central Asia S.A., Naftex Oil and Shipping Corporation, and Euro-Asian Oil Company Inc, accounting for 61 per cent., 13 per cent. and 12 per cent. of total annual deliveries, respectively.

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. During 2002, the Company sold approximately 363,000 barrels of crude oil on the local market for approximately U.S.\$3.3 million and 2.1 million barrels at world market prices for approximately U.S.\$41.83 million. During 2003 the Company sold approximately 103,000 barrels of crude oil on the local market for approximately U.S.\$947,000 and 2.59 million barrels on the export market for approximately U.S.\$56.67 million. Oil sales at world market prices represent 98 per cent. and 92 per cent. of the Company's oil sales revenues during 2003 and 2002, respectively.

The Company continues to seek an amicable resolution with the Government to eliminate local market requirements. If this matter can not be resolved in a satisfactory manner, the Company has, however, reserved the right to commence formal arbitration proceedings pursuant to its contractual arrangements with the Government (See Note 2).

17. Capital Commitments

As of 31 December 2003, the Company has a drilling contract with KazMunayGas-Drilling (“Kazmunaigas”), an affiliate of Kazmunaigas, for one development drilling rig currently operating in the Karakuduk Field. The rig is contracted through 31 December 2004. The minimum payments under the drilling contract with Kazmunaigas for 2004 are U.S.\$5.52 million. The Company’s other drilling and operations related contracts can either be cancelable within 30 days or are on a call-off (as required) basis.

The Company has no other significant commitments other than those incurred during the normal performance of the work program to develop the Karakuduk field.

18. Related Party Transactions

In 2003, the Company approved a one-year agreement with OJSC Kazkommerts Securities (“KKS”), an affiliate of Kazkommertsbank. The agreement is effective as of 7 January 2003 and provides for KKS to assist the Company’s senior management with financial advisory and investment banking services. In consideration for the services KKS received a monthly fee of U.S.\$25,000 (the “Advisory Fee”).

Kazkommerts Policy, an affiliate of Kazkommertsbank, is the major insurer of KKM oil and gas activities. The current insurance policy expires in November 2004.

KKM has a contract to transport 100 per cent. of its oil sales through the pipeline owned and operated by KTO, a wholly owned subsidiary of Kazmunaigas, the 40 per cent. 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 the company 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 and are dependent upon the point of sale of KKM’s exports. During 2003, KKM paid U.S.\$12 million to KTO, of which U.S.\$11.29 million were recognised as transportation costs for sales during 2003. Comparably during 2002, KKM paid U.S.\$8.93 million to KTO, of which U.S.\$9.30 million were recognised as transportation costs for sales during 2002. See Note 4 for prepaid transportation as of 31 December 2003 and 2002.

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 2003 and 2002 were U.S.\$267,000 and U.S.\$169,000, respectively.

KazmunaigosD, a subsidiary of Kazmunaigos, provided a drilling rig for the drilling campaign, which commenced 12 February 2003 and is contracted to provide the services of a drilling rig throughout 2004.

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

Description	Year ended 31 December		
	2001	2002	2003
Kazkommerts Policy	—	82	524
KTO.....	—	9,476	11,561
KazmunaigosD	—	66	5,999

Accounts Payable Balance to affiliates as of 31 December

Description	Year ended 31 December		
	2001	2002	2003
Kazkommerts Policy	—	—	48
KTO.....	—	37	97
KazmunaigosD	—	—	998
	<u>—</u>	<u>37</u>	<u>1,143</u>

All other related party transactions are disclosed on the face of the balance sheet and in the notes to the financial statements. The loans with Kazkommertsbank and CAIH are disclosed in Note 11 and the drilling contract with KazmunaigosD is described in Note 17 and 18, the lease with Nasikhat is described in Note 14, and prepaid transportation to KTO in Note 4.

19. Independent Auditor's Reports on Financial Statements

The Consolidated Financial Statements of Chaparral as at and for the years ended 31 December 2001, 31 December 2002 and 31 December 2003 were prepared on the basis of a going concern.

The independent auditors' reports on the financial statements for the years ended 31 December 2001 and 31 December 2002 contain an explanatory paragraph which refers to "substantial doubt" as to Chaparral's ability to continue as a going concern, however, Chaparral has continued as a going concern for more than twelve months from the date of those reports.

The independent auditors' report on the financial statements for the year ended 31 December 2003 contains an explanatory paragraph which refers to "substantial doubt" as to the Company's ability to continue as a going concern due to uncertainties in relation to available funding. The Group now has sufficient funding arrangements in place and as a result, our opinion in this report is not modified in relation to going concern.

Yours faithfully

Ernst & Young"

SECTION 5
Unaudited Supplemental Information relating to
Chaparral Resources Inc.

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 standardised measure of discounted net cash flows are estimates only, and are not intended to reflect realisable values or fair market values of the Company's reserves. The Company emphasises 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 2.69 million barrels of crude oil in 2003, of which 103,000 barrels, or approximately 4 per cent., were sold to the local market. Comparatively, the Company sold 2.47 million barrels of crude oil in 2002, of which 363,000, or approximately 15 per cent., was sold to the local market. KKM has an existing agreement to sell 100 per cent. of its production on the export market for world market prices and a right to export 100 per cent. of its production under the terms of its agreement with the government. Although the Company expects to sell 100 per cent. of its production on the export market in future years, the year-end prices used for the standardised measure of discounted net cash flows for 2003 reflects the assumption that 5 per cent. of KKM's production will be sold on the local market for a substantially lower net oil price. Year-end prices used for the standardised measure of discounted net cash flows for 2002 and 2001 reflect the assumption that 15 per cent. and 20 per cent. 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 standardised 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, less estimated future income tax expenses. The estimated future net cash flows are then discounted using a rate of 10 per cent. a year to reflect the estimated timing of the future cash flows.

As a result of the acquisition of an additional 10 per cent. interest in KKM through the acquisition of 100 per cent. of the stock in MTI during 2002, the Company's SFAS 69 is presented in full for the years 2003 and 2002.

Proved Oil and Gas Reserve Quantities
(All within the Republic of Kazakhstan)

	Year Ended 31 December					
	2001		2002		2003	
	Oil Reserves (bbls.)	Gas Reserves (Mcf.)	Oil Reserves (bbls.)	Gas Reserves (Mcf.)	Oil Reserves (bbls.)	Gas Reserves (Mcf.)
Proved developed and undeveloped reserves:						
Beginning balance.....	—	—	29,921	—	21,855	—
Revision of previous estimates	—	—	(5,348)	—	6,455	—
Extensions, discoveries and other additions	—	—	—	—	—	—
Production	—	—	(2,718)	—	(2,694)	—
Ending Balance 31 December	—	—	21,855	—	25,616	—
Company's proportional interest in KKM's proved developed and undeveloped Reserves.....	14,961	—	—	—	—	—
Minority interest in KKM's proved developed and undeveloped Reserves	—	—	8,742	—	10,246	—
Proved developed reserves.....	—	—	9,321	—	15,107	—
Minority interest in KKM's proved developed reserves	—	—	3,728	—	6,043	—

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

	Year Ended 31 December		
	2001	2002	2003
	\$	\$	\$
Unproved oil and gas properties	—	11,270	6,131
Proved oil and gas properties.....	—	84,853	118,347
Accumulated depreciation and depletion.....	—	96,123	124,478
Net capitalised cost	—	(25,105)	(40,915)
Company's share of equity method investee's net capitalised cost	—	71,018	83,563
	33,530	—	—

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

	Year Ended 31 December		
	2001 \$	2002 \$	2003 \$
Acquisition costs ⁽¹⁾	—	3,881	—
Exploration and appraisal costs.....	—	—	—
Development costs	—	10,287	27,642
	—	14,168	27,642
Company's share of equity method investee's costs of property acquisition, exploration and development.....	12,446	—	—

(1) Acquisition cost for the year 2002 represents the cost for acquiring an additional 10 per cent. interest in KKM through the acquisition cost of 100 per cent. of the outstanding stock in MTI.

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

	Year ended 31 December		
	2001 \$	2002 \$	2003 \$
Oil revenue	—	45,133	57,615
Transportation costs	—	(9,427)	(11,474)
Operating expenses	—	(7,678)	(5,915)
Depreciation, depletion and amortisation	—	(12,804)	(18,038)
	—	15,224	22,188
Provision for income taxes ⁽¹⁾	—	(3,633)	(6,986)
	—	11,591	15,202
Company's share of equity method investee's results from operations for producing activities.....	6,090	—	—

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

**Standardised 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 31 December		
	2001 \$	2002 \$	2003 \$
Future cash inflows	—	377,660	476,969
Future development costs.....	—	(83,189)	(73,642)
Future production costs	—	(50,952)	(53,338)
Future income tax expenses	—	(55,699)	(90,699)
Future net cash flows.....	—	187,820	259,290
10% annual discount for estimated timing of cash flows	—	(59,081)	(92,108)
Standardised measure of discounted net cash flows	—	128,739	167,182
Minority interest.....	—	51,496	66,873
Company's share of equity method investee's standardised measure of discounted future net cash flows	40,344	—	—

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

	Year Ended 31 December		
	2001 \$	2002 \$	2003 \$
Beginning balance	—	80,688	128,739
Sales of oil produced, net of production and transportation costs	—	(28,028)	(40,226)
Extensions and discoveries	—	—	—
Net changes in prices, production cost and future development cost	—	129,412	(3,377)
Net changes due to revisions of previous quantity estimates	—	(63,344)	79,054
Development cost incurred	—	10,287	27,642
Accretion of discount	—	10,393	463
Net changes in income taxes	—	(10,669)	(25,113)
Ending balance	—	128,739	167,182

2003 Quarterly Information

	For the Three Months Ended				Total as of
	31 March 2003 \$	30 June 2003 \$	30 September 2003 \$	31 December 2003 \$	31 December 2003 \$
Revenue (1)	7,813	8,472	23,308	18,022	57,615
Transportation and operating costs.	2,785	3,048	6,288	5,268	17,389
Depreciation and depletion.....	2,438	3,319	7,140	5,141	18,038
Operating income	<u>2,590</u>	<u>2,105</u>	<u>9,880</u>	<u>7,613</u>	<u>22,188</u>
Income/(loss) before taxes and cumulative effect of change in accounting principle	(617)	(779)	4,550	2,010	5,164
Income taxes	<u>352</u>	<u>330</u>	<u>2,479</u>	<u>960</u>	<u>4,121</u>
Income/(loss) before extraordinary gains.....	(969)	(1,109)	2,071	1,050	1,043
Cumulative effect of change in accounting principle	<u>1,018</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,018</u>
Net income/(loss) available to common Stockholders	<u>49</u>	<u>(1,109)</u>	<u>2,071</u>	<u>1,050</u>	<u>2,061</u>
Diluted earnings per share: Income/(loss) per share before cumulative effect of change in accounting principle	(0.03)	(0.03)	0.05	0.03	0.03
Cumulative effect of change in accounting principle	0.03	0.00	—	—	0.02
Net loss per share	(0.00)	(0.03)	0.05	0.03	0.05
Basic Weighted average number of share outstanding (basic).....	38,209,502	38,209,502	38,209,502	38,209,502	38,209,502
Diluted earnings per share: Loss per share before cumulative effect of change in accounting principle	(0.03)	(0.03)	0.05	0.03	0.03
Cumulative effect of change in accounting principle	0.03	0.00	—	—	0.02
Net loss per share	(0.00)	(0.03)	0.05	0.03	0.05
Diluted Weighted average number of shares outstanding (basic and diluted).....	38,209,502	38,209,635	38,408,726	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

2002 Quarterly Information

	For the Three Months Ended				Total as of
	31 March 2002 \$	30 June 2002 \$	30 September 2002 \$	31 December 2002 \$	31 December 2002 \$
Revenue ⁽¹⁾	8,379	10,646	13,446	12,662	45,133
Transportation and operating costs.....	4,123	4,248	4,609	4,125	17,105
Depreciation and depletion.....	2,932	3,067	3,709	3,096	12,804
Operating income/(loss)	<u>1,324</u>	<u>3,331</u>	<u>5,128</u>	<u>5,441</u>	<u>15,224</u>
Income/(loss) before taxes and extraordinary gains	(2,893)	3	2,465	1,889	1,464
Income taxes	<u>233</u>	<u>287</u>	<u>352</u>	<u>1,813</u>	<u>2,685</u>
Income/(loss) before extraordinary gains.....	(3,126)	(284)	2,113	76	(1,221)
Extraordinary gains	<u>—</u>	<u>5,338</u>	<u>—</u>	<u>—</u>	<u>5,338</u>
Net income/(loss) available to common Stockholders	<u>(3,126)</u>	<u>5,054</u>	<u>2,113</u>	<u>76</u>	<u>4,117</u>
Basic earnings per share:					
Loss per share before cumulative extraordinary gain.....	(0.22)	(0.01)	0.06	(0.00)	(0.04)
Extraordinary gain	<u>—</u>	<u>0.19</u>	<u>—</u>	<u>—</u>	<u>0.18</u>
Net loss per share	(0.22)	0.18	—	(0.00)	0.14
Basic weighted average number of shares outstanding (basic).....	14,283,801	27,955,630	38,209,501	38,209,501	29,753,569
Diluted earnings per share:					
Loss per share before cumulative extraordinary gain.....	(0.22)	(0.01)	0.05	(0.00)	(0.04)
Extraordinary gain	<u>—</u>	<u>0.19</u>	<u>—</u>	<u>—</u>	<u>0.18</u>
Net loss per share	(0.22)	0.18	0.05	(0.00)	0.14
Diluted weighted average number of shares outstanding (basic and diluted).....	14,283,801	28,488,711	39,134,622	38,209,615	29,753,682

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

2001 Quarterly Information

	For the Three Months Ended				Total as of
	31 March 2001 \$	30 June 2001 \$	30 September 2001 \$	31 December 2001 \$	31 December 2001 \$
Operating expense	(1,134)	(1,368)	(1,190)	(1,391)	(5,083)
Other income (loss)	(565)	(75)	(4,575)	(3,398)	(8,613)
Loss before cumulative effect of change in accounting principle.....	(1,699)	(1,443)	(5,765)	(4,789)	(13,696)
Cumulative effect of change in accounting principle	(2,519)	—	—	—	(2,519)
Net loss	(4,218)	(1,443)	(5,765)	(4,789)	(16,215)
Cumulative annual dividend accrued					
Series A Redeemable Preference Stock	(63)	(62)	(63)	(62)	(250)
Discount accretion					
Series A Redeemable Preferred Stock	(25)	(25)	(25)	(25)	(100)
Net loss available to common stockholders	(4,306)	(1,530)	(5,853)	(4,876)	(16,565)
Basic and diluted earnings per share:					
Loss per share before cumulative effect of change in accounting principle	(0.12)	(0.11)	(0.41)	(0.34)	(0.98)
Cumulative effect of change in accounting principle	(0.18)	—	—	—	(0.18)
Net loss per share	(0.30)	(0.11)	(0.41)	(0.34)	(1.16)
Weighted average number of shares outstanding (basic and diluted).....	14,283,746	14,283,801	14,283,801	14,283,801	14,283,788

SECTION 6

Pro forma Statement of Operations for the year ended 31 December 2003

The pro forma statement of operations of the Company is provided for illustrative purposes only to show the effect on the statement of operations had the acquisitions (see columns 2, 3 and 4 below) occurred on 1 January 2003. It has been compiled on the basis described below from the statement of operations of the Company as set out in section 1 of Part IV of this document. Due to its nature, the pro forma statement of operations may not give a true picture of the results of the Company and is designed to give only an indication of the profit/losses of the Company.

	Nelson Resources Limited	Nelson Petroleum Buzachi B.V. (50%)	Chaparral Resources Inc.	Adjustments	Pro forma Enlarged Group
	12 months to 31 December 2003 U.S.\$'000 (Note 1)	12 months to 31 December 2003 U.S.\$'000 (Note 2)	12 months to 31 December 2003 U.S.\$'000 (Note 3)	U.S.\$'000 (Note 4)	U.S.\$'000 (Note 5)
Revenue					
Crude oil.....	40,591	35,586	57,615	(687)	133,105
Expenses					
Cost of production.....	4,452	14,923	5,915	(243)	25,047
Sales and transportation	10,227	9,391	11,474	(164)	30,928
Depreciation and amortisation	5,537	5,659	18,038	(4,513)	24,721
General and administration	14,681	1,053	7,762	(236)	23,260
Derivative instruments	3,887	—	—	—	3,887
Other compensation costs	8,769	—	—	—	8,769
	<u>47,553</u>	<u>31,026</u>	<u>43,189</u>	<u>(5,156)</u>	<u>116,612</u>
(Loss)/Profit from operations	(6,962)	4,560	14,426	4,469	16,493
Other income/(expenses)					
Foreign exchange gain/(loss)	3,555	63	(62)	(23)	3,533
Interest and financing costs (Note 6)	(8,783)	(1,073)	(4,899)	(11,136)	(25,891)
Profit on sale of investment.....	2,731	—	—	—	2,731
Interest and other income	2,683	64	24	(3)	2,768
Other	—	—	(11)	—	(11)
Minority Interest (Note 7)	—	—	(4,314)	—	(4,314)
	<u>186</u>	<u>(946)</u>	<u>(9,262)</u>	<u>(11,162)</u>	<u>(21,184)</u>
Minority Interest in Chaparral (Note 8)	—	—	—	(417)	(417)
(Loss)/profit from continuing operations before income taxes.....	(6,776)	3,614	5,164	(7,110)	(5,108)
Income taxes (Note 9)	(4,235)	—	(4,121)	(1,247)	(9,603)
	<u>(11,011)</u>	<u>3,614</u>	<u>1,043</u>	<u>(8,357)</u>	<u>(14,711)</u>
Loss per share					(\$0.019)

Notes

1. Extracted from the Accountants' Report on the Company as set out in section 1 of Part IV of this document, the results include 50 per cent. of KOA on a proportional consolidation basis.
2. Extrapolated from the unaudited trial balance for 2003 financial year (which represented a 35 per cent. ownership interest) to represent the 50 per cent. interest in the North Buzachi licence that has been owned by BBV since 3 February 2004. The results include 50 per cent. of the North Buzachi field on a proportional consolidation basis.
3. Extracted from the Accountants' Report on Chaparral Resources Inc. as set out in section 4 of Part IV of this document, the results are presented on a full consolidation basis with a 40 per cent. minority interest.
4. Adjustments representing the 15 days of results for BBV that are consolidated within the results of the Company for the 12 months to 31 December 2003 as set out above and an adjustment to reflect depreciation on a cost pool basis for the enlarged group.
5. The Directors have still to complete their fair value exercise so no account has been taken of fair value and accounting basis adjustments that may arise on the additional 15 per cent. interest acquired in the North Buzachi licence and the acquisition of Chaparral Resources Inc.
6. Interest and financing costs have been calculated based on a full year of borrowings associated with the acquisitions.
7. This represents the minority interest shown within the Accountants' Report for Chaparral Resources Inc. to reflect the 40 per cent. minority interest in KKM.
8. The adjustment relates to the 40 per cent. minority interest in Chaparral Resources Inc.
9. Income taxes have been calculated based on statutory tax rates.

SECTION 7

Pro Forma Statement of Net Assets as at 31 December 2003

The pro forma statement of net assets of the Company is provided for illustrative purposes only to show the effect on the balance sheet of the Company had the acquisitions (see columns 2, 3 and 4 below) and Placing occurred on 31 December 2003. It has been compiled on the basis described below from the balance sheet of the Company at 31 December 2003 as set out in section 1 of Part IV of this document. Due to its nature, the pro forma statement of net assets may not give a true picture of the financial position of the Company and is designed to give only an indication of the net assets of the Company.

	Nelson Resources Limited 31 December 2003 U.S.\$000's (Note 1)	Nelson Petroleum Buzachi B.V. 31 December 2003 U.S.\$000's (Note 2)	Chaparral Resources Inc. 31 December 2003 U.S.\$000's (Note 3)	Adjustments U.S.\$000's (Note 4)	Proceeds from Placing U.S.\$000's (Note 5)	Pro forma Enlarged Group U.S.\$000's (Note 6)
Assets						
Current assets						
Cash and cash equivalents	43,246	—	2,639	(9,720)	110,721	146,886
Accounts receivable and prepaid expenses	19,546	—	6,358	(1,025)	—	24,879
Inventory	2,242	—	3,732	—	—	5,974
Total current assets	65,034	—	12,729	(10,745)	110,721	177,739
Oil and gas properties, full cost	108,963	31,000	80,374	(1,146)	—	219,191
Property, plant and equipment	11,750	1,000	5,565	—	—	18,315
Advances to oil and gas limited partnership	23,318	—	—	—	—	23,318
Other non-current assets	384	—	—	—	—	384
Total assets	209,449	32,000	98,668	(11,891)	110,721	438,947
Liabilities						
Current liabilities						
Accounts payable	18,765	—	7,229	—	—	25,994
Accrued liabilities	6,295	—	3,296	(190)	—	9,401
Income taxes payable	924	—	3	1,247	—	2,174
Current portion of loan payable to affiliates	—	—	12,000	—	—	12,000
Derivative instruments	3,887	—	—	—	—	3,887
Bank loan and loan notes	58,000	32,000	—	24,000	—	114,000
Current portion of long term debt	3,550	—	—	—	—	3,550
Total current liabilities	91,421	32,000	22,528	25,057	—	171,006
Loans payable to affiliates	—	—	21,284	—	—	21,284
Minority interest	—	—	4,635	18,468	—	23,103
Long-term liabilities	67,115	—	4,051	—	—	71,166
Total liabilities	158,536	32,000	52,498	43,525	—	286,559
Net Assets	50,913	—	46,170	(55,416)	110,721	152,388

Notes

1. Extracted from the Accountants' Report on the Company at 31 December 2003 as set out in section 1 of Part IV of this document.
2. Adjustments to reflect the acquisition of 15 per cent. interest in the North Buzachi licence by Nelson Petroleum Buzachi B.V. on 3 February 2004 based on unaudited fair value of assets and liabilities.
3. Extracted from the Accountants' Report on Chaparral Resources Inc. on 31 December 2003 as set out in section 4 of Part IV of this document.
4. The adjustment relates to the 40 per cent. minority interest in Chaparral Resources Inc.
5. Expected proceeds of U.S.\$110.7 million from the placing net of expected costs of U.S.\$8.6 million.
6. The Directors still have to complete their fair value exercise so no account has been taken of fair value and accounting basis adjustments that may arise on the additional 15 per cent. interest acquired in the North Buzachi licence and the acquisition of Chaparral Resources Inc.
7. The pro forma statement of net assets does not reflect any post 31 December 2003 transactions other than those set out above.

SECTION 8

Pro forma Statement of Operations for the three months ended 31 March 2004

The pro forma statement of operations of the Company is provided for illustrative purposes only to show the effect on the statement of operations had the acquisition (see column 2 and 3, below) occurred on 1 January 2004. It has been compiled the basis described below from the statement of operations of the Company as set out in section 2 of Part IV of this document. Due to its nature, the pro forma statement of operations may not give a true picture of the results of the Company and is designed to give only an indication of the loss of the Company.

	Nelson Resources Limited 3 months to 31 March 2004 U.S.\$000's (Note 1)	Chaparral Resources Inc. 3 months to 31 March 2004 U.S.\$000's (Note 2)	Adjustments U.S.\$000's (Note 3)	Pro forma Enlarged Group U.S.\$000's (Note 4)
Revenue				
Crude oil.....	26,398	15,609	790	42,797
Expenses				
Cost of production.....	3,471	2,210	163	5,844
Sales and transportation	5,217	3,153	104	8,474
Depreciation and amortisation	3,490	4,386	(481)	7,395
General and administration	3,216	1,724	41	4,981
Derivative instruments	4,019	—	—	4,019
Other compensation costs	7,814	—	—	7,814
	27,227	11,473	(173)	38,527
(Loss)/profit from operations	(829)	4,136	963	4,270
Other income/(expenses)				
Foreign exchange gain/(loss)	1,538	(80)	1	1,459
Interest and financing costs (Note 5)	(4,500)	(1,259)	(1,068)	(6,827)
Interest and other income	750	45	4	799
Minority interest (Note 6)	—	(1,066)	—	(1,066)
	(2,212)	(2,360)	(1,063)	(5,635)
Minority interest in Chaparral (Note 7).....	—	—	(254)	(254)
(Loss)/profit from continuing operations before income taxes.....	(3,041)	1,776	(354)	(1,619)
Income taxes (Note 8).....	(1,684)	(1,142)	(848)	(3,674)
(Loss)/profit from continuing operations after income taxes.....	(4,725)	634	(1,202)	(5,293)
Loss per share				(\$0.0057)

Notes

1. Extracted from the Unaudited Report on the Company as set out in section 2 of Part IV of this document, the results include 50 per cent. of Kazakhoil Aktobe LLP on a proportional consolidation basis.
2. Extracted from the 10-Q filed by Chaparral Resources Inc. for the period ended 31 March 2004, the results are presented on a full consolidation basis with a 40 per cent. minority interest.
3. Adjustments representing the 31 days of results for the 15 per cent. interest in the North Buazchi licence that was not owned by Nelson Petroleum Buzachi B.V. and therefore not consolidated with the Nelson Resources Limited results for the 3 months to 31 March 2004 as set out above.
4. The Directors have still to complete their fair value exercise so no account has been taken of fair value and accounting basis adjustments that may arise on the additional 15 per cent. interest acquired in the North Buzachi licence and the acquisition of Chaparral Resources Inc.
5. Interest and financing costs have been calculated based on a full year of borrowings associated with the acquisitions.
6. This represents the minority interest shown within the 10-Q filed by Chaparral Resources Inc., to reflect the 40 per cent. minority interest in the Karakuduk-Munay JSC.
7. The adjustment relates to the 40 per cent. minority interest in Chaparral Resources Inc.
8. Income taxes have been calculated based on statutory tax rates.

SECTION 9

Pro forma Statement of Net Assets as at 31 March 2004

The pro forma statement of net assets of the Company is provided for illustrative purposes only to show the effect on the balance sheet of the Company had the acquisition (see column 2 and 3, below) and Placing occurred on 31 March 2004. It has been compiled on the basis described below from the balance sheet of the Company at 31 March 2004 as set out in section 2 of Part IV of this document. Due to its nature, the pro forma statement of net assets may not give a true picture of the financial position of the Company and is designed to give only an indication of the net assets of the Company.

	Nelson Resources Limited 31 March 2004 U.S.\$000's (Note 1)	Chaparral Resources Inc. 31 March 2004 U.S.\$000's (Note 2)	Adjustments U.S.\$000's (Note 3)	Proceeds from Placing U.S.\$000's (Note 4)	Pro forma Enlarged Group U.S.\$000's (Note 5)
Assets					
Current assets					
Cash and cash equivalents.....	45,539	5,193	(826)	110,721	160,627
Accounts receivable and prepaid expenses.....	24,802	8,024	—	—	32,826
Inventory.....	7,953	2,524	—	—	10,477
Total current assets	78,294	15,741	(826)	110,721	203,930
Oil and gas properties, full cost.....	144,161	83,409	481	—	228,051
Property, plant and equipment.....	17,242	6,364	—	—	23,606
Advances to oil and gas limited partnership	24,635	—	—	—	24,635
Other non-current assets	339	—	—	—	339
Total assets	<u>264,671</u>	<u>105,514</u>	<u>(345)</u>	<u>110,721</u>	<u>480,561</u>
Liabilities					
Current liabilities					
Accounts payable.....	18,520	10,504	—	—	29,024
Accrued liabilities.....	9,132	2,507	—	—	11,639
Income taxes payable	282	—	848	—	1,130
Current portion of loan payable to affiliates	—	14,000	—	—	14,000
Derivative instruments.....	7,838	—	—	—	7,838
Bank loan and loan notes	90,000	—	24,000	—	114,000
Current portion of long term debt ..	8,967	—	—	—	8,967
Total current liabilities	134,739	27,011	24,848	—	186,598
Loans payable to affiliates.....	—	21,393	—	—	21,393
Minority interest	—	5,701	18,722	—	24,423
Long-term liabilities	73,626	4,605	—	—	78,231
Total liabilities	<u>208,365</u>	<u>58,710</u>	<u>43,570</u>	<u>—</u>	<u>310,645</u>
Net Assets/(Liabilities)	<u>56,306</u>	<u>46,804</u>	<u>(43,915)</u>	<u>110,721</u>	<u>169,916</u>

Notes:

1. Extracted from the Unaudited Report of the Company at 31 March 2004 as set out in section 2 of Part IV of this document.
2. Extracted from the 10-Q filed by Chaparral Resources Inc. for the period ended 31 March 2004, the results are presented on a full consolidation basis with a 40 per cent. minority interest.
3. The adjustments relate to the effect on cash of the interest cost on borrowings related to the acquisitions, the loan note liabilities for the acquisition of Chaparral Resources Inc., accruals for tax liabilities and the 40 per cent. minority interest in Chaparral Resources Inc.
4. Expected proceeds of U.S.\$110.7 million from the placing net of expected costs of U.S.\$8.6 million.
5. The Directors have still to complete their fair value exercise so no account has been taken of fair value and accounting basis adjustments that may arise on the additional 15 per cent. interest acquired in the North Buzachi licence and the acquisition of Chaparral Resources Inc.
6. The pro forma statement of net assets does not reflect any post 31 March 2004 transactions other than those set out above.

PART V: ADDITIONAL INFORMATION

1. The Company and its subsidiaries

- 1.1 The Company was incorporated as an “exempted company” under the Companies Act 1981 of Bermuda on 31 March 1993 with registered number 18154. The liability of the shareholders is limited.
- 1.2 The registered office of the Company is located at Chancery Hall, 52 Reid Street, Hamilton HM12, Bermuda. The representative office of the Company in the UK is located at 19 Berkeley Street, London W1J 8ED, England.
- 1.3 The principal legislation under which the Company operates is the Companies Act 1981 of Bermuda (as amended). The Company is also subject to the securities laws of the Provinces of Ontario and British Columbia, Canada.
- 1.4 The principal activity of the Company is that of a holding company.
- 1.5 The Company has the following subsidiary companies:
 - (a) CBS is a wholly owned subsidiary of the Company. CBS is incorporated as a private company under the laws of England and Wales. CBS is a service company providing management services to the Company. CBS was incorporated on 14 December 1993.
 - (b) AMS is a limited liability partnership organised under the laws of Kazakhstan. CBS is the sole partner. AMS was established on 15 May 2002.
 - (c) NBH is a wholly owned subsidiary of the Company. NBH is organised as a private company under the laws of Jersey. NBH acts as a holding company and holds 100 per cent. of the share capital of NBL. NBH was incorporated on 1 November 2001.
 - (d) NBL is a wholly owned subsidiary of NBH. NBL is incorporated as a private company under the laws of England and Wales. NBL acts as a holding company and holds 100 per cent. of the share capital of BHBV. NBL was incorporated on 19 March 2001.
 - (e) BHBV is a wholly owned subsidiary of NBL. BHBV is organised as a private company under the laws of The Netherlands. BHBV acts as a holding company and holds 100 per cent. of the share capital of BBV. BHBV was incorporated on 25 June 1998.
 - (f) BBV is a wholly owned subsidiary of BHBV. BBV is organised as a private company under the laws of The Netherlands. BBV holds a 50 per cent. interest in the North Buzachi licence. BBV was incorporated on 25 June 1998.
 - (g) NAC is a wholly owned subsidiary of the Company. NAC is organised under the laws of the state of Delaware. NAC holds 60 per cent. of the share capital of Chaparral. NAC was incorporated on 6 May 2004.
 - (h) The Company owns approximately 60 per cent. of the issued and outstanding common stock of Chaparral, and in addition the Company holds the Chaparral Warrant exercisable over an additional 3,076,923 shares of common stock in the capital of Chaparral. Chaparral is a company organised under the laws of the State of Delaware.
 - (i) KMTI, CAP-G and CAP-D are all wholly-owned subsidiaries of Chaparral. Through these subsidiaries, Chaparral owns a controlling interest of 60 per cent. in KKM. The other 40 per cent. interest in KKM is held by Kazmunaigas. KKM is the operator of the Karakuduk field. Chaparral also wholly owns two dormant subsidiaries, Chaparral Acquisition Corporation and Road Runner Services Company.

2. Share capital

- 2.1 The authorised share capital of the Company is U.S.\$15.5 million divided into 1,500,000,000 Common Shares with a par value of U.S. \$0.01 each and 50,000,000 preference shares with a par value of U.S. \$0.01 each. As at the date of this document, the issued and outstanding share capital of the Company is 745,113,967 Common Shares and no preference shares are in issue.

Class of Shares	Authorised		Issued and fully paid or credited as fully paid	
	Number	Amount (U.S.\$)	Number	Amount (U.S. \$)
Common Shares	1,500,000,000	15,000,000	745,113,967	7,451,140
Preference Shares	50,000,000	500,000	0	0

- 2.2 Following completion of the Placing, the authorised and issued share capital of the Company will be as follows:

Class of Shares	Authorised		Issued and fully paid or credited as fully paid	
	Number	Amount (U.S.\$)	Number	Amount (U.S. \$)
Common Shares	1,500,000,000	15,000,000	857,258,095	8,572,581
Preference Shares	50,000,000	500,000	0	0

2.3 Options

The maximum number of Common Shares reserved for issue under the Company's Stock Option Plan (the "Plan") is 70,000,000 (approximately 9.4 per cent. of the currently issued and outstanding Common Shares). As at the date of this document, the Company has 51,926,667 Common Shares reserved for issue under the Plan and 18,073,333 Common Shares outstanding under stock options.

The Company, on an exceptional basis, grants options outside of the Plan. In March 2003, as part of the settlement with Mr. Teck Soon Kong, a former Chairman and Chief Executive Officer of the Company, 13,080,000 options were granted to Mr. Kong outside the Plan. As at 12 July 2004, Mr. Kong had exercised 6,540,000 and continues to hold 6,540,000 of such options, which are exercisable at Cdn.\$0.21 and expire in March 2006.

Options over 18,073,333 Common Shares amounting to 24.3 per cent. of the issued share capital on Admission are held under the terms of the Plan as follows:

Number of Common Shares	Date of grant	Exercise price per Common Share	Dates between which normally exercisable
18,073,333	17 April 2001 – 25 April 2003	Cd.\$0.30 – Cd.\$0.67	17 April 2001 – 15 August 2008

2.4 Class rights

Common Shares

Subject to the prior rights of the holders of any preference shares and any other shares ranking senior to the Common Shares with respect to priority in the payment of dividends, the holders of Common Shares are entitled to receive dividends, if, as and when they are declared by the Board. After payment of all debts and subject to the preference of the holders of the preference shares and any other shares ranking senior to the Common Shares, in the event of the liquidation, dissolution or winding-up or other distribution of the assets of the Company among its shareholders for the purpose of winding-up its affairs, the remaining assets of the Company will be distributed in equal amounts per share on all the Common Shares at the time outstanding without preference or priority of one share over another. If a poll is duly demanded the holders of the Common Shares are entitled to one vote per share at all meetings of shareholders of the Company other than a meeting of the holders of another class or series of shares of the Company. If a poll is not demanded voting shall be on a show of hands and every person present and entitled to vote on the show of hands shall have one vote.

Preference Shares

The Company is authorised to issue preference shares. As at the date of this document no preference shares have been issued. Preference shares are issuable from time to time in one or more series. The Board will fix before issuance the number, the consideration per share, and the designation of, and the provisions attaching to, the shares of each series. The preference shares of each series will rank equally with the preference shares of every other series with respect to accumulated dividends and the return of capital in the event of a liquidation. The preference shares will be entitled to preference over the Common Shares and any other shares ranking junior to the preference shares with respect to the payment of dividends and the return of capital. The holders of the preference shares are not entitled to receive notice of, attend or vote as a class except as provided by law or in accordance with any voting rights which may, from time to time, be attached to any series of preference shares.

- 2.5 The Common Shares are listed on the TSX under the trading symbol "NLG". The Common Shares were admitted to trading on the TSX in November 1994.

3. Bye-laws

The principal object of the Company is to carry on business as a holding company and to do all such things as are incidental or conducive to the carrying on of any trade or business by it. The objects of the Company are set out in full in clause 6 of its Memorandum of Association.

In this paragraph, “Act” means the Companies Act 1981 of Bermuda and any successor statute or as the same may from time to time be amended and “law” means the laws of Bermuda and every other statute or statutory instrument, rule, order or regulation from time to time in force concerning companies in so far as they apply to the Company.

3.1 *Dividends*

The Board may declare cash dividends or distributions out of contributed surplus to be paid to the shareholders according to their rights and interests including such interim dividends as appear to the Board to be justified by the position of the Company.

3.2 *Allotment of shares*

All unissued shares in the Company are at the disposal of the Board, which may allot them to such persons, at such times, for such consideration and generally on such terms as the Board in its absolute discretion thinks fit (save always in accordance with the provisions of the Act), but no shares shall be issued at a discount to nominal value. Neither the Company nor the Board is obliged, when making or granting any allotment of shares, to make available any offer to shareholders or others with registered addresses in any particular territory being a territory, in the absence of a registration statement or other special formalities, in which this would or might be unlawful or impracticable.

3.3 *Pre-emption rights*

The Company may by resolution, before the issue of any new shares, determine that the same be offered in the first instance, either at par or at a premium, to all existing holders of any class of shares in proportion as nearly as may be to the number of shares of such class held by them respectively, or make any provisions as to the issue and allotment of the shares, but in default of any such determination such shares may be dealt with as if they formed part of the capital of the Company existing prior to the issue of such shares.

3.4 *Return of capital*

The Company may reduce its share capital if authorised by a general meeting of shareholders subject to compliance with the Act.

3.5 *Voting rights (Common Shares)*

Every shareholder is entitled to vote the shares shown opposite his name on the shareholder list. Where two or more persons hold the same shares jointly, any one of them may in the absence of the other vote in respect of such shares, but if more than one of such persons are present or represented and vote, they vote together as one on the shares jointly held by them. Every shareholder entitled to vote may by means of a proxy appoint a proxy holder.

At each meeting of shareholders, questions proposed are decided by a majority of votes, unless otherwise required by the Bye-laws of the Company or by law. In case of an equality of votes the chairman of the meeting is entitled to a casting vote. At each meeting of shareholders, voting is by show of hands unless a poll is required or demanded.

3.6 *Transfer of shares*

Subject to the Act, all transfers of shares may be effected by transfer in writing in the usual or common form or in such other form as the Board may accept and may be under hand only.

The registration of transfers may, on giving notice by advertisement in an appointed newspaper in Bermuda and in one or more newspapers circulating in Canada or such territory as the Board may decide, be suspended and the register closed at such times and for such periods as the Board may determine generally or in respect of any class of shares. The register cannot be closed for more than thirty days in any year.

3.7 *Alteration of capital*

The Company may in general meetings: (a) divide its shares into several classes and attach respectively any preferential, deferred, qualified or special rights, privileges or conditions; (b) consolidate all or any of its share capital into shares of larger par value than its existing shares; (c) sub-divide its shares into shares of smaller par-value than is fixed by its memorandum, so that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share is the same as it was in the case of the share from which the reduced share is derived; (d) change the currency denomination of its capital; (e) make provision for the issue and allotment of shares which do not carry any voting rights; and (f) cancel shares which have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

3.8 *Directors*

(a) Minimum and maximum number.

The number of Directors cannot be less than two. There is no prescribed maximum number.

(b) Remuneration.

The Board determines the amount, if any, of the Directors' fees. Directors are paid their travelling, hotel and incidental expenses properly and reasonably incurred in the conduct of the Company's business or in the discharge of their duties as Directors.

(c) The Board.

The Board is responsible for the general management of the business and affairs of the Company as provided by Bermuda law and the memorandum of association and the Bye-laws of the Company. Except for matters expressly reserved to the general meetings of Shareholders, the Board has the full authority to make decisions on all aspects of the activities of the Company.

(d) Appointment, retirement, removal and shareholding.

Members of the Board are elected at the annual general meeting of Shareholders for a one-year period and can be re-elected for an unlimited number of terms. At least one-third of the directors should not be officers or employees of the Company or of any affiliate of the Company.

In October 2000, the Company concluded a private placement whereby CAIH and EII each acquired 148,813,492 Common Shares and 82,500,000 warrants of the Company for a total consideration of U.S.\$15,211,923. Under the terms of the share purchase agreement entered into in connection with the private placement, CAIH and EII, as the principal shareholders of the Company, may each nominate three Directors at each annual election of the Board and one nominee of CAIH is entitled to be Chairman of the Board.

Currently, CAIH is represented by Mr. Alshinbayev and EII is represented by Mr. Abuov and Mr. Tiku.

The Board has the power at any time and from time to time to appoint any individual to be a Director so as to fill a vacancy. In addition, the Company may, in a special general meeting called for that purpose, remove a Director as long as the Director has 14 days' notice of the meeting. Any such Director is entitled to be heard at the meeting.

(e) Executive Directors.

The Board supervises the management of the business and affairs of the Company, and may meet for the dispatch of business, adjourn and otherwise regulate its meetings as it thinks fit.

(f) The Chairman of the Board.

The Chairman of the Board or in his absence the vice-chairman or in his absence a director designated by the Board or a Director designated by the meeting shall be chairman of any meeting of the Board. In case of an equality of votes, the chairman of the meeting is not entitled to a casting or deciding vote.

3.9 *Directors' interests*

A Director who presently or in the future is at any time party to, or has a material interest in another person who is a party to, any existing or proposed material contract or transaction with the Company must disclose his interest in writing to the Company or request to have entered in the minutes of meetings of the Board the nature and extent of his interest.

3.10 *Branch register*

Subject to the provisions of the Act, if the Board considers it necessary or appropriate, the Company can establish and maintain a branch register of members at a location outside Bermuda. While the issued share capital of the Company is listed on any stock exchange in Canada, the Company shall keep a branch register in Canada.

3.11 *General meetings*

A general meeting of Shareholders is required to be held annually on such day as the Board may, subject to the Act, determine. In addition, according to the rules of the TSX on which the Common Shares of the Company are listed, the Company is required to hold a meeting of its Shareholders within six months of its fiscal year-end. The Board may also call a special meeting of the Shareholders, and any such meeting may be combined with an annual general meeting.

3.12 *Borrowing powers*

Under its memorandum of association, the Company has the power to borrow and raise money in any currency or currencies and to secure or discharge any debt or obligation in any manner.

3.13 *Variation of class rights*

Without prejudice to any special rights or restrictions for the time being attaching to any shares or any class of shares, any share may be issued upon such terms and conditions and with such preferred, deferred or other special rights, or such restrictions as the Company may by resolution determine or as the Board may determine.

If, at any time, the capital is divided into different classes of shares, all or any of the special rights attached to any class may, subject to the provisions of the Act, be varied or abrogated either with the consent in writing of the holders of not less than two-thirds of the issued shares of that class or with the sanction of a special resolution passed at a separate general meeting of the holders of the shares of that class.

3.14 *Senior management*

The officers of the Company have those duties and powers usually pertaining to their respective offices and such specific duties or powers as are delegated by the Board. The Chief Executive Officer and the other senior officers may be removed at any time by a decision of the Board.

3.15 *Indemnity of officers*

Every person who at any time is or has been a director or officer of the Company shall at all times be indemnified by the Company in every circumstance that is permitted or required.

4. Stock option plan

The Company may grant options to directors, officers and employees under the Plan. The rules of the TSX relating to stock option plans require, among other things, that the maximum number of shares issuable under such a plan be fixed.

Subject to the requirements of the TSX, the Board selects those individuals to receive options under the Plan and determines the type, size and term of the option and the time when the options are granted. In determining the number of Common Shares subject to each option, the Board considers the present and potential contribution of the individual to the success of the Company and its affiliates. There are no express performance criteria under the terms of the Plan.

The exercise price for each option granted is also determined by the Board in its discretion, although the exercise price per share for options granted under the Plan will not be less than the closing price of the Common Shares on the TSX on the last trading day prior to the grant of the option. No option may be exercised more than ten years after the date of grant.

Each option granted under the Plan is evidenced by a separate option agreement which sets forth the “vesting” periods per option granted, if any. Each option is exercisable by the holder in such amounts and at such times as determined by the Board.

All options granted under the Plan are non-assignable except in the event of the death of the participant. The Company may grant financial assistance to participants in the Plan to facilitate the purchase of Common Shares upon the exercise of options. To date, the Company has not provided any such financial assistance.

The maximum number of Common Shares reserved for issue to any one person under the Plan shall not exceed 5 per cent. of the outstanding number of Common Shares from time to time.

5. Directors’ interests

- 5.1 The interests of the Directors in the issued share capital of the Company as they are expected to be immediately following Admission are as follows:

	Prior to Admission Common Shares	%	Following Admission and Placing Common Shares	%
Baltabek Kuandykov ⁽¹⁾	154,208,994	20.7	154,208,994	18.0
Peter Luis O. Gross ⁽²⁾	68,338,956	9.17	68,338,956	8.0
Mirbulat Abuov ⁽³⁾	0	0	0	0
Arvind Tiku ⁽³⁾	0	0	0	0
Askar Alshinbayev ⁽⁴⁾	0	0	0	0

(1) Held through Cott Holdings Group Ltd, a company wholly owned by Mr. Kuandykov.

(2) Mr. Gross, a member of the Board, is a representative of Alyco, the management company of Center Finance Corp, which holds 68,338,956 Common Shares.

(3) Mr. Abuov and Mr. Tiku, members of the Board, each respectively owns 40 per cent. and 32 per cent. of the voting shares of the holding company of EII. EII holds 171,343,328 Common Shares. Accordingly, each may be seen as exercising control or direction over such Common Shares.

(4) Mr. Alshinbayev, a member of the Board, owns 11.05 per cent. of the ultimate holding company of CAIH, which owns approximately 23.2 per cent. of the Company.

- 5.2 The following Directors are also interested in unissued Common Shares granted to them by the Company under share options held by them pursuant to individual option arrangements under the Plan:

Name	Date of option agreement	Exercise Price	Number of Common Shares	Latest exercise date
Baltabek Kuandykov	1 November 2001	Cdn. \$0.40/ 0.45/0.50	6,000,000	31 October 2007
E. Nick Zana.....	25 April 2003	Cdn. \$0.67	6,500,000	24 April 2008
Mirbulat Abuov	25 April 2003	Cdn. \$0.67	3,000,000	24 April 2008

- 5.3 Save as disclosed in paragraphs 5.1 and 5.2 above, none of the Directors has any interests in the share capital or loan capital of the Company.

- 5.4 In addition to their directorships in the Company, the Directors have held the following directorships and/or been a partner in the following partnerships within the five years prior to the date of this document:

Name	Current	Past
E. Nick Zana	None	Chevron Petroleum Technology Corporation Zanalar Corporation
Baltabek Kuandykov	None	Chevron Eurasian Group
Mirbulat Abuov	EII HSBK Firma Almex LLP Trans Oil Investments Pte Ltd Euro-Asian Oil Company, Inc. JSC International Airport Almaty	None

Name	Current	Past
Askar Alshinbayev	Meridian Capital Limited Meridian Securities (UK) Limited Gissar Holdings Chaparral Central Asian Industrial Holdings B.V. Petrokazakhstan Meridian Capital CIS Fund Meridian Capital International Fund Gunersbury Limited Central Asian Capital Corporation NV Central Asian Investment Company Kazakhtelecom UzPEC Limited CAIH KKB KKS	None
Peter Luis O. Gross	Alyco Advisory AG Thor Services Limited	Credit Suisse Group
Azziz Ait-Said	None	TOTAL
Robert Connon	None	Sasol Chevron Global Joint Venture Chevron Europe United Kingdom Offshore Operators Association
Arvind Tiku	EII Trans Oil Investments Pte Ltd Ocean Oil (UK) Ltd	Grain Procurement Agency Limited
Gilles Thieffry	Pestalozzi Lachenal Patry	Andersen Legal (Garretts) Norton Rose

5.5 No Director:

- (a) has any unspent convictions in relation to indictable offences; or
- (b) has been bankrupt or the subject of an individual voluntary arrangement, or has had a receiver appointed to any asset of such director; or
- (c) has been a director of any company which, while he was a director or within 12 months after he ceased to be a director, had a receiver appointed or went into compulsory liquidation, creditors voluntary liquidation, administration or company voluntary arrangement, or made any composition or arrangement with its creditors generally or with any class of its creditors; or
- (d) has been a partner of any partnership which, while he was a partner or within 12 months after he ceased to be a partner, went into compulsory liquidation, administration or partnership voluntary arrangement, or had a receiver appointed to any partnership asset; or
- (e) has had any public criticism by statutory or regulatory authorities (including recognised professional bodies); or
- (f) has been disqualified by a court from acting as a director of a company or from acting in the management or conduct of the affairs of any company.

5.6 Save as set out below, the Directors are not aware of any person, directly or indirectly, jointly or severally, who exercises or could exercise control over the Company or who is interested in 3 per cent. or more of the issued share capital of the Company as at the date of the publication of this document and immediately following Admission:

Name and Address	Prior to Admission Common Shares	%	Following Placing and Admission Common Shares	%
Central Asian Industrial Holdings N.V. ⁽¹⁾ .. Schartooweg 81 Curaçao, Netherland Antilles.	172,501,551	23.2	172,501,551	20.1
Energy Investments International Ltd. ⁽²⁾ Trident Chambers, P.O. Box 146, Road Town, Tortola British Virgin Islands	171,343,328	23.0	171,343,328	20.0
Cott Holdings Group Ltd ⁽³⁾	154,208,994	20.7	154,208,994	18.0
P.O. Box 556 Main Street Charlestown, Nevis				
Center Finance Corporation ⁽⁴⁾	68,338,956	9.2	68,338,956	8.0
Landstrasse Postfach 439 FL-9490 Vaduz Liechtenstein				
International Finance Corporation	26,747,834	3.6	26,747,834	3.1
2121 Pennsylvania Avenue NW Washington DC 20433, USA				
Merrill Lynch Investment Managers	0	0	26,620,000	3.1

(1) Mr. Alshinbayev, a Director, owns 11.05 per cent. of the ultimate holding company of CAIH, and may be seen as exercising control or direction over the said Common Shares. Mr. Nurzhan Subkhanberdin, a former Director, owns 33.15 per cent. of the ultimate holding company of CAIH.

(2) Mr. Abuov and Mr. Tiku, Directors, each respectively owns 40 per cent. and 32 per cent. of the voting shares of the holding company of EII and each may be seen as exercising control or direction over the said Common Shares. In addition, Mr. Yakov Tskhay owns a 20 per cent. share of the holding company of EII.

(3) Cott Holdings Group Ltd., is a company wholly owned by Mr. Kuandykov.

(4) Mr. Gross, a Director, is a representative of Alyco, the management company of Center Finance Corporation.

CAIH owns approximately 23.2 per cent. of the Common Shares. In addition, Mr. Alshinbayev, a Director, is a member of the board of directors of KKB and the chief executive officer of CAIH.

AMS obtained a U.S.\$20 million loan from KKB. KKB and CAIH are related parties. The loan was on reasonable commercial terms applicable to arms-length transactions.

EII owns approximately 23.0 per cent. of the Common Shares of the Company. Mr. Abuov, a Director, is a shareholder of the holding company of EII. In addition, Mr. Tiku, a Director, is the managing director and a shareholder of the holding company of EII.

In June 2002, AMS obtained a U.S.\$27 million loan from HSBK. On 28 June 2004, BBV entered into a credit facility agreement with HSBK. The maximum principal amount available under the facility is U.S.\$53 million. U.S.\$21.5 million of the maximum amount will be used to repay the U.S.\$27 million June 2002 facility between AMS and HSBK. HSBK is related to EII. In addition, Mr. Abuov is a director of HSBK. The loan was obtained on reasonable commercial terms applicable to arms-length transactions in Kazakhstan.

During 2002, 2003 and 2004, KOA and BBV entered into various crude oil off-take agreements, pre-export credit agreements and an oil sales contract with certain affiliates of EII, Euro-Asian Oil A.G. and UniOil. Mr. Tiku, a Director, is a beneficial owner of UniOil. Mr. Abuov, a Director, is a beneficial owner of Euro-Asian Oil A.G. These contracts relate to ordinary course activities of KOA and were entered into on an arm's length basis.

During 2002 and 2003, a subsidiary of the Company provided technical and administration services to KOA in the amount of U.S.\$677,000 and U.S.\$413,000 respectively.

On 17 May 2004 the Company entered into the Chaparral Share Purchase Agreement with CAIH, one of the principal shareholders of the Company, pursuant to which the Company acquired, through its wholly-owned subsidiary NAC, a 60 per cent. interest in Chaparral from CAIH, the Chaparral Warrant exercisable in respect of an additional 3,076,923 shares in Chaparral and the CAIH Note. In consideration of this the Company issued a promissory note in the principal amount of U.S.\$23.9 million payable to CAIH. The promissory note has a term of one year and bears interest at 10.5 per cent. per annum, payable at maturity.

In connection with the acquisition of Chaparral, as CAIH owned 23.2 per cent. of the Common Shares and representatives of CAIH currently sit on the boards of directors of both the Company and Chaparral, the Company appointed a special committee of two of its independent Directors with extensive oil field assessment and corporate finance experience for the purpose of evaluating and making recommendations to the Board in respect of the transaction. After reviewing the due diligence reports from management and a consultant, the special committee recommended that the Board approve the transaction. CAIH's representatives on the Board did not participate in the approval process with respect to the transaction. Following consideration of the special committee's recommendation, the Board approved the transaction.

At the time KOA entered into the BNP Paribas Facility, Mr. Thieffry, who has since become a Director, was employed as General Counsel of BNP Paribas (Suisse) SA.

- 5.7 No loans made or guarantees granted or provided by any member of the Group to or for the benefit of any Director are outstanding.
- 5.8 Save as set out in this document, no Director is or has been interested in any transaction which is or was unusual in its nature or conditions or significant to the business of the Group and which was effected by the Company or any of its subsidiaries and remains in any respect outstanding or unperformed.

6. Directors' service agreements

- 6.1 The Company entered into a service agreement dated 16 January 2002 with Mr. Zana in respect of his services as Chief Executive Officer of the Company. Mr. Zana's agreement continues until 31 January 2005, after which date it will terminate or be renewed on mutually acceptable terms (provided that the Company must give Mr. Zana 90 days' notice if it does not intend to renew the agreement). The service agreement may also be terminated by 12 months' notice by the Company or summarily in certain circumstances. Mr. Zana's salary for the year 2004 is U.S.\$800,000 per annum, paid monthly, to be reviewed annually, and may be increased at the sole discretion of the Board of Directors. Mr. Zana's agreement states a salary figure after tax. For the purposes of tax, Mr. Zana's salary is increased by an additional payment of salary times 0.6; such additional payment is also paid monthly. In addition, Mr. Zana was granted 6,500,000 options to acquire Common Shares of the Company at an exercise price of Cdn.\$0.35 per share, expiring 31 December 2007. The services agreement further provides that, subject to shareholder and regulatory approvals, if the Company issues Common Shares or securities convertible into Common Shares during the term of the service agreement or any extension thereof for consideration equal to 90 per cent. or less of the 20 trading day weighted average of the price at which the Common Shares traded on the TSX, Mr. Zana is entitled to receive an option to acquire up to 1.5 per cent. of such Common Shares (on a fully diluted basis), exercisable at the market price of the Common Shares on the TSX (or such other market on which the Common Shares are listed or quoted) as of the date of such issuance, exercisable for a period of three years from the date of grant.
- 6.2 CBS entered into an individual employment agreement dated 1 November 2001 with Mr. Kuandykov for his services as a Director of the Company, continuing until 1 November 2004, after which date the agreement is terminated, unless CBS offers a new agreement to Mr. Kuandykov. Mr. Kuandykov's individual employment agreement may also be terminated by one month's notice by either party or summarily by CBS in certain circumstances. Mr. Kuandykov's salary for year 2004 is U.S.\$400,000 per annum. The individual employment agreement provides for the salary to be paid monthly gross of tax and the salary may be increased periodically, at the discretion of CBS. In addition, Mr. Kuandykov was awarded 6,000,000 options to acquire Common Shares of the Company at an exercise price of Cdn.\$0.40 to Cdn.\$0.50, that will expire on 31 October 2007.
- 6.3 Save as set out in paragraphs 6.1 and 6.2, above, there are no service agreements in existence between any of the Directors and the Company or any of its subsidiaries which cannot be determined by the employing company without payment of compensation (other than statutory compensation) within one year.
- 6.4 The aggregate remuneration payable and benefits in kind granted to the Directors was approximately U.S.\$2.2 million for the financial year ended 31 December 2003 and is estimated to be approximately U.S.\$1.7 million for the current financial year ending 31 December 2004 under the arrangements in force at the date of this document.

7. Material contracts

The following contracts, not being contracts entered into in the ordinary course of business, have been entered into by the Company and its subsidiaries during the two years preceding the date of this document and are or may be material:

7.1 KOA acquisition

Pursuant to an agreement for the sale and purchase of an interest in KOA dated 10 July 2000 entered into between Kazakhoil and the Company, Kazakhoil sold a 50 per cent. interest in KOA to the Company in consideration of the payment of U.S.\$2 million in cash and assumption of 50 per cent. of the loan amounts provided by Kazakhoil to KOA, which amounted to U.S.\$422,000. The agreement contains certain limited warranties from each party to another.

7.2 North Buzachi acquisition

Pursuant to a sale and purchase agreement for the sale and purchase of the entire issued share capital of BHBV (and subsidiary) dated 1 December 2003 entered into between CNPC (as the seller), and the Company and NBL (together, the purchasers), the purchasers agreed to repay U.S. \$58 million of BHBV's outstanding loans to CNPC and pay U.S.\$1,000 for the entire issued share capital of BHBV. In addition, the purchasers agreed to (i) pay the seller 50 per cent. of the seller's costs and expenses incurred in the acquisition of BHBV and BBV and CNPC (Buzachi) (ii) pay the seller 50 per cent. of taxes and fees levied on the seller arising from the aforementioned acquisitions by the seller, and (iii) pay to the seller 50 per cent. of that company's reasonable legal costs in connection with the acquisition agreement. The agreement contains certain warranties and indemnities from each party to the other. The seller's maximum liability for a claim under the warranties is limited to U.S.\$29 million.

Pursuant to a farm out agreement dated 16 December 2003 between CNPC (Buzachi) and BBV, CNPC (Buzachi) assigned a further 15 per cent. interest in the North Buzachi licence and related hydrocarbon contract. BBV paid U.S.\$32,250,000. The assignment was ratified on 5 February 2003.

7.3 Glencore Off-take Agreement

KOA has agreed to sell to Glencore all of the oil production from KOA operations pursuant to the terms of an off-take agreement dated 8 August 2003 between KOA and Glencore. The oil sold under the agreement is CPC Blend oil and is delivered free-on-board the CPC terminal at Novorossisk. Oil is delivered in lots from August 2003 until either the date falling 3 years and 7 months from August 2003 or, if BNP Paribas so directs, such later date as BNP Paribas may advise in order for KOA to satisfy all of its obligations under the BNP Paribas Facility. The parties may also agree on terminating the agreements provided that BNP Paribas gives its consent for such termination. Each lot and the price is defined in additional agreements to this framework agreement. The price is payable in U.S. Dollars on or before the 30th day after the date of delivery. Under the BNP Paribas Facility KOA has agreed not to sell any oil otherwise than in accordance with the Glencore off-take agreement, unless approved in accordance with the terms of the BNP Paribas Facility.

7.4 Vitol Off-take Agreement

On 28 May 2004, BBV entered into a crude oil sale and purchase agreement with Vitol. The oil is delivered free-on-board Vitol's vessel at the loading port in Aktau, or other port if so agreed between the parties. The parties will agree separately on the quantity of oil to be delivered monthly, subject to a monthly minimum quantity of 15,000 tonnes. All payments are made in U.S. dollars on the 30th day from the bill of lading date on a collection account with BNP Paribas. Vitol has a right to set off any liability of Vitol to BBV against any liability of BBV to Vitol, including the obligations BBV has against Vitol under the oil delivery advance payment agreement. The agreement will remain in force until the later of (i) the date which falls 48 months after the date of the first delivery of oil under the agreement, (ii) the date on which the minimum quantity of 720,000 tonnes of crude oil has been delivered and (iii) the date on which all of BBV's obligations under the oil delivery advance payment agreement have been discharged in full.

7.5 KOA Constituting Documents

The KOA Constituting Documents govern certain aspects of the relationship between the Company and Kazmunaigas.

General meetings

Under the KOA Foundation Agreement and the Charter, the general meeting has the ultimate power to decide on matters relating to the partnership. Each of the Company and Kazmunaigas has 50 per cent. of the voting rights at a general meeting of the partnership. Each partner has, therefore, a constructive veto over matters to be determined at general meetings. Certain matters are in the exclusive competence of the general meeting and require an approval by a qualified majority of three-quarters of the votes of the general meeting. These matters include, among others, the following:

- (a) approval of the annual works programmes and budgets for the Alibekmola and Kozhasai fields;
- (b) approval of the amount of the annual net income to be distributed to the partners and procedure for covering losses, if any;
- (c) decision to pledge all or part of the property of the partnership;
- (d) election of members of the supervisory board and approval of appointment of members of the directorate (see below); and
- (e) approval of decisions on incurring indebtedness in excess of U.S.\$1.0 million and approval of any transaction exceeding U.S.\$1.0 million.

Supervisory board

KOA has a supervisory board that exercises general management and control and develops strategy. The supervisory board has six members. Each of the Company and Kazmunaigas may appoint three representatives. The current permanent members of the supervisory board are S.A. Sehsuvaroglu, Kulyan Nursultanova, Mirbulat Abuov, Bolat Akchulakov, Airat Nurgaziyev and Eygeni Ogai. Kazmunaigas has the right to nominate the chairman of the supervisory board. The chairman does not have a casting vote. The current chairman is Bolat Akchulakov, Executive Director of Kazmunaigas.

Directorate

The directorate are responsible for the day-to-day operations of KOA. The members are the Director General, the Financial Director and the Commercial and Technical Directors. The Company has the right to nominate the Director General and the Financial Director. Kazmunaigas has the right to nominate the Commercial and Technical Directors.

Each member of the directorate has a contract of employment for a term of three years, which may be extended for an additional three year period.

Internal audit committee

The internal audit committee is responsible for supervision over the financial and business activity of the partnership. The internal audit committee has three members, one appointed by the Company, one by Kazmunaigas and the third is appointed jointly. A member of the directorate may not serve as a member of the internal audit committee.

Deadlock/Right of first refusal

Under the KOA Constituting Documents, in the event of a deadlock at the general meeting or supervisory board level, either partner may either sell its interest or initiate a dispute resolution procedure. In the event of any sale, each party has a right of first refusal to purchase the interest of the other at the fair price offered to a third party.

Financing of Operations

The Company has agreed to finance 100 per cent. of KOA's oil operations. The Company may also arrange third party financing for KOA. The financing provided by the Company is covered by an agreement between the Company and KOA dated 12 June 2001 pursuant to which financing provided by the Company is repayable only after KOA has sufficient available positive cash flow and such positive cash is projected for the next 12 months.

Termination

Either partner may terminate the partnership in the event of any of the bankruptcy or insolvency of the other, the suspension from management of a partner as provided in the KOA Constituting Documents and the mutual agreement between the partners. Following any termination event, the partners have agreed to take required actions to reorganise or to liquidate the partnership or to assign its interest to the other partner.

7.6 North Buzachi Joint Operating Agreement

The North Buzachi Joint Operating Agreement establishes the respective rights and obligations of BBV and CNPC (Buzachi) in relation to operations under the North Buzachi Hydrocarbon Contract. Pending the establishment of NBOC, CNPC (Buzachi) continues to act as the operator of the North Buzachi field.

Joint Operating Committee

BBV and CNPC (Buzachi) exercise their decision-making powers through their representatives at joint operating committee meetings. Each of BBV and CNPC (Buzachi) currently has 50 per cent. of the voting rights at such meetings. Except as otherwise expressly provided in the North Buzachi Joint Operating Agreement, all matters to be decided by the joint operating committee must be decided unanimously. Matters over which the joint operating committee has authority include, among others:

- (a) adoption and approval of the annual working programme and budget and material amendments thereto with associated contracting plans;
- (b) abandonment of any well;
- (c) any voluntary relinquishment of all or a portion of the licensed area or requests to the government for extensions of periods for the conduct of exploration, development and production activities under the North Buzachi Hydrocarbon Contract; and
- (d) approval of sub-contractors as well as procedures for the award of such contracts.

General Management

General management is responsible for the day-to-day operations of the joint operating company. General management are the General Manager, the Finance Deputy General Manager, the Commercial Deputy General Manager, and the Technical Deputy General Manager. CNPC (Buzachi) has the right to appoint the General Manager and the Technical Deputy General Manager. BBV has the right to appoint the Finance Deputy General Manager and the Commercial Deputy General Manager.

Deadlock/exclusive operations

In the event of a deadlock at a meeting of the joint operating committee relating to exploration and appraisal operations, either party may pursue such operations themselves, provided that such operations do not conflict with joint operations and the other parties do not wish to pursue such operations themselves. The continuing party or parties are responsible for all the costs and liabilities created by such independent operations. If a party decides not to participate in independent operations within a certain time period after a discovery has been made, the party loses their right to receive any hydrocarbons produced. In situations where this procedure cannot be used and an agreement between the parties cannot be reached, subject to certain conditions, any party may withdraw from the North Buzachi Joint Operating Agreement by giving a notice to all other parties. Any such notice will be unconditional and irrevocable, provided that the Government of Kazakhstan approved the withdrawal.

Financing of operations and default

Under the terms of the North Buzachi Joint Operating Agreement, the operating company is financed jointly by the partners in accordance with their respective interests. If a partner does not fulfil its financing obligations, receives a notice of default and fails to remedy that default, the defaulting partner loses certain entitlements, such as representation on the joint operating committee and access to information. As long as the defaulting partner is in default, the hydrocarbons produced will be the property of the non-defaulting partner(s), who may sell the defaulting partner's entitlement in order to recover the sum owed by the defaulting partner. If the

default continues following a period of 90-days after the notice of default, the non-defaulting partner(s) may require the defaulting partner to withdraw from the North Buzachi Joint Operating Agreement, the licence and the contract and the defaulting partner is deemed to have transferred its ownership interest in the licence and contract to the non-defaulting partners without compensation.

Term and withdrawal

The North Buzachi Joint Operating Agreement will remain in force until the North Buzachi Hydrocarbon Contract terminates. Any party may withdraw from the agreement (either wholly or partially) subject to the provisions of the agreement.

Right of first refusal

In the event of a proposed sale of the licence interest, each party has a right of first refusal to purchase the interest of the other at the price offered to a third party.

7.7 KOA Hydrocarbon Contract

On 10 August 1999, the MEMR and Kazakhoil (now, Kazmunaigas) entered into the KOA Hydrocarbon Contract relating to both the Alibekmola and Kozhasai fields. On 13 June 2000, the MEMR approved the assignment of the KOA Hydrocarbon Contract from Kazmunaigas to KOA. On 7 November 2001, Government Decree 1415 confirmed the assignment of the Alibekmola and Kozhasai licences and the KOA Hydrocarbon Contract. The term of the KOA Hydrocarbon Contract expires on the last day of the term of the licences to develop the Alibekmola and Kozhasai fields.

The MEMR has extensive rights to terminate the KOA Hydrocarbon Contract. These include where either of the related licences is terminated, where KOA has suspended production under the working programme for a period exceeding 90 days or KOA refuses to fulfil its obligations under the KOA Hydrocarbon Contract.

The MEMR must suspend the KOA Hydrocarbon Contract if either of the related licences is suspended or if a direct threat is created to the life or health of those working or living in the area influenced by the development work on the field. In addition, the MEMR may suspend the KOA Hydrocarbon Contract if KOA conducts activities not provided for in the KOA Hydrocarbon Contract, breaches legislation on sub-soil and environmental protection and work safety, does not pay taxes and other mandatory payments under the contract or is declared bankrupt. KOA has a grace period to rectify the situation but, if not rectified on time, the MEMR may terminate the contract for failure to remedy the underlying situation within a period set by the MEMR at the time of suspension.

Under the KOA Hydrocarbon Contract, the Government of Kazakhstan has the right to purchase a maximum of 25 per cent. of the total annual production of oil and gas from the licensed area.

KOA paid the Government of Kazakhstan a U.S.\$613,649 signing bonus in connection with entering into the KOA Hydrocarbon Contract. In addition, KOA has to pay a bonus for commercial discovery in the amount of 0.05 per cent. from the cost of the recoverable reserves in the event of increase in reserves in comparison with the approved reserves on the date of the KOA Hydrocarbon Contract. KOA is also required to pay U.S.\$69,619,900 to the Government of Kazakhstan for the past historical cost of discovering the two oil fields. This sum will be paid in quarterly instalments of U.S.\$1,087,810 commencing on 1 January 2007 until 31 December 2022.

The KOA Hydrocarbon Contract requires KOA to give preference to suppliers of Kazakh equipment, materials and services and to employ Kazakh nationals in preference to foreign nationals and to provide finance in the amount of U.S.\$50,000 annually to train such employees.

The KOA Hydrocarbon Contract also includes provisions on sub-soil and environmental protection, health and safety and reporting obligations to MEMR on the implementation of the working programme and compliance with the terms of the licences and the contract itself.

The KOA Hydrocarbon Contract requires KOA to pay certain taxes, royalties and historical cost charges during the development of the Alibekmola and Kozhasai fields based on the combined production from both Alibekmola and Kozhasai.

Pursuant to the tax stabilisation clause included in the KOA Hydrocarbon Contract, taxes and duties are determined under the tax regime that existed at the date of signing of the KOA Hydrocarbon Contract.

7.8 *North Buzachi Hydrocarbon Contract*

On 29 May 1997, the MEMR and Nimir Petroleum Company Buzachi Ltd. entered into the North Buzachi Hydrocarbon Contract. In 1998, Nimir Petroleum Company Buzachi Ltd. assigned 65 per cent. of its development and production rights with regard to the North Buzachi field to CNPC (Buzachi) and assigned the remaining 35 per cent. interest to BBV. These assignments were registered with the MEMR on 30 October 1998. On 5 February 2004, the MEMR registered an amendment to reflect the 50:50 allocation between CNPC (Buzachi) and BBV. The term of the North Buzachi Hydrocarbon Contract expires on the last day of the term of the licence.

If either party to the North Buzachi Hydrocarbon Contract materially breaches the contract, the other party may demand that the breach is remedied within a reasonable specified period. If the breach is not remedied within that time, the non-defaulting party may terminate the contract by giving 90 days' notice to the defaulting party. If the defaulting party contests such material breach, termination shall not occur unless pursuant to an arbitral award. Termination does not relieve the parties of all of their respective obligations under the North Buzachi Hydrocarbon Contract.

BBV may also terminate by giving notice that it intends to abandon production at the site; BBV and MEMR will then agree on a date for the abandonment.

Conduct of petroleum operations is prohibited if production poses a threat to life or health, in accordance with the applicable laws.

Under the North Buzachi Hydrocarbon Contract, the Government of Kazakhstan has the right to purchase any or all of the total oil produced in the licensed area. The maximum amount of oil as to which the Government may use its priority is limited to 50 per cent. of the level of total production at the time of the exercise of the preferential right.

If the Company wishes to commence commercial production of natural gas it would first have to pay an additional fee to the MEMR. The operator of the field may use natural gas freely in its production operations.

The North Buzachi Hydrocarbon Contract also includes provisions on sub-soil and environmental protection, health and safety and reporting obligations to MEMR on the implementation of the working programme.

The North Buzachi Hydrocarbon Contract requires BBV to pay certain taxes and royalties during the development of the North Buzachi field.

Pursuant to the tax stabilisation clause included in the North Buzachi Hydrocarbon Contract, taxes and duties are determined under the tax regime that existed at the effective date of the North Buzachi Hydrocarbon Contract.

The North Buzachi Hydrocarbon Contract requires the operator of the field to give preference to suppliers of Kazakh equipment, materials and services and to employ Kazakh nationals in preference to foreign nationals and to provide finance to train such employees.

7.9 *Credit facilities with HSBK*

AMS is a party to a revolving credit facility agreement with HSBK dated 7 June 2002 (the "June 2002 Facility"). The initial maximum principal amount of the June 2002 Facility of U.S.\$20 million was increased to U.S.\$27 million in November 2002. In April 2003, the currency of the loans granted under the June 2002 Facility was changed to Tenge. As at 31 December 2003, AMS had drawn down U.S.\$22.6 million under the June 2002 Facility. Pursuant to the terms of the facility agreement, any amounts drawn down under the June 2002 Facility can only be used for the development of the Alibekmola and Kozhasai fields.

HSBK and certain Directors of the Company are associated with EII, one of the principal shareholders of the Company. In addition, Mr. Abuov, a Director, is a director of HSBK.

Loans drawn under the June 2002 Facility bear an annual interest of 12.5 per cent. for loans in U.S. dollars, 15 per cent. for loans in Tenge and 4.5 per cent. for any amounts drawn for purposes of bank guarantees and/or letters of credit. Interest is payable twice a year. The credit line is available until 7 June 2005 and all the loans drawn down under the June 2002 Facility will mature on 11 June 2005. However, AMS expects to repay the June 2002 Facility prior to that date, as described below. Loans, bank guarantees and letters of credit mature pursuant to the terms of each instrument. Any amounts can be prepaid before their maturity.

The Company has irrevocably and unconditionally guaranteed the repayment of all the obligations of AMS under the June 2002 Facility. Pursuant to the terms of the June 2002 Facility, the Company's obligations under the June 2002 Facility prevail over other obligations assumed by it to third parties, except the KKB Credit Facility.

On 28 June 2004, BBV entered into a credit facility agreement with HSBK (the "June 2004 Facility"). The maximum principal amount available under the June 2004 Facility is U.S.\$53 million. U.S.\$21.5 million of the maximum amount is earmarked to repay the amounts owed by AMS to HSBK under the June 2002 Facility (as amended) and U.S.\$31.5 million will be available to finance the operations of BBV. Timing and details of the repayment of the June 2002 Facility will be agreed on separately.

Loans drawn under the June 2004 Facility bear an annual interest of 11.5 per cent. Any amounts utilised for purposes of bank guarantees and/or letters of credit bear a maximum annual interest of 3 per cent. Interest is payable twice a year starting 12 months after the first drawdown. In addition, BBV will pay HSBK a U.S.\$1.4 million fee after a 12-month grace period from the first drawdown.

The Company has irrevocably and unconditionally guaranteed the repayment of all the obligations of BBV under the June 2004 Facility.

The June 2004 Facility is available until 28 June 2009. Loans, bank guarantees and letters of credit drawn under the June 2004 Facility will mature pursuant to the terms of each draw down.

7.10 *KKB Credit Facility, as amended*

AMS is a party to a credit facility agreement with KKB dated 4 June 2002. The maximum principal amount available under the facility is U.S.\$20 million. As at 31 December 2003, AMS had drawdown U.S.\$16.8 million under the facility. Pursuant to the terms of the facility, KKB has a unilateral right to suspend or terminate the credit facility.

KKB and certain Directors of the Company are associated with CAIH, one of the principal shareholders of the Company. In addition, Mr. Alshinbayev, a Director, is also a director of KKB.

Loans drawn under the facility bear an annual interest of 15 per cent. for loans in U.S. dollars and 15 per cent. for loans in Tenge. Interest is payable monthly.

The Company has irrevocably and unconditionally guaranteed the repayment of all the obligations of AMS under the facility. The Company's obligations under the KKB facility prevail over other obligations assumed by it to third parties except the June 2002 Facility.

The credit line is available until 4 June 2005 when all loans under the facility will also mature.

7.11 *BNP Paribas Facility, as amended*

KOA is a party to a term loan facility with BNP Paribas and certain other banks dated 27 August 2003. The maximum principal amount available under the facility was increased from U.S.\$60 million to U.S.\$100 million in May 2004.

Under a subordination agreement entered into between BNP Paribas, AMS and KOA on 27 August 2003, all existing and current finance agreements between AMS and KOA are subordinated to the BNP Paribas facility in priority of payment. See "Advances and Loans to KOA" below.

Borrowings under the BNP Paribas Facility bear interest at a floating rate based upon LIBOR plus a 4 per cent. margin. In addition, KOA is responsible for payment of an additional amount to compensate BNP Paribas for the costs of compliance with the requirements of the Bank of England and the European Central Bank. Amounts drawn down under the facility accrue interest from the date of the drawdown to the date when the amount is repaid. Interest is payable monthly.

KOA has also paid certain up-front and agency fees in connection with the facility and will pay an annual commitment fee based on the principal amount available under the facility limit.

The Company has irrevocably and unconditionally guaranteed the repayment of amounts borrowed under the BNP Paribas Facility. In addition, the loans under the BNP Paribas Facility are secured by certain crude oil contracts between KOA and its off-takers (currently, 100 per cent. of KOA's production is sold under the Glencore Off-take Agreement), hedging agreements with BNP Paribas, and certain insurance policies as well as letters of credit, all of which may be assigned to the vendor.

The BNP Paribas Facility contains certain negative covenants that restrict the borrower from, among other things, disposing of any crude oil otherwise than in accordance with the terms of the Glencore Off-take Agreement or other crude oil sales agreements approved by BNP Paribas, as the case may be, or terminating any of these agreements. In addition, KOA is restricted from paying any amounts exceeding U.S.\$10 million due to entities holding an interest in KOA, including the Company, prior to the payment of all outstanding amounts due under the BNP Paribas Facility as well as declaring or paying any dividends to its owners.

The facility also requires the borrower to observe certain affirmative covenants, including covenants relating to maintenance of minimum available free cash flow and the funding of a debt service reserve account. In addition, the facility also includes terms on the sale of crude oil, which has to comply with the off-take agreement between KOA and Glencore.

Furthermore, KOA is subject to certain financial covenants that require a current assets to current liabilities ratio at a level of at least 0.5:1, a ratio of EBITDA (as defined) to net interest expenses at a level greater than 3:1, and a ratio of net debt (as defined) to net operating cash flow (as defined) at a level not greater than 25:1 at the end of each three-month period and 6:1 at the end of each financial year.

Loans under the BNP Paribas Facility will mature on 27 August 2006. KOA is obligated to repay the principal amount of loans drawn under the facility in 24 equal monthly instalments beginning on 27 September 2004. This repayment schedule may be accelerated if proven reserves of Alibekmola fall below 25 per cent. of the total proved reserves at the date of the BNP Paribas Facility.

7.12 *Vitol crude oil advance payment agreement*

BBV is a party to a crude oil advance payment agreement with Vitol dated 28 May 2004. Under the agreement, Vitol makes available to BBV an oil prepayment facility with a maximum principal amount of U.S.\$70 million. Under a facility participation agreement dated 28 May 2004 between BNP Paribas and Vitol, BNP Paribas participates in the funding of the facility. Any amounts drawn under the facility will be considered prepayments for the oil to be delivered under the Vitol Off-take Agreement. BBV agreed to apply all amounts advanced to it under the facility towards the payment of any fees and expenses or other amounts due and payable under the agreement and the repayment of part of the debt owed by BBV to CSFB under the CSFB bridge loan.

The amount advanced is to be repaid by monthly instalments, equal to $\frac{1}{42}$ nd (one forty second) of the amount advanced, which commence six months from the date of the agreement. The performance of BBV's obligations are guaranteed by the Company.

Loans under the facility bear an annual interest rate which is the aggregate of the applicable margin (3.25 per cent. until 28 May 2005 and 4.25 per cent. thereafter) and LIBOR. In addition, BBV agreed to pay an arrangement fee on the date when an advance payment is made under the facility.

The obligations of BBV under the advance payment facility and the Vitol Off-take Agreement are guaranteed on a senior basis by the Company.

The facility includes certain covenants, among other things, requiring BBV to maintain the Vitol Off-take Agreement.

BBV is obligated to repay the U.S.\$70 million in equal monthly instalments starting on 28 November 2004. The final repayment date is 48 months after the facility has been utilised. These payments will be made in the form of crude oil deliveries under the Vitol Off-take Agreement. If the value of crude oil in any month is less than the amount to be repaid, BBV has to pay the shortfall in cash.

7.13 *CSFB Bridge Loan*

BBV was a party to a credit facility agreement with CSFB dated 15 December 2003. The maximum principal amount available under the facility was U.S.\$90 million of which U.S.\$58 million was drawn down in connection with the purchase of the first 35 per cent. interest in the licence to develop the North Buzachi field in December 2003 and another U.S.\$32 million in February 2004 when the transfer of the additional 15 per cent. interest in the licence to BBV was approved by the Government of Kazakhstan.

The facility terminated on 4 June 2004 and the balance of the amounts drawn under the facility repaid. BBV is in the process of discharging the guarantees and pledges provided by various Group companies for the benefit of CSFB. Repayment of the facility was partly financed by the new financing obtained under the crude oil advance payment agreement with Vitol.

7.14 *Advances and loans to KOA*

The Company and its subsidiaries provided financial support to KOA in 2003, 2002 and 2001 in the form of advances or loans. The terms of the advances/loans are included in a financing agreement between KOA and the Company dated 12 June 2001. Under the terms of this agreement the Company agreed to finance all expenses of KOA stipulated in the annual working programme and the budget approved by the joint venture partners. The advances bear interest at the lower of (i) LIBOR plus 6.5 per cent., (ii) 12 per cent. per annum, (iii) the yield for the outstanding Kazakh sovereign debt plus 3.5 per cent., or (iv) the actual cost incurred by the Company for the funds recovered and re-loaned to KOA. Under the terms of the financing agreement, accrued but unpaid interest is added to the principal amount.

The financing provided by the Company under the 12 June 2001 loan agreement is repayable only after KOA has sufficient available positive cash flow and such positive cashflow is projected for the next 12 months. All advances and loans, including the interest thereof, have to be paid in full before KOA can distribute any net profits to its owners.

7.15 *Chaparral acquisition, as amended*

Under the terms of the Chaparral Share Purchase Agreement and certain other transaction documents, the Company's wholly-owned subsidiary, NAC, has purchased from CAIH 22,925,701 shares of common stock of Chaparral, the Chaparral Warrant in respect of an additional 3,076,923 shares in Chaparral, and the CAIH Note, for an aggregate purchase price of approximately U.S.\$23.9 million. In consideration for the shares, the Chaparral Warrant and the CAIH Note, Nelson has issued a promissory note in the principal amount of U.S.\$ 23.9 million payable to CAIH. The promissory note has a term of one year and bears interest at 10.5 per cent. per annum, payable at maturity.

The Company now owns 60 per cent. of the issued and outstanding shares of Chaparral (55.53 per cent. on a fully diluted basis). The shares of common stock issuable under the Chaparral Warrant would, assuming no other issuances of shares of common stock of Chaparral, upon the full exercise of the Chaparral Warrant, constitute approximately 7.45 per cent. of the issued and outstanding shares of Chaparral on a fully diluted basis. This would give the Company ownership of 62.98 per cent. of the issued and outstanding shares of Chaparral on a fully diluted basis.

7.16 *Zhambai/Zaburunye Option, as amended*

On 6 February 2002, the Company entered into an option agreement with Kazmunaigas to acquire from Kazmunaigas an interest in Zhambai LLP. Zhambai LLP holds a licence for the exploration and production of hydrocarbons at the Caspian Sea offshore blocks known as South Zhambai and South Zaburunye.

Pursuant to the terms of the Zhambai/Zaburunye Option as amended on 19 December 2003, the Company is entitled to acquire 50 per cent. of the interest of Kazmunaigas held at the date of exercise of the option, such that such 50 per cent. shall not be less than a 25 per cent. interest in Zhambai LLP. Zhambai/Zaburunye Option requires the Company and Kazmunaigas to conclude a financing agreement before the Company can exercise the option. The Company may exercise the option at any time after 1 January 2005 or, subject to the conclusion of an agreement between Kazmunaigas and a strategic partner who will be responsible for initial exploration of the field, prior to 1 January 2005. As at the date of this document, Kazmunaigas has not entered into such an agreement. The option will expire 30 days after the announcement of a commercial discovery of hydrocarbons.

Upon exercising the option, the Company has agreed to (i) pay Kazmunaigas U.S.\$40,000 to U.S.\$50,000 per one million tonnes of recoverable reserves from which production is possible; (ii) reimburse 50 per cent. of the historical costs incurred by Kazmunaigas with respect to operations of such offshore blocks; and (iii) issue a guarantee covering 100 per cent. of Kazmunaigas' financing obligations arising out of its participatory interest.

7.17 The Placing Agreement between the Company, Hoare Govett, Canaccord, and the executive Directors of the Company (being Mr. Zana and Mr. Kuandykov) dated 13 July 2004, pursuant to which each of Hoare Govett and Canaccord has agreed, as agent for the Company, to use its reasonable endeavours to procure subscribers for 112,144,128 new Common Shares at the Placing Price. The Placing Agreement is conditional upon, *inter alia*, Admission becoming effective by no later than 08.00 a.m. on 19 July 2004 (or such later date as the Company, Hoare Govett and Canaccord may agree), and upon Hoare Govett and Canaccord receiving signed commitments from placees agreeing to subscribe (on the terms of the Placing Agreement), in aggregate, for such number of the Placing Shares as would, at the Placing Price, raise U.S.\$119.3 million (£64.2 million) (gross) for the Company or such lesser amount as the Company, Hoare Govett and Canaccord may agree. In consideration of their services in connection with the Placing, the Company will pay to Hoare Govett and Canaccord the following fees:

- (a) on Admission to Hoare Govett, an advisory fee equal to 60 per cent. of the “Advisory Fee” (the Advisory Fee being the aggregate amount which is calculated by multiplying 0.5 per cent. by the Placing Price multiplied by the aggregate number of Placing Shares);
- (b) on Admission to Canaccord, an advisory fee equal to 40 per cent. of the Advisory Fee;
- (c) on Admission to Hoare Govett, commission equal to 55 per cent. of the “Commission” (the Commission being the aggregate amount which is calculated by multiplying 5 per cent. by the amount of the gross proceeds of the Placing);
- (d) on Admission to Canaccord, commission equal to 45 per cent. of the Commission.

The Placing Agreement contains warranties given by the Company and Mr. Zana and Mr. Kuandykov as to the accuracy of the information contained in this document and other matters relating to the Group and its businesses. In addition, the Company has given an indemnity to each of Hoare Govett and Canaccord in respect of certain matters. Hoare Govett and Canaccord are each entitled to terminate the Placing Agreement in certain circumstances at any time prior to Admission, including, amongst others, where there is an event of force majeure or a material adverse change in the business or where the Company is in material breach of its obligations under the Placing Agreement or there is a material breach of the warranties. If either of Hoare Govett or Canaccord terminates the Placing Agreement where the Company is in material breach of its obligations under the Placing Agreement or there is a material breach of the warranties, the Company shall (save where either breach is due to an event of force majeure) pay the advisory fees set out above to each of Hoare Govett and Canaccord.

7.18 A nominated adviser agreement dated 13 July 2004 between the Company, Canaccord and the executive Directors, pursuant to which the Company has appointed Canaccord to act as nominated adviser to the Company in relation to the issue of this document and Admission and thereafter. This agreement is for an initial term of 3 months and is terminable thereafter on 1 month’s notice. Canaccord will receive a fee of £50,000 per annum for its services. The agreement contains an indemnity given by the Company to Canaccord and provides, *inter alia*, that the Company and the executive Directors undertake to comply with the AIM Rules.

7.19 On 13 July 2004, each of Hoare Govett and Canaccord entered into separate broker agreements with the Company (on terms which are materially identical save for the change of identity of the parties), pursuant to which the Company has appointed each of Hoare Govett and Canaccord as joint brokers to the Company in relation to the issue of this document and Admission and thereafter. The broker agreement with Hoare Govett is for an initial term of 12 months and is terminable thereafter on 1 month’s notice. The broker agreement with Canaccord is for an initial term of 3 months and is terminable thereafter on 1 month’s notice. Each agreement contains an indemnity given by the Company to each of Hoare Govett and Canaccord and provides, *inter alia*, that the Company undertakes to comply with the AIM Rules.

8. Taxation

Certain UK tax consequences

The comments below are of a general nature and are based on the current UK law and Inland Revenue practice at the date of this document, all of which are subject to change, possibly with retroactive effect. This summary (1) only addresses the certain UK tax consequences for holders who hold the Common

Shares as capital assets and does not address the tax consequences which may be relevant to certain other categories of holders, for example, dealers; (2) assumes that the Shareholder is not a company which either directly or indirectly controls 10 per cent. or more of the share capital or the voting power or the profits of the Company; and (3) assumes that the Shareholder does not hold the Common Shares in trust.

The following is intended only as a general guide and is not intended to be, nor should it be considered to be, legal or tax advice to any particular holder. Accordingly, potential investors should satisfy themselves as to the overall tax consequences, including the consequences under UK law and practice, of acquisition, ownership and disposition of Common Shares in their own particular circumstances, by consulting their own tax advisers.

Dividends

A Shareholder who is a UK resident individual or company, or a company who is not resident in the UK but who carries on a trade, in the UK through a branch or agency (in the case of an individual) or a permanent establishment in connection with which the Common Shares are held, will generally be subject to UK income tax or corporation tax, as the case may be, on the gross amount of any dividend paid. The rates of tax applicable to dividends received by individuals will be 10 per cent. or 32.5 per cent. depending on the individual's particular circumstances.

Persons in the UK paying "foreign dividends" to or receiving "foreign dividends" (which may include certain payments on or under the Common Shares) on behalf of another person may be required to provide certain information to the UK Inland Revenue regarding the identity of the payee or the person entitled to the "foreign dividend" and, in certain circumstances, such information may be exchanged with tax authorities in other countries.

Capital Gains

A disposal or deemed disposal of Common Shares by an individual or corporate holder who is resident in the UK may give rise to a chargeable gain or allowable loss for the purposes of UK taxation of capital gains, depending on the individual circumstances of the holder. In the case of a Shareholder who is a company, an indexation allowance can be used to reduce or eliminate a chargeable gain but not to create or increase an allowable loss. If the holder is an individual, a tapering relief (if available) can be used to reduce a chargeable gain. A holder who is an individual is entitled to an annual exemption from UK tax on chargeable gains, currently of up to £8,200.

Stamp Duty

No UK stamp duty will be payable on the issue of the Common Shares or CDIs. No UK stamp duty will be payable on a transfer of the Common Shares provided that the instrument of transfer is executed outside the UK and subsequently remains at all times outside the UK and the instrument of transfer does not relate to any matter or thing done or to be done in the UK.

No UK stamp duty reserve tax will be payable on the issue or transfer of the Common Shares or CDIs.

Any person who is in any doubt as to his or her tax position or who may be subject to tax in any jurisdiction other than the United Kingdom should consult their own professional adviser.

Certain Bermuda Tax Consequences

In the opinion of Wakefield Quin, attorneys in Bermuda for the Company, there will be no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable in respect of the issue or delivery of the Common Shares pursuant to the Placing. In addition, as of the date of this document, there is no Bermuda income, corporation or profits tax, withholding tax, capital gains tax, capital transfer tax, estate duty or inheritance tax payable in respect of capital gains realised on a disposition of Common Shares or in respect of distributions by the Company with respect to Common Shares. Furthermore, the Company has received from the Minister of Finance of Bermuda under the Exempted Undertakings Tax Protection Act of 1966 an undertaking that, in the event of there being enacted in Bermuda any legislation imposing any tax computed on profits or income, including any dividend or capital gains withholding tax, or computed on any capital assets, gain or appreciation or any tax in the nature of an estate or inheritance tax or duty, the imposition of such tax shall not be applicable to the Company or any of its operations, nor to the Common Shares nor to obligations of the Company until the year 2016. This undertaking applies to the Common Shares. It does not, however, prevent the application of Bermuda taxes to persons ordinarily resident in Bermuda.

9. Working capital

The Directors, having made due and careful enquiries, are of the opinion that following Admission and after taking into account the financial facilities available and the net proceeds of the Placing receivable by the Company, the working capital available to the Group will, from the date of Admission, be sufficient for its present requirements, that is, for the period of twelve months from Admission.

10. Litigation

- 10.1 Save as disclosed in this paragraph 10, there are no legal or arbitration proceedings, active, pending or threatened against, or being brought by, the Company or any member of the Group which are having or may have a significant effect on the financial position of the Company.
- 10.2 The Company has received notice of a claim from the former Chief Operating Officer of the Company, Mr. Roy Meade. Mr. Meade is demanding that the Company make a payment of U.S. \$2.80 million to him pursuant to a stock option agreement concluded between the Company and Mr. Meade on or about 1 December 1999. Management believes that no monies are due and owing to Mr. Meade. Mr. Meade has not commenced proceedings in pursuit of his claim. Management intends to defend any proceedings that may be commenced by Mr. Meade.
- 10.3 During the first quarter ended 31 March 2004, the Government of Kazakhstan limited the export quota of Chaparral to approximately 87 per cent. of production available for sale. Chaparral has the right to export 100 per cent. of all hydrocarbons produced from the Karakuduk field. On 17 July 2003, Chaparral took the first step towards the commencement of arbitration proceedings in Switzerland for the breach of its export rights by the Government of Kazakhstan by initiating a required three-month period of consultation with the Government of Kazakhstan. The consultation period expired without resolution. Chaparral continues to seek an amicable resolution with the Government on this matter rather than proceeding with arbitration.

11. General

- 11.1 Except as set out in this Part V, there are no patents or other intellectual property rights, licences or particular contracts that are of fundamental importance to the Company's business. Save as disclosed in Part I, there are no exceptional factors which have influenced the Group's activities and there are no significant investments in progress.
- 11.2 The total costs and expenses relating to the Placing (including those fees and commissions referred to in paragraph 7.17 above) payable by the Company are estimated to amount to approximately U.S.\$8.6 million (£4.6 million) (excluding VAT). The net proceeds of the Placing receivable by the Company will be U.S.\$110.7 million (£59.6 million).
- 11.3 The minimum amount which, in the opinion of the Directors, must be raised under the Placing to provide the sums required in respect of the matters specified in Schedule 1 of the POS Regulations is divided as follows:
- (a) the purchase price of any property: U.S.\$ nil (£nil)
 - (b) preliminary expenses and expenses of the Placing: U.S.\$8.6 million (£4.6 million)
 - (c) repayment of money borrowed in respect of (a) and (b) above: U.S.\$ nil (£nil)
 - (d) working capital: U.S.\$110.7 million (£59.6 million)
- 11.4 Except for fees payable to the professional advisers whose names are disclosed in this document, payments to trade suppliers, no person has received any fees, securities in the Company or other benefits to a value of £10,000 or more, whether directly or indirectly, from the Company within the 12 months preceding the application for Admission, or has entered into any contracted arrangement to receive from the Company, directly or indirectly, any such fees, securities or other benefit on or after Admission.
- 11.5 Ernst & Young LLP has given and have not withdrawn their written consent to the issue of this document with the inclusion in this document of its reports in Part IV of this document above and the references to such reports and to its name in the form and context in which they appear.

- 11.6 Canaccord has given and not withdrawn its written consent to the issue of this document with the references to it in the form and context in which such references are included.
- 11.7 Hoare Govett has given and not withdrawn its written consent to the issue of this document with the references to it in the form and context in which such references are included.
- 11.8 McDaniel & Associates Consultants Ltd. has given and not withdrawn its written consent to the issue of this document with the inclusion in this document of its report in Part III and the references to such report and to its name in the form and context in which they appear elsewhere in this document.
- 11.9 Ryder Scott Company, L.P. has given and not withdrawn its written consent to the issue of this document with the inclusion in this document of its report in Part III and the references to such report and to its name in the form and context in which they appear elsewhere in this document.
- 11.10 The Directors have applied for the Common Shares to be admitted to CREST with effect from Admission. Accordingly, it is expected that the Common Shares will be enabled for settlement in CREST following Admission.
- 11.11 The Placing Shares will not commence trading on the TSX until the expiry of a period of 4 months and one day commencing on the closing of the Placing, during which period settlement of the Placing Shares will only take place in CREST.
- 11.12 Save as disclosed in this document there has been no significant change in the trading or financial position of the Group since 31 March 2004, the date of the financial information contained in the Unaudited Reports for the three months ended 31 March 2004 in section 2 of Part IV of this document.

12. Availability of documents

Copies of this document will be available free of charge to the public at the registered office of Canaccord at 1st Floor, Brook House, 27 Upper Brook Street, London, W1K 7QF, during normal business hours on any weekday (Saturdays and public holidays excepted) until the date falling one month after the date of Admission.

Dated: 13 July 2004

