

CHINA NORTH EAST PETROLEUM HOLDINGS LTD
Form 10QSB
November 23, 2005

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-QSB

QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the quarterly period ended September 30, 2005

TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 for the transition period from _____ to _____

Commission file number 0-49846

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED

(Exact name of small business issuer as specified in its charter)

Nevada
(State of other jurisdiction of
incorporation or organization)

87-0638750
(IRS Employer identification No.)

20337 Rimview Place, Walnut, California 91789
(Address of principal executive offices)

(909) 468-2840
(Issuer's telephone number)

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

Number of shares of common stock outstanding as of September 30, 2005: 18,274,08

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PART I

Item 1 □ Financial Statements (Unaudited)

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Balance Sheet
At September 30, 2005 (Unaudited)

ASSETS

CURRENT ASSETS

Cash and cash equivalents	\$	5,571
Other receivables and prepaid expenses		341,362
Total Current Assets		346,933
OIL AND GAS PROPERTIES, NET		
		4,636,652

FIXED ASSETS, NET		219,602
TOTAL ASSETS	\$	5,203,187
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$	416,256
Other payables and accrued liabilities		188,757
Notes payable		369,914
Due to directors and stockholders		2,369,884
Income tax payable		678,615
Total Current Liabilities		4,023,426
COMMITMENTS AND CONTINGENCIES		
-		
STOCKHOLDERS' EQUITY		
Common stock, \$0.001 par value, 50,000,000 shares authorized,		
18,274,080 shares issued and outstanding		18,274
Additional paid-in capital		1,400,847
Retained earnings (deficit)		
Unappropriated		(239,919)
Appropriated		76,901
Accumulated other comprehensive loss		(76,316)
Total Stockholders' Equity		1,179,787
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$	5,203,213

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CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statements of Operations

For the three months and nine months ended September 30, 2005 and 2004 (Unaudited and Restated)

	Three months ended		Nine months ended	
	2005	2004 (As Restated)	2005	2004 (As Restated)
REVENUE	\$ 386,282	\$ 337,752	\$ 1,053,166	\$ 1,137,737
COST OF SALES				
Production cost	14,782	98,186	80,557	357,208
Management fees paid	7,723	6,755	21,061	22,755
Resource tax	2,039	2,194	5,796	8,375
Depreciation and amortization	6,355	8,600	19,818	32,749
Total cost of sales	30,899	115,735	127,232	421,087

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GROSS PROFIT	355,383	222,017	925,934	716,650
OPERATING EXPENSES				
General and administrative expenses	21,499	13,827	102,509	122,407
Professional fees	3,500	-	10,500	-
Consulting fee	-	99,900	948,000	280,262
Depreciation and amortization	8,795	7,670	24,148	18,875
Total Operating Expenses	33,794	121,397	1,085,157	421,544
INCOME (LOSS) FROM OPERATIONS	321,589	100,620	(159,223)	295,106
OTHER INCOME (EXPENSE)				
Other expenses	-	(1)	-	(1,450)
Interest expense	(66,006)	(35,085)	(134,104)	(59,210)
Bank interest expense	(4,608)	-	(4,612)	-
Interest income	134	78	376	85
Profit on disposal of oil and gas properties	-	-	1,455	-
Total Other Expenses	(70,480)	(35,008)	(136,885)	(60,575)
INCOME (LOSS) FROM OPERATIONS BEFORE TAXES	251,109	65,612	(296,108)	234,531
INCOME TAX EXPENSE	89,206	59,460	238,140	188,753
NET INCOME (LOSS)	\$ 161,903	\$ 6,152	\$ (534,248)	\$ 45,778
OTHER COMPREHENSIVE INCOME				
Foreign currency translation loss	(76,316)	0	(76,316)	0
COMPREHENSIVE INCOME (LOSS)	\$ 85,587	\$ 6,152	\$ (610,564)	\$ 45,778
Net income (loss) per share-basic and diluted	\$ 0.01	*	\$ (0.03)	-
Weighted average number of shares outstanding during the period basic and diluted	18,274,080	19,922,080	18,411,358	19,373,822

* Less than \$0.01

The accompanying notes are an integral part of these condensed consolidated financial statements

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CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows

For the nine months ended September 30, 2005 and 2004 (Unaudited and Restated)

	2005	2004 (As restated)
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	\$ (534,248)	\$ 45,778
Adjusted to reconcile net income to cash (used in) provided by operating activities:		
Amortization of oil and gas properties	19,411	32,749
Depreciation of fixed assets	23,666	18,875

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Profit on disposal of oil and gas properties	(1,455)	-
Stock issued for services	948,000	-
Imputed interest expense	134,104	59,210
Changes in operating assets and liabilities		
(Increase) decrease in:		
Other receivables and prepaid expenses	(318,307)	52,657
Increase (decrease) in:		
Due to directors and stockholders	13,355	1,096,350
Accounts payable	6,852	(67,505)
Other payables and accrued liabilities	(976,632)	(892,313)
Deferred taxation	-	(131,493)
Income tax payable	247,183	320,004
Net cash provided by (used in) operating activities	(438,071)	534,312
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds on disposal of oil and gas properties	182,006	-
Purchase of oil and gas properties	(2,114)	(28,744)
Purchase of fixed assets	(30,635)	(107,432)
Net cash provided by (used in) investing activities	149,257	(136,176)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from the issuance of notes payable	369,914	-
Additional paid-in capital	-	(404,900)
Net cash provided by financing activities	369,914	(404,900)
EFFECT OF EXCHANGE RATE ON CASH	(76,316)	-
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,784	(6,764)
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	787	7,699
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$ 5,571	\$ 935
Supplemental disclosures of non cash financing activities:		
Imputed interest on advances from directors and stockholders	\$ 134,104	\$ 59,210

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**CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 2005 (UNAUDITED AND RESTATED)**

Note 1 - Basis Of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

In the opinion of management, the unaudited condensed consolidated financial statements contain all adjustments consisting only of normal recurring accruals considered necessary to

present fairly the Company's financial position at September 30, 2005, the results of operations for the three months and nine months ended September 30, 2005 and 2004, and cash flows for the nine months ended September 30, 2005 and 2004. The results for the nine months ended September 30, 2005 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2005.

These financial statements should be read in conjunction with the Company's annual report on Form 10-KSB as filed with the Securities and Exchange Commission.

Note 2 - Organization

China North East Petroleum Holdings Limited ("North East Petroleum") is a US listed company which was incorporated in Nevada on August 20, 1999 under the name of Draco Holding Corporation ("Draco"). Draco was authorized to issue 20,000,000 shares of common stock of \$0.001 par value. On June 28, 2004, the Articles of Incorporation were amended to change the name of the Company to China North East Petroleum Holdings Limited and its authorized shares of common stock were increased from 20,000,000 to 50,000,000. On July 21, 2005, the definitive Schedule 14C was filed with the Securities and Exchange Commission to increase the Company's authorized shares of common stock from 50,000,000 shares to 150,000,000 shares. The corresponding Articles of Amendment were filed with the Secretary of State of Nevada on August 11, 2005.

Hong Xiang Petroleum Group Limited ("Hong Xiang Petroleum Group") was incorporated in the British Virgin Islands ("BVI") on August 28, 2003.

On December 5, 2003, Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. ("Hong Xiang Technical") was incorporated in the People's Republic of China ("PRC") as a limited liability company with a registered capital of \$484,000. Hong Xiang Technical provides technical advisory services to oil and gas exploration companies in the PRC.

During 2004, Hong Xiang Petroleum Group acquired a 100% ownership of Hong Xiang Technical.

During 2004, Hong Xiang Technical acquired a 100% interest in Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Ltd. ("Hong Xiang Oil Development"), a limited liability company incorporated on April 1, 2003 in the PRC with a registered capital of \$604,800.

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**CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 2005 (UNAUDITED AND RESTATED)**

Hong Xiang Oil Development is engaged in the exploration and production of crude oil in the Jilin Oil Region of the PRC. Subsequent to the Cooperative Exploration Contract entered into by the non-operating interest owner and Jilin Office, PetroChina Group ("Sub-Owner") in December 2002, Hong Xiang Oil Development entered into another Cooperative Exploration Contract (the "Contract") with the non-operating interest owner in respect of the development rights to the proven reserves in the Qian'an Oil Field Zone 112 ("Qian'an 112") in the Jilin Oil

Region for 20 years (the "Contract Period").

In accordance with the Contract, Hong Xiang Oil Development is responsible for providing working capital to develop the oil reserves in Qian'an 112. Production from Qian'an 112 is shared in the following manner:

Contract period	For the Sub-Owner	For the Company
First 10 years	20%	80%
Remaining 10 years	40%	60%

The acquisition of Hong Xiang Oil Development by Hong Xiang Technical has been accounted for as a reorganization of entities under common control as the companies were beneficially owned by principally identical shareholders and share common management. The financial statements have been prepared as if the reorganization had occurred retroactively.

On March 29, 2004, Draco executed a Plan of Exchange ("the Agreement") with all the shareholders of Hong Xiang Petroleum Group to exchange 18,700,000 shares of common stock of Draco for 100% of the outstanding shares of Hong Xiang Petroleum Group.

The Agreement was consummated on April 30, 2004. As a result of the Agreement, the exchange of shares with Hong Xiang Petroleum Group have been accounted for as a reverse acquisition under the purchase method of accounting since the shareholders of Hong Xiang Petroleum Group obtained control of the consolidated entity ("North East Petroleum"). Accordingly, the merger of North East Petroleum and Hong Xiang Petroleum Group has been recorded as a recapitalization by Hong Xiang Petroleum Group, with Hong Xiang Petroleum Group being treated as the continuing entity. The financial statements have been prepared as if the reorganization had occurred retroactively. North East Petroleum, Hong Xiang Petroleum Group, Hong Xiang Technical and Hong Xiang Oil Development are hereafter referred to as ("the Company").

Accordingly, the financial statements include the following:

- a) The balance sheet consists of the net assets of the acquirer at historical cost and the net assets of the acquiree at historical cost; and
- b) The statements of operations include the operations of the acquirer for the years presented and the operations of the acquiree from the date of the merger.

The financial statements of the acquiree are not significant. Therefore, no pro forma financial statements are submitted.

In addition to the Exchange Agreement, on April 30, 2004, Draco executed a Distribution Agreement with its wholly-owned subsidiary, Jump'n Jax, Inc., a Utah corporation (["Jump'n Jax"]) pursuant to which the Company agreed to distribute all of the outstanding shares of Jump'n Jax as a dividend to the shareholders of record of Draco as of March 8, 2004. Under the Distribution Agreement, the effective date of the dividend distribution was also April 30, 2004.

Note 3 - Principles Of Consolidation

The accompanying unaudited condensed consolidated financial statements for 2005 and 2004 include the financial statements of North East Petroleum and its wholly owned subsidiaries, Hong Xiang Petroleum Group, Hong Xiang Technical and Hong Xiang Oil Development. All significant inter-company accounts and transactions have been eliminated in consolidation.

Note 4 - Use Of Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and 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.

Note 5 - Oil And Gas Properties

The Company follows the full cost method of accounting for oil and gas properties. Accordingly, all costs associated with the acquisition of development rights and the development of oil reserves including directly related overhead costs, are capitalized.

Depreciation, depletion and amortization of capitalized costs, excluding properties with unproven oil reserves, are based on the unit-of-production methods based on proven reserves. Investments in properties with unproven oil reserves and major development projects are not amortized until proven reserves associated with the projects can be determined or until impairment occurs. If the results of an assessment indicate that the properties are impaired, the amount of the impairment is added to the capitalized costs to be amortized.

In addition, the capitalized costs are subject to a "ceiling test", which basically limits such costs to the aggregate of the "estimated present value", discounted at a 10-percent interest rate of future net revenues from proven reserves, based on current economic and operating conditions, plus the lower of cost or fair market value of unproved properties with unproven oil reserves.

Sales of a portion of the development rights and properties with proven and unproven oil reserves are accounted for as adjustments to capitalized costs with no gain or loss recognized, unless such adjustments would significantly alter the relationship between capitalized costs and proven reserves of oil and gas, in which case the gain or loss is recognized as income.

Abandonment of oil and gas properties other than the development rights are accounted for as adjustments to capitalized costs with no loss recognized.

**CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
AS OF SEPTEMBER 30, 2005 (UNAUDITED AND RESTATED)**

Note 6 - Earnings Per Share

Basic earnings per share are computed by dividing income available to common stockholders by the weighted average number of shares of common stock outstanding during the period. Diluted income per share is computed similar to basi