UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

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FORM 10-Q

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

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FOR QUARTER ENDING SEPTEMBER 30, 1998

COMMISSION FILE NUMBER 0-6247

ARABIAN SHIELD DEVELOPMENT COMPANY
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| DELAWARE | 75-1256622 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. employer identification no.) |

| | |
|---|---|
| 10830 NORTH CENTRAL EXPRESSWAY, SUITE 175<br>DALLAS, TEXAS | 75231 |
| (Address of principal executive offices) | (Zip code) |

Registrant's telephone number, including area code: (214) 692-7872

Former name, former address and former fiscal year, if changed since last report.
NONE

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

YES X NO

Number of shares of the Registrant's Common Stock (par value $0.10 per share), outstanding at September 30, 1998: 22,019,494.

ARABIAN SHIELD DEVELOPMENT COMPANY AND SUBSIDIARIES

PART I. FINANCIAL INFORMATION

ITEM I. FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

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<TABLE>
<CAPTION>

| <S> | SEPTEMBER 30, 1998 (UNAUDITED) <C> | DECEMBER 31, 1997 <C> |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and Cash Equivalents | $ 2,029,569 | $ 534,086 |
| Short-Term Investments | 86,428 | 407,542 |
| Trade Receivables | 3,632,551 | 3,047,311 |
| Inventories | 205,313 | 548,320 |
| Total Current Assets | 5,953,861 | 4,537,259 |
| REFINERY PLANT, PIPELINE & EQUIP | 6,335,541 | 5,926,188 |
| Less: Accumulated Depreciation | (3,542,975) | (3,238,623) |

| | | |
|---|---|---|
| Net Equipment | 2,792,566 | 2,687,565 |
| AL MASANE PROJECT | 34,006,163 | 33,522,427 |
| OTHER INTERESTS IN SAUDI ARABIA | 2,431,248 | 2,431,248 |
| MINERAL PROPERTIES IN THE UNITED STATES | 1,417,295 | 1,411,190 |
| OTHER ASSETS | 408,530 | 463,230 |
| TOTAL ASSETS | $ 47,009,663 | $ 45,052,919 |
| LIABILITIES | | |
| CURRENT LIABILITIES: | | |
| Accounts Payable-Trade | $ 1,038,141 | $ 790,759 |
| Accrued Liabilities | 813,758 | 673,511 |
| Accrued Liabilities in Saudi Arabia | 1,444,156 | 1,283,401 |
| Notes Payable | 11,375,780 | 11,375,780 |
| Current Portion of Long-Term Debt | 498,000 | 598,000 |
| Current Portion of Long-Term Obligations | -- | 37,915 |
| Total Current Liabilities | 15,169,835 | 14,759,366 |
| LONG-TERM DEBT | 2,210,773 | 3,435,773 |
| LONG-TERM OBLIGATIONS | -- | 21,205 |
| ACCRUED LIABILITIES IN SAUDI ARABIA | 816,271 | 779,149 |
| DEFERRED REVENUE | 102,553 | 114,181 |
| MINORITY INTEREST IN CONSOLIDATED SUBSIDIARY | 1,037,249 | 1,044,487 |
| STOCKHOLDERS' EQUITY | | |
| COMMON STOCK-authorized 40,000,000 shares of $.10 par value; 22,019,494 shares issued and outstanding | 2,201,949 | 2,186,149 |
| ADDITIONAL PAID-IN CAPITAL | 36,101,150 | 35,875,950 |
| RECEIVABLE FROM STOCKHOLDER | (126,000) | (126,000) |
| ACCUMULATED DEFICIT | (10,504,117) | (13,037,341) |
| Total Stockholders' Equity | 27,672,982 | 24,898,758 |
| TOTAL LIABILITIES & STOCKHOLDERS' EQUITY | $ 47,009,663 | $ 45,052,919 |

</TABLE>

See notes to consolidated financial statements.



ARABIAN SHIELD DEVELOPMENT COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF OPERATIONS (UNAUDITED)

<TABLE>
<CAPTION>

| <S> | Three Months Ended Sept.30,1998 <C> | Three Months Ended Sept.30,1997 <C> | Nine Months Ended Sept.30,1998 <C> | Nine Months Ended Sept.30,1997 <C> |
|---|---|---|---|---|
| REVENUES | | | | |
| Refined Product Sales | $ 6,632,986 | $ 6,459,566 | $ 18,813,838 | $ 18,849,743 |
| Processing Fees | 165,647 | 146,505 | 570,998 | 397,235 |
| | 6,798,633 | 6,606,071 | 19,384,836 | 19,246,978 |
| OPERATING COSTS AND EXPENSES | | | | |
| Cost of Refined Product Sales and Processing | 4,704,962 | 5,470,319 | 14,311,093 | 16,566,461 |
| General and Administrative | 775,452 | 618,999 | 2,072,272 | 1,734,621 |
| Depreciation and Amortization | 105,806 | 100,380 | 312,994 | 425,993 |
| | 5,586,220 | 6,189,698 | 16,696,359 | 18,727,075 |
| OPERATING INCOME | 1,212,413 | 416,373 | 2,688,477 | 519,903 |
| OTHER INCOME (EXPENSE) | | | | |
| Interest Income | 28,419 | 20,043 | 78,532 | 31,414 |
| Interest Expense | (75,010) | (103,614) | (285,242) | (317,942) |
| Minority Interest | 3,410 | 6,788 | 7,238 | 25,578 |
| Miscellaneous Income | 38,361 | 44,802 | 112,719 | 157,015 |
| INCOME BEFORE INCOME TAXES | 1,207,593 | 384,392 | 2,601,724 | 415,968 |
| INCOME TAX EXPENSE | (46,800) | -- | (68,500) | -- |

| | | | | |
|---|---|---|---|---|
| NET INCOME | $ 1,160,793 | $ 384,392 | $ 2,533,224 | $ 415,968 |
| NET INCOME PER COMMON SHARE: | | | | |
| Basic | $ .05 | $ .02 | $ .12 | $ .02 |
| Diluted | $ .05 | $ .02 | $ .11 | $ .02 |
| WEIGHTED AVERAGE NUMBER OF COMMON EQUIVALENT SHARES OUTSTANDING: | | | | |
| Basic | 21,987,815 | 21,456,494 | 21,960,476 | 21,205,945 |
| Diluted | 22,916,524 | 22,041,282 | 22,915,453 | 21,819,402 |

</TABLE>

See notes to consolidated financial statements.



ARABIAN SHIELD DEVELOPMENT COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 1998

<TABLE>
<CAPTION>

| | COMMON STOCK | | ADDITIONAL PAID-IN CAPITAL | RECEIVABLE FROM STOCKHOLDER | ACCUMULATED DEFICIT | TOTAL |
|---|---|---|---|---|---|---|
| | SHARES | AMOUNT | | | | |
| <S> | <C> | <C> | <C> | <C> | <C> | <C> |
| DECEMBER 31, 1997 | 21,861,494 | $ 2,186,149 | $ 35,875,950 | $ (126,000) | $(13,037,341) | $ 24,898,758 |
| Common Stock Sold | 100,000 | 10,000 | 140,000 | | | 150,000 |
| Stock Options Exercised | 58,000 | 5,800 | 85,200 | | | 91,000 |
| Net Income | | | | | 2,533,224 | 2,533,224 |
| SEPTEMBER 30, 1998 | 22,019,494 | $ 2,201,949 | $ 36,101,150 | $ (126,000) | $(10,504,117) | $ 27,672,982 |

</TABLE>

See notes to consolidated financial statements.



ARABIAN SHIELD DEVELOPMENT COMPANY AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS (UNAUDITED)

<TABLE>
<CAPTION>

| | NINE MONTHS ENDED SEPT. 30, 1998 | NINE MONTHS ENDED SEPT. 30, 1997 |
|---|---|---|
| <S> | <C> | <C> |
| OPERATING ACTIVITIES: | | |
| Net Income | $ 2,533,224 | $ 415,968 |
| Adjustments for Non-Cash Transactions: | | |
| Depreciation and Amortization | 312,994 | 425,993 |
| Decrease in Deferred Revenue | (11,628) | (11,628) |

| | | |
|---|---|---|
| Effect of Changes in: | | |
| Decrease (Increase) in Trade Receivables | (585,240) | (346,290) |
| Decrease (Increase) in Inventories | 343,007 | 12,402 |
| Decrease (Increase) in Other Assets | 54,700 | 115,153 |
| (Decrease) Increase in Accounts Payable and Accrued Liabilities | 387,629 | (94,516) |
| Other | (15,880) | (44,701) |
| NET CASH PROVIDED BY (USED FOR) OPERATING ACTIVITIES | 3,018,806 | 472,381 |
| INVESTING ACTIVITIES: | | |
| Decrease (Increase)in Short-Term Investments | 321,114 | (58,380) |
| Additions to Al Masane Project | (483,736) | (410,760) |
| Additions to Plant, Pipeline & Equipment | (409,353) | (164,030) |
| Decrease (Increase)in Mineral Properties in U.S. | (6,105) | 33,257 |
| Increase in Accrued Liabilities in Saudi Arabia | 197,877 | 41,313 |
| NET CASH PROVIDED BY (USED FOR) INVESTING ACTIVITIES | (380,203) | (558,600) |
| FINANCING ACTIVITIES: | | |
| Common Stock Sold | 241,000 | 500,000 |
| Additions to Notes Payable & Long-Term Obligations | -- | -- |
| Reductions of Notes Payable & Long-Term Obligations | (1,384,120) | (412,621) |
| NET CASH PROVIDED BY (USED FOR) FINANCING ACTIVITIES | (1,143,120) | 87,379 |
| NET INCREASE (DECREASE) IN CASH | 1,495,483 | 1,160 |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 534,086 | 385,290 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | $ 2,029,569 | $ 386,450 |

</TABLE>

See notes to consolidated financial statements.



ARABIAN SHIELD DEVELOPMENT COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q. These financial statements have not been examined by independent certified public accountants, but in the opinion of management, all adjustments (consisting of normal recurring accruals) necessary for a fair presentation of consolidated results of operations, consolidated financial position and consolidated cash flows at the dates and for the periods indicated, have been included.

These financial statements do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. Operating results for the nine month period ended September 30, 1998 are not necessarily indicative of the results that may be expected for the year ended December 31, 1998. For further information, refer to the Consolidated Financial Statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1997.

These financial statements include the accounts of Arabian Shield Development Company (the "Company") and its wholly-owned subsidiaries, American Shield Refining Company (the "Refining Company") and American Shield Coal Company (the "Coal Company"). The Refining Company owns all of the outstanding common stock of Texas Oil and Chemical Company II, Inc. ("TOCCO"). South Hampton Refining Company ("South Hampton")is a wholly-owned subsidiary of TOCCO, and Gulf State Pipe Line Company, Inc. ("Gulf State")is a wholly-owned subsidiary of South Hampton. The Company also has voting rights to approximately 52%, and directly owns approximately 44%, of the capital stock of Pioche-Ely Valley Mines, Inc. ("Pioche"), which owns mining properties in Nevada. Pioche has been consolidated for financial statement purposes since January 1, 1996.

2. GOING CONCERN

These financial statements have been prepared assuming the Company will continue as a going concern. The Company's sources of cash flow in 1997 and the first nine months of 1998 were the operations of South Hampton's refinery and the proceeds from stock sales and loans. The Company is not currently generating cash flow from any other activities. As the cash flow attributable to the refinery is fully dedicated to repayment of debt and funding of refinery operations, the cash flow attributable to the refinery currently is not adequate to support the Company's operations. The Company is liable to the Saudi Arabian government for an $11,000,000 loan. The Company does not currently have the financial resources to pay this obligation.

Management plans to fund future operations through sales of its common stock and borrowings. It is expected that the operations and obligations of the Company will be eventually funded from operations of the Al Masane mine. However, because of uncertainties with respect to future sales of common stock, obtaining suitable financing, and reaching an agreement on the repayment of the loan to the Saudi Arabian government, there is



substantial doubt about the Company's ability to continue as a going concern. These financial statements do not include any adjustments that might result from the outcome of these uncertainties.

3. LEGAL PROCEEDINGS

South Hampton was a defendant in two lawsuits in two district courts in Jefferson County, Texas brought in 1993 and 1994 by two former employees of the Goodyear Tire & Rubber Company who were seeking unspecified actual and punitive damages for certain alleged illness and diseases resulting from alleged exposure to certain chemicals during their employment with Goodyear. One of these lawsuits was settled in March 1997 and the other in January 1998. The cost to the Company was not significant. A new lawsuit by another former Goodyear employee was filed in a Jefferson County District Court on December 16, 1997 for unspecified actual damages for the same reasons as the other two. The outcome of this lawsuit is not expected to have a material effect on the Company's financial position, results of operations or liquidity.

In August 1997, the Texas Natural Resource Conservation Commission ("TNRCC") notified South Hampton that it had violated various rules and procedures and proposed administrative penalties totaling $709,408 and recommended that South Hampton undertake certain actions necessary to bring its operations at the refinery into compliance. The violations generally relate to various air and water quality issues. South Hampton feels the penalty is greatly overstated and intends to vigorously defend against it. A preliminary hearing was held in November 1997 and a subsequent meeting is to be scheduled.

On May 15, 1991, the Company filed a complaint with the U. S. Department of Justice ("DOJ") against Hunt Oil Company of Dallas, Texas ("Hunt"), alleging violations of the Foreign Corrupt Practices Act ("FCPA")by Hunt in obtaining its Petroleum Production Sharing Agreement ("PSA") in Yemen in 1981, subsequent to the Company presenting a bid to the Yemen government for the same area before Hunt made its application. On May 5, 1995, Company's attorneys in Washington, D.C. informed the Company that, because the PSA of Hunt is still ongoing, and under its auspices, payments and receipts occur daily, the DOJ still has ample jurisdiction to continue its investigation. A letter from the DOJ on December 19, 1995 stated its interest in receiving additional documentation regarding the Company's allegations. On February 28, 1996, the Company sent more documents to the DOJ which it believed would further support its allegations. The Company's attorneys in Washington, D.C. believe that the Victim Restitution Act provides for restitution to the Company of monies lost as a result of the alleged wrongdoing by Hunt, if Hunt is convicted under the FCPA. On October 1, 1996, the DOJ wrote that the documents presented did not suggest that any criminal events happened within the statute of limitations, and that, at that time, the DOJ did not intend to pursue its investigation. On November 18, 1996, legal counsel retained by the Company, after studying the facts of the case, sent the DOJ an analysis concluding that, while the statute of limitations of FCPA may have lapsed, the statute of limitations for conspiracy to violate the FCPA had not lapsed, and that, as a consequence, the DOJ could criminally prosecute Hunt for conspiracy to violate the FCPA. The legal counsel met with the Fraud Section of the DOJ on December 13, 1996 and was told that the DOJ would take a more aggressive stance if more information of evidentiary quality were presented to them. The Company intends to vigorously pursue obtaining such further information in the United States and in Yemen.

Late in 1994, articles were published in two prominent Yemen newspapers in which Yemen Hunt Oil Company, a wholly-owned subsidiary of Hunt Oil Company of Dallas, Texas ("Yemen Hunt"), was accused of obtaining a petroleum production sharing agreement in Yemen in 1981 through the corruption of Yemen officials in order to exclude the application of the Company and it then partner, Dorchester Gas Company, from consideration for the same area. A letter to the editor of one of these newspapers, published on December 7, 1994 and signed by the executive vice president of Yemen Hunt, after explicitly mentioning the Company and Dorchester Gas Company, stated that "(Yemen Hunt) knows well those suspicious companies who are mainly engaged in political activities for the purpose of undermining the economic interest of Yemen..." On December 26, 1995, the Company filed a complaint of criminal libel with the Yemen Attorney General for Publications in Sana'a, Yemen against Yemen Hunt, alleging that Yemen Hunt, in its published letter to the prominent Yemen newspaper, had criminally libeled the Company, which, if not addressed, could seriously affect the business and reputation of the Company and its employees in the Middle East. In October 1996, the Company received the official decision from the Deputy Attorney General for Publications of Yemen which stated that, after taking the statement of the President of the Company and the statement of the chief of the legal department of Yemen Hunt, it was evident that the letter from Yemen Hunt published in the Yemen newspaper on December 7, 1994 was libelous to the Company. However, since the four month statute of limitations period under Yemen criminal law had run, Yemen Hunt could not be prosecuted for criminal libel. The Company intends to vigorously pursue the matter under the civil libel laws of Yemen.

4. INVENTORIES

Inventories include the following:

<TABLE>
<CAPTION>

| | SEPT. 30, 1998 | DEC. 31, 1997 |
|---|---|---|
| <S> | <C> | <C> |
| Refinery feedstock | $ -- | $ 86,591 |
| Refined products | 205,313 | 461,729 |
| Total inventories | $ 205,313 | $ 548,320 |

</TABLE>

Refined products and feedstock are recorded at the lower of cost, determined on the last-in, first-out method (LIFO), or market. At September 30, 1998, because LIFO value exceeded market, inventories were written down by approximately $82,500. At December 31, 1997, LIFO value approximated current cost.



5. EARNINGS PER COMMON SHARE

The following table (in thousands, except per share amounts) sets forth the computation of basic and diluted earnings per share for the nine months ended September 30, 1998 and 1997, respectively.

<TABLE>
<CAPTION>

| | Nine Months Ended September 30 | |
|---|---|---|
| | 1998 | 1997 |
| <S> | <C> | <C> |
| Net Income | $ 2,533 | $ 416 |
| Weighted average shares outstanding (basic) | 21,960 | 21,206 |
| Effect of dilutive stock options | 955 | 613 |
| Weighted average shares outstanding (diluted) | 22,915 | 21,819 |

| | | |
|---|---|---|
| Earnings per share | | |
| Basic | $ .12 | $ .02 |
| Diluted | $ .11 | $ .02 |

</TABLE>

In the nine months ended September 30, 1998 and 1997, the effect of assumed debt conversions was anti-dilutive.





ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

RESULTS OF OPERATIONS

The Company had net income of $2,533,224 for the nine months ending September 30, 1998, compared to net income of $415,968 for the same period in 1997, resulting in a net income increase of $2,117,256 in 1998.

For the first nine months ending September 30, 1998 and 1997, the refinery had operating income of $3,003,802 in 1998 and operating income of $902,735 in 1997, and net income of $2,799,456 in 1998 and net income of $690,256 in 1997, a net income increase in 1998 of $2,109,200. The refinery had positive cash flow from operations of $1,330,881 for the third quarter of 1998, which was in contrast to the comparable figure of $606,717 in 1997. Sales volume was comparable in 1998 and 1997 at a level of 7.4 and 7.5 million gallons, respectively, and the average selling price per gallon in 1998 was slightly higher than that of the third quarter of 1997 by $.01 per gallon. Feedstock prices were lower by almost 30% from the price for the same period in 1997. Sales for the third quarter in 1998 continued the trend set throughout 1997 and stayed at record volume levels for the premium pentane products. The lower feedstock costs in 1998 were the primary reason for the much improved performance from the same period in 1997. Pricing commitments and competitive pressures prevent raising product prices instantly as feed prices go up while the reverse is true during periods of falling prices. Margins are generally larger for a time until competitive pricing pressures force product prices down. In this economic cycle, demand has been strong enough to support current product pricing levels and the downward pressure has been avoided to some degree. Feedstock prices began falling in February 1997 and have held at unusual lows in 1998. The current low prices have held longer than most parties in the petroleum industry have expected.

Expenses at the refinery for the third quarter of 1998 were higher than a year ago. To meet competitive pressures and retain its experienced and trained personnel, the refinery raised the pay rates substantially for both hourly and salaried personnel during the second quarter. The refinery is near the Beaumont/Port Arthur area which is a world renowned oil refining and petrochemical producing region. As the larger companies in the area seek out qualified individuals for jobs during times of expansion, the personnel from the refinery, because of their varied experience and high level of training, are very desirable recruits. Personnel costs are the only area in which the refinery has seen inflationary pressure during this economic cycle. Many of the other major expenses, such as insurance, have actually decreased from 1997 levels.

Contributing to the higher operating expenses is the effort the refinery is making toward the clean-up of the operating area and the efficient management of the higher production rates. The additional expenses stem mainly from increased maintenance personnel, increased environmental testing and analysis and increased preventative maintenance efforts. Approximately $150,000 was spent or accrued for this type of work in the first nine months of 1998. Administrative expenses increased slightly compared to prior periods. Interest expense was down in 1998 since the refinery has prepaid most of its bank debt. Under terms of the bank Credit Agreement, the prepayment is available to be redrawn if necessary.



Processing fees for the third quarter of 1998 were $165,647, which was comparable to the $146,505 recorded for the same period in 1997. The refinery has found that there are many opportunities for a smaller company to provide processing services on streams which the larger companies no longer want to handle themselves. The refinery is in the process of erecting four distillation towers to increase the capacity and capabilities of the toll processing side of the business. In August 1998, the refinery signed a contract with a major customer to make use of this equipment, which should boost processing revenues to over three million dollars annually starting in the second quarter of 1999, however, there is no assurance that this level of revenues can be achieved.

The outlook for the industry is good from the perspective of increased opportunities for toll processing. The refinery is currently operating processes for four different entities and, while the contracts are being renewed on a year-to-year basis, the outlook on all the contracts is that they will be longer term operations. Sales of the refinery's prime products remain stable and expanded marketing efforts have kept the refinery near capacity since the third quarter of 1997.

Maintenance and capital items are on schedule in accordance with the refinery's budget plan for the year. The refinery is now planning for the construction of two new spherical storage tanks to make maximum use of the available PenHex Unit capacity and should allow the expansion of sales capacity by approximately 20%. Capital expenditures for the project will be approximately $800,000 and the tanks are expected to be completed in the second quarter of 1999. The outlook for the fourth quarter is good. Sales remain firm and there is no immediate outlook for higher feed prices. The refinery has bought feedstock ahead for the next three months to hedge against any spikes in prices and the natural gas hedging program should control any sudden rises in the refinery's single largest expense. In June 1997, the refinery resumed the hedging program to help decrease the volatility of the price of fuel gas. Commodity based derivative futures contracts are periodically purchased. Gains and losses are recognized when the contracts expire. A net loss of approximately $15,000 was included in the cost of refined product sales and processing for the first nine months in 1998.

General and Administrative Expenses for the first nine months in 1998 were $337,651 higher than for the same period in 1997, an increase of 19%. Interest Expense in 1998 and 1997 was practically all attributable to the debt of the refinery and decreased by $32,700 in 1998 due to the periodic payment of existing debt. The Minority Interest amount in the first nine months of 1998 and 1997 of $7,238 and $25,578, respectively, represents the Pioche minority shareholders' portion of Pioche's losses. The losses in Pioche are primarily attributable to the costs of maintaining the Nevada mining properties.

Interest Income in the first nine months of 1998 increased over the same period in 1997 due primarily from interest received on a note resulting from the installment sale of an office building by the refinery in June 1997. Other interest income is from short-term investments by the refinery and from the investment of temporary excess cash in time deposits in Saudi Arabia. Miscellaneous Income includes income from tank rentals, commission income and occasional small asset sale proceeds at the refinery, and until June 1997, it also included income from the rental of the office building.

Income Tax Expense includes $24,758 for the payment of 1997 federal income tax in the third quarter of 1998, plus $22,042 and $43,742 for estimated



1998 federal income taxes on net income for the three and nine months ended September 30, 1998, respectively.

## LIQUIDITY AND CAPITAL RESOURCES

Prior to the acquisition in June 1987 of the refinery in Silsbee, Texas, the Company had substantially no significant operating revenues since 1972. Because of the lack of operating revenues, it has been necessary for the Company continually to seek additional debt and equity financing in order to have funds to continue operations.

Since the granting by Saudi Arabia of the Al Masane mining lease in May 1993, the Company has been planning for the mobilization program and financing to implement the construction and commissioning of the mining treatment plant and housing facilities for the mine. The firm of Watts, Griffis and McOuat Limited of Toronto, Canada, has been appointed as owner's agent and project manager. The Company also plans to start an intensive exploration program to increase the reserves at the mine site and elsewhere in the lease area. In addition, the Company is engaged in the establishment of a petrochemical plant in Jubail, Saudi Arabia similar to the one at the refinery. The products to be manufactured would be solvents for the plastics industry which are anticipated to be sold in the Middle East, Europe and the Far East. An industrial license to build the plant has been received and further planning and design work are underway. There has been a strong interest from a German firm who would like to participate in the development of the site with processes of their own.

The principal assets of Pioche are an undivided interest in 48 patented and 80 unpatented mining claims and a 300 ton-per-day mill located in southeastern Nevada. Due to the lack of capital, the properties held by Pioche have not been commercially operated for approximately 35 years. In late 1996, Pioche was extended a proposal from a prominent mining company for the lease of its mining claims. In October 1997, an

"Exploration Agreement and Option to Purchase" was executed between the two parties. The agreement provided for annual payments to Pioche of $50,000 for seven years until, or unless, an option was exercised to purchase an 85% interest in the mining claims for $3,000,000. The mining company would pay all annual claim taxes and rentals and agreed to expend at least $50,000 in exploration work each year and to drill at least one hole during the first year. After almost a year of exploration work, the mining company in September 1998 gave 60 days written notice that it was terminating the agreement, effective November 9, 1998.

In addition to the actions taken in 1997 to generate additional equity capital and improve its financial condition, which are detailed in the 1997 Form 10-K, the Company has experienced the following activity in the first nine months of 1998:(1) the sale in January of 100,000 shares of the Company's Common Stock at $1.50 per share to a Saudi Arabian investor; (2)the issuance of 58,000 shares of the Company's Common Stock pursuant to option exercises by officers of the Company for a total of $91,000; (3) the payment in February of accrued mining lease rentals for four years on the Al Masane project to the Saudi Arabian government totaling $469,333; and (4) the extension in March 1998 of the maturity date of the notes to Den norske and Saudi Fal to December 31, 1999 from December 31, 1998.

At September 30, 1998, the outstanding principal amount under the new Amended and Restated Credit Agreement with Den norske was $265,000 all of which is classified as long-term debt since prepayments of $1,175,000



were made in the second and third quarter of 1998. The entire balance under the Amended and Restated Credit Agreement is due on December 31, 1999, pursuant to an extension in March 1998 of the maturity date. South Hampton has agreed to make minimum quarterly principal payments of $75,000 plus interest at the Den norske prime lending rate, plus 1%, and under certain conditions, can make distributions to Saudi Fal and the Company. The debt is secured by all of the assets of the refinery and all of the issued and outstanding shares of the Company's three subsidiaries there.

On October 15, 1996, there was also a restructuring of the loan of $1,500,000 owed by South Hampton to Saudi Fal, pursuant to Board of Director approval in October 1995. The loan, plus accrued interest, was converted into a Second Lien Promissory Note in the principal amount of $1,945,773 bearing interest at the Den norske prime lending rate, plus 1%. Interest only is due and payable monthly on the note and the entire unpaid balance of principal and accrued interest is now due on December 31, 1999, pursuant to an extension in March 1998 of the maturity date. The principal amount at September 30, 1998 remained at $1,945,773. Interest payments of $202,801 were made in the first nine months of 1998 and the amount of unpaid accrued interest at September 30, 1998 was approximately $46,000. The note is secured by all of the assets of the refinery and is subordinate to the Den norske note.

The Company, through its wholly-owned subsidiary American Shield Refining Company, advanced funds in 1990 for some of the costs to increase the processing capacity of the refinery. These advances were in the form of a note from the refinery. This note was also restructured at October 15, 1996, whereby accrued interest of $361,250 was added to principal with the note bearing interest at the Den norske prime lending rate, plus 1%. This resulted in a new principal amount of $1,694,605 at that time. In the first nine months of 1998, a total of $270,000 was paid on the note principal by the refinery, leaving a principal amount at September 30, 1998 of $1,424,605. The note was originally due on December 31, 1998, but in March 1998, the maturity date was extended to December 31, 1999. No interest payments have been made by the refinery to the Company through September 30, 1998 and the amount of unpaid accrued interest was approximately $307,000. The note is secured by all of the assets of the refinery and is subordinate to the promissory note issued to Saudi Fal.

On September 30, 1995, the Company made a formal application to the Saudi Industrial Development Fund ("SIDF")to obtain 50% of the capital needed to finance the development of the Al Masane project and on December 17, 1997, conditional approval was received for a $38.08 million loan. The Company plans to finance the remaining cost of the project with loans from commercial banks and equity funds from Saudi Arabian investors. The Company and its Saudi Arabian advisors have recently formed a joint venture which was officially registered as a Saudi limited liability company on August 23, 1998. The joint venture, which is equally owned by the Company and Al-Mashreq Mining Investments Company, has been infused with equity capital of $26.0 million and will immediately commence operations. Both the Company and the joint venture have applied to the Saudi Ministry of Petroleum and Mineral Resources requesting the transfer of the Company's existing Al Masane mining lease to the joint venture company. Documents have been sent to three major engineering contractors to solicit bids for the construction and development of the surface and underground facilities required for the mining and production of zinc and copper concentrates and silver and gold bullion from the Al Masane mine ore. Each prospective bidder has already visited the mine site and has agreed to submit its bid.

Construction and development of the mine by the



new company will take approximately twenty-one months to complete after the bids are received and evaluated and the winning bidder is selected. This is expected to be done by the end of 1998.

At September 30, 1998, a total of approximately $2,260,000 in salaries and termination benefits was due to Company employees in Saudi Arabia in accordance with Saudi Arabian employment laws. This amount includes approximately $816,000 due to Hatem El-Khalidi, the Company's President and Chief Executive Officer. The payment of these amounts has been deferred until the Company's working capital position improves. At September 30, 1998, the Company had not yet made the 1998 surface rental payment of approximately $117,000, which was due in May 1998, to the Saudi Arabian government under the terms of the Al Masane Project lease. The unpaid amount of these rental payments at December 31, 1997 was approximately $469,000, but in February 1998 a payment in full was made. The Company has not complied with certain statutory reporting requirements in Saudi Arabia. Management of the Company believes that the lack of compliance with these requirements will not have any effect on the Company's planned operations in Saudi Arabia.

A major component of the Company's activities relates to the acquisition, exploration and development of mineral deposits. There can be no assurance that the Company will successfully develop any of its properties, and if developed, whether the mineral acquisition, exploration and development costs incurred will ultimately be recovered. The recovery of such costs is dependent upon a number of future events, some of which are beyond the control of the Company. The ability of the Company to develop any of these properties is dependent upon obtaining additional financing as may be required and, ultimately, its financial success depends on its ability to attain successful operations from one or more of its projects.





PART II. OTHER INFORMATION

ITEM 5. OTHER INFORMATION

STOCKHOLDERS' PROPOSALS

Any proposal by a stockholder of the Company intended to be presented at the 1999 annual meeting of stockholders, which is currently scheduled for May 14, 1999, must be received by the Company at its principal executive office no later than December 4, 1998 for inclusion in the Company's Proxy Statement and form of proxy. Any such proposal must also comply with the other requirements of the proxy solicitation rules of the Securities and Exchange Commission. The Company intends to exercise discretionary voting authority granted under any proxy which is executed and returned to the Company on any matter that may properly come before the 1999 annual meeting of stockholders, unless written notice of the matter is delivered to the Company at its principal executive office no later than February 18, 1999.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) EXHIBITS

None

(b) REPORTS ON FORM 8-K

One report on Form 8-K was filed during the quarter ended September 30, 1998. The report was dated on September 29, 1998 and stated that, on August 23, 1998, a Saudi limited liability company was officially registered with the Saudi Ministry of Commerce. The Company has a 50% interest in the new Saudi company, which will develop and operate the Al Masane mining project in Saudi Arabia.

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SIGNATURES

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

| | |
|---|---|
| DATE: November 10, 1998 | ARABIAN SHIELD DEVELOPMENT COMPANY |
| | (Registrant) |
| | /s/ J. A. CRICHTON |
| | J. A. Crichton, Chairman of the Board of Directors |
| | /s/ DREW WILSON, JR. |
| | Drew Wilson, Jr. Secretary/Treasurer |



INDEX TO EXHIBITS

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| Exhibit Number | Description |
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| 27 | Financial Data Schedule |

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