

CHINA NORTH EAST PETROLEUM HOLDINGS LTD

Form 10-Q

August 14, 2009

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

FORM 10-Q

- ☒ QUARTERLY REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
for the quarterly period ended June 30, 2009
- ☐ TRANSITION REPORT UNDER SECTION 13 OR 15 (d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

for the transition period from to

Commission file number 000-49846

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.)

445 Park Avenue, New York, New York 10022  
(Address of principal executive offices)

(212) 307-3568  
(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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

Indicate by check mark whether the registrant is a large accelerate filer, an accelerate filer, a non-accelerated filer, or a smaller reporting company. See the definition of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated ☐ Accelerated filer ☐

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filer

Non-accelerated ☐

filer

Smaller reporting

company

☒

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 August 7, 2009: 20,989,087

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## INDEX TO FORM 10-Q

		Page No.
PART I		
Item 1.	Financial Statements	1
	Condensed Consolidated Balance Sheets – June 30, 2009 (Unaudited) and December 31, 2008 (Audited)	2
	Condensed Consolidated Statements of Operations and Comprehensive Income - three and six months ended June 30, 2009 and 2008 (Unaudited)	3
	Condensed Consolidated Statements of Cash Flows – six months ended June 30, 2009 and 2008 (Unaudited)	4
	Notes to Condensed Consolidated Financial Statements as of June 30, 2009 (Unaudited)	5
Item 2.	Management’s Discussion and Analysis of Financial Condition And Results of Operations	15
Item 3.	Quantitative and Qualitative Disclosure About Market Risk	24
Item 4T.	Controls and Procedures	24
PART II		
Item 1.	Legal Proceedings	24
Item 1A.	Risk Factors	25
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	25
Item 3.	Defaults Upon Senior Securities	25
Item 4.	Submission of Matters to a Vote of Security Holders	25
Item 5.	Other Information	25
Item 6.	Exhibits	25
SIGNATURES		26

## SPECIAL NOTE REGARDING FORWARD—LOOKING STATEMENTS

On one or more occasions, we may make forward-looking statements in this Quarterly Report on Form 10-Q regarding our assumptions, projections, expectations, targets, intentions or beliefs about future events. Words or phrases such as “anticipates,” “may,” “will,” “should,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will likely result,” “will continue” or similar expressions identify forward-looking statements. These forward-looking statements are only our predictions and involve numerous assumptions, risks and uncertainties, including, but not limited to those listed below and those business risks and factors described elsewhere in this report and our other Securities and Exchange Commission filings.

Forward-looking statements involve risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed. We caution that while we make such statements in good faith and believe such statements are based on reasonable assumptions, including without limitation, management’s examination of historical operating trends, data contained in records and other data available from third parties, we cannot assure you that our projections will be achieved. Factors that may cause such differences include but are not limited to:

- Our expectation of continued growth in the demand for our oil;
- Our expectation that we will have adequate liquidity from cash flows from operations;
- A variety of market, operational, geologic, permitting, labor and weather related factors; and
- The other risks and uncertainties which are described below under “RISK FACTORS”, including, but not limited to, the following:
- Unanticipated conditions may cause profitability to fluctuate.
- Decreases in purchases of oil by our customer will adversely affect our revenues.

We have attempted to identify, in context, certain of the factors that we believe may cause actual future experience and results to differ materially from our current expectation regarding the relevant matter or subject area. In addition to the items specifically discussed above, our business and results of operations are subject to the uncertainties described under the caption “Risk Factors” which is a part of the disclosure included in Item 2 of this Report entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations.”

From time to time, oral or written forward-looking statements are also included in our reports on Forms 10-K, 10-Q and 8-K, Proxy Statements on Schedule 14A, press releases, analyst and investor conference calls, and other communications released to the public. Although we believe that at the time made, the expectations reflected in all of these forward looking statements are and will be reasonable, any or all of the forward-looking statements in this quarterly report on Form 10-Q, our reports on Forms 10-K and 8-K, our Proxy Statements on Schedule 14A and any other public statements that are made by us may prove to be incorrect. This may occur as a result of inaccurate assumptions or as a consequence of known or unknown risks and uncertainties. Many factors discussed in this Quarterly Report on Form 10-Q, certain of which are beyond our control, will be important in determining our future performance. Consequently, actual results may differ materially from those that might be anticipated from forward-looking statements. In light of these and other uncertainties, you should not regard the inclusion of a forward-looking statement in this Quarterly Report on Form 10-Q or other public communications that we might make as a representation by us that our plans and objectives will be achieved, and you should not place undue reliance

on such forward-looking statements.

We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. However, your attention is directed to any further disclosures made on related subjects in our subsequent annual and periodic reports filed with the SEC on Forms 10-K, 10-Q and 8-K and Proxy Statements on Schedule 14A.

Unless the context requires otherwise, references to “we,” “us,” “our,” the “Company” and “NEP” refer specifically to China North East Petroleum Holdings Limited and its subsidiaries.

## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES ("NEP")

## Condensed Consolidated Balance Sheets

	June 30, 2009 (Unaudited)	December 31, 2008 (Audited)
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$22,675,024	\$ 13,239,213
Accounts receivable, net	5,083,803	4,230,080
Prepaid expenses and other current assets	510,008	781,121
Value added tax recoverable	-	311,240
Total Current Assets	28,268,835	18,561,654
<b>PROPERTY AND EQUIPMENT</b>		
Oil and gas properties, net	66,338,774	70,193,852
Fixed assets, net	1,705,301	1,684,377
Oil and gas properties under construction	-	714,629
Total Property and Equipment	68,044,075	72,592,858
<b>LAND USE RIGHTS, NET</b>	30,288	36,198
<b>DEFERRED FINANCING COSTS, NET</b>	790,819	939,098
<b>TOTAL ASSETS</b>	<b>\$97,134,017</b>	<b>\$ 92,129,808</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES</b>		
Accounts payable	\$12,098,584	\$ 10,985,894
Current portion of secured debenture, net of discount	2,864,844	1,489,126
Other payables and accrued liabilities	880,945	742,264
Due to related parties	14,610	66,262
Income tax and other taxes payable	3,264,378	3,710,870
Due to a stockholder	2,998,932	738
Total Current Liabilities	22,122,293	16,995,154
<b>LONG-TERM LIABILITIES</b>		
Accounts payable	9,295,090	13,944,903
Secured debenture, net of discount	4,138,732	6,594,700
Deferred tax payable	359,901	762,405
Total Long-term Liabilities	13,793,723	21,302,008
<b>TOTAL LIABILITIES</b>	<b>35,916,016</b>	<b>38,297,162</b>
<b>COMMITMENTS AND CONTINGENCIES</b>	-	-
<b>EQUITY</b>		

## NEP Stockholders' Equity

Common stock (\$0.001 par value, 150,000,000 shares authorized,  
20,904,080 shares issued and outstanding as of  
June 30, 2009; 20,784,080 shares issued and  
outstanding as of December 31, 2008)

	20,904	20,784
Additional paid-in capital	22,295,107	21,384,816
Deferred stock compensation	(843,750 )	(1,248,750 )
Retained earnings		
Unappropriated	29,625,009	24,536,079
Appropriated	1,372,999	1,372,999
Accumulated other comprehensive income	3,328,123	3,253,068
Total NEP Stockholders' Equity	55,798,392	49,318,996
Noncontrolling interests	5,419,609	4,513,650
TOTAL EQUITY	61,218,001	53,832,646
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$97,134,017	\$ 92,129,808

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

**CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations and Comprehensive Income**

	(Unaudited)		(Unaudited)	
	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
<b>NET SALES</b>	<b>\$ 11,351,405</b>	<b>\$ 14,167,538</b>	<b>\$ 20,250,628</b>	<b>\$ 24,991,512</b>
<b>COST OF SALES</b>				
Production costs	1,152,199	782,972	1,666,599	1,495,277
Depreciation of oil and gas properties	2,833,995	2,506,302	5,458,249	4,380,994
Amortization of land use rights	2,982	2,926	5,961	5,768
Government oil surcharge	580,375	3,173,380	618,167	5,384,700
Total Cost of Sales	4,569,551	6,465,580	7,748,976	11,266,739
<b>GROSS PROFIT</b>	<b>6,781,854</b>	<b>7,701,958</b>	<b>12,501,652</b>	<b>13,724,773</b>
<b>OPERATING EXPENSES</b>				
Selling, general and administrative expenses	610,754	288,331	1,183,337	545,925
Professional fees	153,032	39,818	225,048	97,330
Consulting fees	98,615	146,208	156,295	227,838
Amortization of deferred financing costs	74,140	74,139	148,279	98,852
Amortization of discount on debenture	509,355	486,803	1,002,058	649,071
Depreciation of fixed assets	70,986	58,253	139,801	110,485
Total Operating Expenses	1,516,882	1,093,552	2,854,818	1,729,501
<b>INCOME FROM OPERATIONS</b>	<b>5,264,972</b>	<b>6,608,406</b>	<b>9,646,834</b>	<b>11,995,272</b>
<b>OTHER INCOME (EXPENSE)</b>				
Other income	-	68,153	-	65,842
Other expense	(1,008 )	(105,601 )	(1,801 )	(105,601 )
Interest expense	(260,664 )	(305,347 )	(540,664 )	(425,044 )
Imputed interest expense	(37,669 )	(5,845 )	(49,917 )	(32,741 )
Interest income	4,668	25,924	19,764	29,966
Total Other Expense, net	(294,673 )	(322,716 )	(572,618 )	(467,578 )
<b>NET INCOME BEFORE INCOME TAXES</b>	<b>4,970,299</b>	<b>6,285,690</b>	<b>9,074,216</b>	<b>11,527,694</b>
Income tax expense	(1,667,848 )	(1,865,268 )	(3,087,667 )	(3,304,537 )
<b>NET INCOME</b>	<b>3,302,451</b>	<b>4,420,422</b>	<b>5,986,549</b>	<b>8,223,157</b>
Less: net income attributable to noncontrolling interests	(484,874 )	(548,373 )	(897,619 )	(976,093 )
<b>NET INCOME ATTRIBUTABLE TO NEP COMMON STOCKHOLDERS</b>	<b>2,817,577</b>	<b>3,872,049</b>	<b>5,088,930</b>	<b>7,247,064</b>
<b>OTHER COMPREHENSIVE INCOME</b>				
Total other comprehensive income	4,456	930,422	83,395	1,867,981
Less: foreign currency translation gain attributable to noncontrolling interests	(446 )	(93,042 )	(8,340 )	(186,798 )
	4,010	837,380	75,055	1,681,183



Foreign currency translation gain attributable to NEP  
common stockholders

COMPREHENSIVE INCOME ATTRIBUTABLE TO  
NEP COMMON

STOCKHOLDERS	\$ 2,821,587	\$ 4,709,429	\$ 5,163,985	\$ 8,928,247
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Net income per share

- basic	\$ 0.14	\$ 0.20	\$ 0.24	\$ 0.38
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- diluted	\$ 0.13	\$ 0.18	\$ 0.24	\$ 0.35
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Weighted average number of shares outstanding during  
the period

- basic	20,855,289	19,224,080	20,819,881	19,224,080
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- diluted	21,898,245	21,435,012	20,864,326	20,542,229
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The accompanying notes are an integral part of these condensed consolidated financial statements

## CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows  
For the six months ended June 30, 2009 and 2008 (Unaudited)

	2009	2008
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$5,088,930	\$7,247,064
Adjusted to reconcile net income to cash provided by operating activities:		
Depreciation of oil and gas properties	5,458,249	4,380,994
Depreciation of fixed assets	139,801	110,485
Amortization of land use rights	5,961	5,768
Amortization of deferred financing costs	148,279	98,852
Amortization of discount on debenture	1,002,058	649,071
Amortization of stock option compensation	340,384	12,504
Warrants issued for services	206,602	91,963
Noncontrolling interests	897,619	976,093
Stocks issued for services	-	27,125
Stock-based compensation for service	405,000	-
Imputed interest expense	49,917	32,741
Changes in operating assets and liabilities		
(Increase) decrease in:		
Accounts receivable	(853,723 )	(3,362,131 )
Prepaid expenses and other current assets	271,113	(2,099,397 )
Value added tax recoverable	311,240	111,227
Increase (decrease) in:		
Accounts payable	(3,537,123 )	(9,735,812 )
Other payables and accrued liabilities	138,681	(127,249 )
Income tax and other taxes payable	(446,492 )	2,687,453
Deferred tax payable	(402,504 )	(247,727 )
Net cash provided by operating activities	9,223,992	859,024
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of oil and gas properties	(790,110 )	(8,338,953 )
Purchase of fixed assets	(158,416 )	(596,055 )
Additions to oil and gas properties under construction	-	(563,024 )
Net cash used in investing activities	(948,526 )	(9,498,032 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payment of deferred financing costs	-	(1,186,229 )
Proceeds from issuance of secured debenture	-	15,000,000
Repayment of secured debenture	(1,770,000 )	-
Proceeds from exercise of stock warrants	1,200	-
Increase in amount due to a stockholder	2,998,194	265,076
Decrease in amounts due to related parties	(51,652 )	(1,715,330 )
Net cash provided by financing activities	1,177,742	12,363,517
<b>EFFECT OF EXCHANGE RATE ON CASH</b>	(17,397 )	(1,371,559 )

NET INCREASE IN CASH AND CASH EQUIVALENTS	9,435,811	2,352,950
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	13,239,213	74,638
CASH AND CASH EQUIVALENTS AT END OF PERIOD	\$22,675,024	\$2,427,588
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Income tax expense	\$4,077,609	\$2,851,704
Interest expense	\$280,839	\$425,044

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

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

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 June 30, 2009, the results of operations and cash flows for the three and six months ended June 30, 2009 and 2008. The results for the six months ended June 30, 2009 are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2009.

These financial statements should be read in conjunction with the Company's annual report on Form 10-K for the fiscal year ended December 31, 2008, previously filed with the Securities and Exchange Commission on March 30, 2009.

NOTE 2 ORGANIZATION

China North East Petroleum Holdings Limited ("North East Petroleum") was incorporated in Nevada on August 20, 1999 under the name of Draco Holding Corporation ("Draco").

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

Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. ("Hong Xiang Technical") was incorporated in the People's Republic of China ("PRC") on December 5, 2003 to provide 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") which is engaged in the exploration and production of crude oil in the Jilin Oil Region, of the PRC. In December 2002, Hong Xiang Oil Development entered into an oil lease agreement with Song Yuan City Yu Qiao Oil and Gas Development Limited Corporation ("Yu Qiao") to develop the proven reserves in the Qian'an Oil Field Zone 112 (Qian'an 112) in Jilin Oil Region for 20 years.

During 2004, Draco executed a Plan of Exchange to acquire 100% of Hong Xiang Petroleum Group.

On July 26, 2006, the Company entered into a Joint Venture Agreement (the "JV Agreement") with a principal stockholder and a related party, hereafter referred to as the "Related Parties," to acquire oil and gas properties for the exploration of crude oil in the PRC. Pursuant to the JV Agreement, the Company and the Related Parties are

obligated to contribute \$1 million and \$121,000, respectively, to the registered capital of Song Yuan North East Petroleum Technical Service Co., Ltd. (“Song Yuan Technical”), and the Company and the Related Parties will each share 90% and 10% respectively of the equity and profit interests of Song Yuan Technical.

On June 1, 2005, Song Yuan Technical acquired from third parties 100% equity interest of LongDe Oil & Gas Development Co. Ltd. (“LongDe”) at a consideration of \$120,773 in cash. LongDe is engaged in the exploration and production of crude oil in the Jilin Oil Region of the PRC.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 2 ORGANIZATION (CONTINUED)

On January 26, 2007, Song Yuan Technical acquired 100% of the equity interest of Yu Qiao for 10,000,000 shares of the Company's common stock having a fair value of \$3,100,000. Yu Qiao is engaged in the extraction and production of crude oil in Jilin Province, PRC and operates 3 oilfields with a total exploration area of 39.2 square kilometers. Pursuant to a 20-year exclusive Cooperative Exploration Contract (the "Oil Lease") which was entered into on May 28, 2002 with PetroChina Group, a corporation organized and existing under the laws of PRC ("PetroChina"), the Company has the right to explore, develop and extract oil at Qian'an 112, Da 34 and Gu 31 area.

After the acquisition of Yu Qiao, the oil lease agreement between Yu Qiao and Hong Xiang Oil Development was rescinded and Hong Xiang Technical and Hong Xiang Oil Development were dissolved in March 2007.

North East Petroleum, Hong Xiang Petroleum Group, Song Yuan Technical, LongDe and Yu Qiao are hereinafter referred to as ("the Company").

NOTE 3 PRINCIPLES OF CONSOLIDATION

The accompanying unaudited condensed consolidated financial statements include the unaudited financial statements of North East Petroleum and its wholly owned subsidiary, Hong Xiang Petroleum Group and 90% equity interest owned subsidiaries, Song Yuan Technical, LongDe and Yu Qiao (collectively, "the Company"). The noncontrolling interests represent the minority shareholders' 10% share of the results of Song Yuan Technical, LongDe and Yu Qiao.

All significant inter-company accounts and transactions have been eliminated in consolidation.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 4 SECURED DEBENTURE

The following is a summary of secured debenture at June 30, 2009 and December 31, 2008:

	June 30, 2009 (Unaudited)	December 31, 2008 (Audited)
8% Secured Debenture, net of unamortized discount of \$5,476,424 as of June 30, 2009 at 8% interest per annum, secured by 66% of the Company's equity interest in Song Yuan Technical and certain properties of the Company and 6,732,000 shares of common stock of the Company owned by a stockholder, due on February 28, 2012	\$ 7,003,576	\$ 8,083,826
	7,003,576	8,083,826
Less: current maturities	(2,864,844 )	(1,489,126 )
Long-term portion	\$ 4,138,732	\$ 6,594,700

On February 28, 2008, the Company entered into a Securities Purchase Agreement (the "Purchase Agreement") with Lotusbox Investments Limited (the "Investor"). Pursuant to the Purchase Agreement, the Company issued to the Investor an 8% Secured Debenture due 2012 (the "Debenture") in the aggregate principal amount of \$15,000,000, and issued to the Investor five-year warrants exercisable for up to (i) 1,200,000 shares of the Company's common stock at an initial exercise price equal to \$0.01 per share ("Class A Warrants"), (ii) 1,500,000 shares of the Company's common stock at an initial exercise price equal to \$3.20 per share ("Class B Warrants") and (iii) 2,100,000 shares of the Company's common stock at an initial exercise price equal to \$3.45 per share ("Class C Warrants"), with all warrant exercise prices being subject to certain adjustments. The Class B Warrants are subject to certain call rights by the Company. The Company also granted the Investor an option to purchase up to 24% of the registered capital of Song Yuan Technical at a fair market value which option shall vest immediately on the date following the occurrence of an event of default.

On March 5, 2009, the Company and the Investor entered into Amendment No.1 to 8% Secured Debenture (the "Amendment") which amended the Debenture issued to the Investor on February 28, 2008 for the principal amount of \$15,000,000. Pursuant to the Amendment, the Investor agreed to extend the Company's requirement to effect a listing of its common stock on either the NYSE AMEX LLC or NASDAQ until August 30, 2010, and the Company issued four-year warrants to the Investor to purchase up to (i) 250,000 shares of common stock at an exercise price of \$2 per share and (ii) 250,000 shares of common stock at an exercise price of \$2.35 per share. Also pursuant to the Amendment, the parties have agreed to amend the monthly principal repayment schedule of the Debenture. Pursuant to Section 2(e) of the Series B and C Common Stock Purchase Warrant issued on February 28, 2008 (the "B Warrants" and "C Warrants") for the purchase of 3,600,000 shares of common stock of Company, the exercise price of the B Warrants and C Warrants have been reset to \$2.35 per share.

The Company accounts for warrants as liability instruments in accordance with paragraph 8 of EITF 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially settled in, a Company's Own Stock. The

beneficial conversion feature associated with the secured debenture is measured at its intrinsic value after allocation between the warrant and the debenture and before transaction costs in accordance with EITF 00-27, Application of Issue 98-5 to Certain Convertible Instruments. Debt proceeds are first allocated to the warrant (as it is mark-to-market, fair-value liability instrument) and the remaining proceeds are allocated to the debt. The debenture will be accreted to liquidation value over two years, using the effective interest rate method.

The Company has recorded a cost of \$8,101,160 for the beneficial conversion feature granted to the Investor. The beneficial conversion feature is reflected as a discount to the carrying value of the debenture and is being amortized as an interest expense over the term of the debenture.

Interest expense on the secured debenture for the three and six months ended June 30, 2009 was \$260,664 and \$540,664 respectively.



CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 4 SECURED DEBENTURE (CONTINUED)

Discount amortized on the secured debenture for the three and six months ended June 30, 2009 was \$509,355 and \$1,002,058 respectively.

NOTE 5 NET INCOME PER SHARE

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net income per share (in thousands, except per share amounts):

	Six months ended June 30,	
	2009	2008
Numerator:		
Net income attributable to NEP common stockholders used in computing basis net income per share	\$ 5,089	\$ 7,247
Net income attributable to NEP common stockholders used in computing diluted net income per share	\$ 5,089	\$ 7,247
Denominator:		
Shares used in the computation of basic net income per share (weighted average common stock outstanding)	20,820	19,224
Dilutive potential common stock:		
Options and warrants	44	1,318
Shares used in the computation of diluted net income per share	20,864	20,542
Basic net income per share	\$ 0.24	\$ 0.38
Diluted net income per share	\$ 0.24	\$ 0.35

For the six months ended June 30, 2009, options to purchase 470,000 shares of common stock and warrants to purchase 4,260,000 shares of common stock with exercise prices greater than the average fair market value of the Company's stock of \$2.34 were not included in the calculation because the effect is anti-dilutive.

	Three months ended June 30,	
	2009	2008
Numerator:		
Net income attributable to NEP common stockholders used in computing basis net income per share	\$ 2,818	\$ 3,872
Net income attributable to NEP common stockholders used in computing diluted net income per share	\$ 2,818	\$ 3,872
Denominator:		
Shares used in computation of basic net income per share		

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(weighted average common stock outstanding)	20,855	19,224
Dilutive potential common stock:		
Options and warrants	1,043	2,211
Shares used in computation of diluted net income per share	21,898	21,435
Basic net income per share	\$ 0.14	\$ 0.20
Diluted net income per share	\$ 0.13	\$ 0.18

For the three months ended June 30, 2009, options to purchase 410,000 shares of common stock with exercise prices greater than the average fair market value of the Company's stock of \$3.01 were not included in the calculation because the effect is anti-dilutive.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 6 COMMITMENTS AND CONTINGENCIES

(A) Lease commitment

The Company leases office spaces from a stockholder, land and office spaces from third parties under four operating leases which expire on September 20, 2023, December 31, 2009, January 20, 2011 and September 14, 2009 at annual rental of \$183, \$5,844, \$18,993 and \$37,200 respectively.

As of June 30, 2009, the Company had outstanding commitments with respect to the above operating leases, which are due as follows:

2009	\$20,261
2010	19,176
2011	1,765
2012	183
Thereafter	1,967
	\$43,352

(B) Capital commitments

As of June 30, 2009, the Company had commitments for capital expenditure of \$10,519,000 with a contractor to complete the drilling of 48 oil wells.

NOTE 7 STOCK-BASED COMPENSATION

From May 2008 to June 2009, the Company granted to its employees, stock options qualified under the Company's 2006 Stock Option/Stock Issuance Plan to purchase Common Stock. As of June 30, 2009, stock options granted under the Company's 2006 Stock Option/Stock Issuance Plan to purchase 470,000 shares of its Common Stock (the "Options") at an exercise prices from \$2.94 to \$4.50 per share were outstanding. 25% of the 160,000 stock options shall vest upon grant and 25% shall vest every three months thereafter, these stock options granted shall expire ten years after the grant date. 50% of the 310,000 stock options shall vest upon grant and 50% shall vest on the first anniversary of the grant date.

The fair value of stock options granted was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions:

Expected Life	Expected Volatility	Dividend Yield	Risk Free Interest Rate	Grant Date Fair Value
1 to 2 years	102% to 173%	0%	0.49% to 2.66%	\$2.94 to \$4.50

- Dividend Yield: The expected dividend yield is zero. The Company has not paid a dividend and does not anticipate paying dividends in the foreseeable future.
- Risk Free Rate: Risk-free interest rate of 0.49% to 2.66% was used. The risk-free interest rate was based on U.S. Treasury yields with a remaining term that corresponded to the expected term of the option calculated on the granted date.
- Expected Life: Because the Company has no historical share option exercise experience to estimate future exercise patterns, the expected life was determined using the simplified method as these awards meet the definition of "plain-vanilla" options under the rules prescribed by Staff Accounting Bulletin No. 107.

Stock compensation expense is recognized based on awards expected to vest. There was no estimated forfeiture as the Company has a short history of issuing options. SFAS No. 123R requires forfeiture to be estimated at the time of grant and revised in subsequent periods, if necessary, if actual forfeitures differ from those estimates.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 7 STOCK-BASED COMPENSATION (CONTINUED)

As of June 30, 2009, 470,000 stock options with a fair value of approximately \$1,218,848 were issued to staff, of which the Company recognized \$340,384 as staff compensation expenses included in selling, general and administrative expenses for the six months ended June 30, 2009.

As of June 30, 2009, the total compensation cost related to stock options not yet recognized was \$541,486 and these will be recognized over the next 2 years.

The following is a summary of the stock options activity:

	Number of Options Outstanding	Weighted- Average Exercise Price
Balance, December 31, 2008	410,000	\$ 4.43
Granted	60,000	\$ 2.94
Forfeited	-	-
Exercised	-	-
Balance, June 30, 2009	470,000	\$ 4.24

The following is a summary of the status of options outstanding at June 30, 2009:

Outstanding Options		Exercisable Options			
Exercise Price	Number	Average Remaining Contractual Life	Average Exercise Price	Number	Weighted Average Exercise Price
\$4.05	60,000	8.88 years	\$4.05	60,000	\$4.05
\$4.50	40,000	9.04 years	\$4.50	20,000	\$4.50
\$4.50	310,000	9.04 years	\$4.50	155,000	\$4.50
\$2.94	60,000	9.88 years	\$2.94	15,000	\$2.94

NOTE 8 STOCKHOLDERS' EQUITY

(A) Changes in Equity

The following table summarizes the changes in equity for the six months ended June 30, 2009 (in thousands):

NEP Common	Noncontrolling
------------	----------------

	Stockholders	Interests	Total
Total equity as of December 31, 2008	\$ 49,319	\$ 4,513	\$ 53,832
Common stock	-	-	-
Additional paid-in capital	910	-	910
Deferred stock compensation	405	-	405
Net income	5,089	898	5,987
Other comprehensive income	75	9	84
Total equity as of June 30, 2009	\$ 55,798	\$ 5,420	\$ 61,218

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 8 STOCKHOLDERS' EQUITY (CONTINUED)

(B) Stock issuance

On May 8, 2009, the Company issued 120,000 shares of common stock to a consultant who exercised the Class A Warrants at the exercise price of \$0.01 per share.

(C) Issuance of warrants

Pursuant to a consulting agreement with effect from April 29, 2009 for a term of two years, the Company issued to a consultant for investor relations consulting services a four-year warrant for 50,000 shares of the common stock of the Company at an exercise price equal to \$2.65 per share. The Company's stock was trading at \$1.90 at the time of issuance of the warrant. The warrant shall be exercisable as of the effective date of the consulting agreement. The warrant has been determined to have a market value of \$38,472 using the Black-Scholes option pricing model with market value per common stock of \$0.77, an exercise period of 2 years and a volatility of 92%. The Company recognized \$3,206 and \$3,206 as consulting expenses for the three and six months ended June 30, 2009 respectively.

Pursuant to an engagement agreement with effect from February 28, 2008 for a term of two years, the Company issued to a law firm for legal services at rates lower than its billing rate a warrant for 100,000 shares of the common stock of the Company at an exercise price equal to \$2.15 per share. This warrant may be exercised until January 1, 2013. The Company's stock was trading at \$2.14 at the time of issuance of the warrant. The warrant shall be exercisable as of the effective date of the engagement agreement. The warrant has been determined to have a market value of \$158,420 using the Black-Scholes option pricing model with market value per common stock of \$1.58, an exercise period of 2 years and a volatility of 158%. The Company recognized \$105,613 and \$105,613 as professional fees for the three and six months ended June 30, 2009 respectively.

On February 28, 2008, the Company issued to a consultant five-year warrants exercisable for up to (i) 120,000 shares of the Company's common stock at an initial exercise price equal to \$0.01 per share ("Class A Warrants"), (ii) 150,000 shares of the Company's common stock at an initial exercise price equal to \$3.20 per share ("Class B Warrants") and (iii) 210,000 shares of the Company's common stock at an initial exercise price equal to \$3.45 ("Class C Warrants"), with all warrant exercise prices being subject to certain adjustments. The exercise prices of Class B Warrants and Class C Warrants were subsequently revised to \$2.35 per share. The Class B Warrants are subject to certain call rights. The Company's stock was trading at \$2.93 at the time of issuance of warrants. The warrants have been determined to have a total market value of \$788,306 using the Black-Scholes option pricing model with market value per common stock of \$2.13, \$1.48 and \$1.48 for Class A Warrants, Class B Warrants and Class C Warrants respectively, an exercise period of 2 years and a volatility of 158%, 82% and 82% respectively. The Company recognized \$48,681 and \$97,783 as consulting expenses for the three and six months ended June 30, 2009 respectively.

NOTE 9 RELATED PARTY TRANSACTIONS

- a) As of June 30, 2009, the Company owed a stockholder of \$2,998,932 which is unsecured and repayable on demand. Imputed interest is computed at 5% per annum on the amount due.
- b) As of June 30, 2009, the Company owed a related party of \$14,610 which is unsecured and repayable on demand. Imputed interest is computed at 5% per annum on the amount due.
- c) Total imputed interest expenses recorded as additional paid-in capital amounted to \$37,669 and \$49,917 for the three and six months ended June 30, 2009 respectively.
- d) The Company paid a stockholder \$0 and \$3,507 for leased office spaces for the three and six months ended June 30, 2009 respectively.



CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 10 CONCENTRATIONS AND RISKS

During 2009, 98% and 2% of the Company's assets were located in the PRC and the United States respectively.

During 2009, 100% of the Company's revenues were derived from one customer located in the PRC. The Oil Lease requires the Company to sell crude oil to PetroChina only.

The accounts receivable from PetroChina as of June 30, 2009 was \$5,083,803.

NOTE 11 RECLASSIFICATIONS

Certain reclassifications have been made in the consolidated financial statements for the six months ended June 30, 2008 to conform to the current period's presentation.

NOTE 12 THE EFFECT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157 "Fair Value Measurements". Effective January 1, 2008, the Company adopted the measurement and disclosure other than those requirements related to nonfinancial assets and liabilities in accordance with guidance from FASB Staff Position 157-2 "Effective Date of FASB Statement No. 157", which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal year 2009. In April 2009, the FASB issued Staff Position No. FAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS No. 157-4"). FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS No. 157 "Fair Value Measurements", which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP FAS No. 157-4 is effective for interim and annual reporting periods ending after June 15, 2009 and will be applied prospectively. The adoption of SFAS No. 157 did not have a material impact on the financial statements.

On December 31, 2008, the SEC published the revised rules and interpretations updating its oil and gas reporting requirements. Many of the revisions are updates to definitions in existing oil and gas rules to make them consistent with the petroleum resources management system, which is a widely accepted standard for the management of petroleum resources that was developed by several industry organizations. Key revisions include the ability to include nontraditional resources in reserves, the use of new technology for determining reserves, permitting disclosure of probable and possible reserves, and changes to the pricing used in determining reserves. To determine reserves companies must use a 12-month average price. The Company is required to comply with the amended disclosure requirement for registration statements filed after January 1, 2010, and for annual reports for fiscal years ending on or after December 15, 2009. Early adoption is not permitted. The Company is currently assessing the impact that the adoption will have on the Company's disclosures, operating results, financial position and cash flows.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 “Employers’ Disclosures about Postretirement Benefit Plan Assets” (“FSP FAS 132(R)-1”). FSP FAS 132(R)-1 requires more detailed disclosures about employers’ plan assets in a defined benefit pension or other postretirement plan, including employers’ investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 12 THE EFFECT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONTINUED)

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 “Interim Disclosures about Fair Value of Financial Instruments” (“FSP FAS No. 107-1 and APB Opinion No. 28-1”). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 are effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165 “Subsequent Events” (“SFAS 165”). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for the interim report and annual periods that end after June 15, 2009. The adoption of SFAS 165 has no impact on the financial statements as management has already followed a similar approach prior to the adoption of this standard.

In June 2009, the FASB issued SFAS No. 166 “Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140” (“SFAS 166”). SFAS 166 amends various provisions of SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125” by removing the concept of a qualifying special-purpose entity and removes the exception from applying FIN 46(R) to variable interest entities that are qualifying special-purpose entities; limits the circumstances in which a transferor derecognizes a portion or component of a financial asset; defines a participating interest; requires a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and requires enhanced disclosure; among others. SFAS 166 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 166 on the financial statements.

In June 2009, the FASB issued SFAS No. 167 “Amendments to FASB Interpretation No. 46(R)” (“SFAS 167”). SFAS 167 amends FASB Interpretation No. 46 (Revised December 2003) “Consolidation of Variable Interest Entities—an interpretation of ARB No. 51” (FIN 46(R)) to require an enterprise to perform an analysis to determine whether the enterprise's variable interest or interests give it a controlling financial interest in a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in

facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity's economic performance; and to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise's involvement in a variable interest entity. SFAS 167 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 167 on the financial statements.

CHINA NORTH EAST PETROLEUM HOLDINGS LIMITED  
AND SUBSIDIARIES  
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL  
STATEMENTS AS OF JUNE 30, 2009  
(UNAUDITED)

NOTE 12 THE EFFECT OF RECENTLY ISSUED ACCOUNTING STANDARDS (CONTINUED)

In June 2009, the FASB issued SFAS No. 168 “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162” (“SFAS 168”). SFAS 168 replaces SFAS No. 162 and establishes the FASB Accounting Standards Codification (“Codification”) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or EITF Abstracts; instead the FASB will issue Accounting Standards Updates. Accounting Standards Updates will not be authoritative in their own right as they will only serve to update the Codification. The issuance of SFAS 168 and the Codification does not change GAAP. SFAS 168 will be effective for interim and annual periods that end after September 15, 2009. Management has determined that the adoption of SFAS 168 will not have an impact on the financial statements.

NOTE 13 SUBSEQUENT EVENTS

On July 27, 2009, the Company issued 65,007 shares of its common stock to a consultant at a volume weighted average price of \$4.1474 per share pursuant to a cashless exercise option in place of the consultant exercising all of his Class B Warrants for 150,000 shares of common stock at \$2.35 per share.

During July 2009, the Company repaid \$2,922,000 due to a stockholder.

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

The following discussion and analysis of financial condition and results of operations should be read in conjunction with our financial statements and related notes included elsewhere in this report. This discussion contains forward-looking statements that involve risks, uncertainties and assumptions. Forward-looking statements can be identified by the fact that they do not relate strictly to historic or current facts. They use words such as “anticipate,” “estimate,” “project,” “intend,” “plan,” “believe” and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. In particular, these include statements relating to:

- Deviations in and volatility of the market price of crude oil produced by us;
- Uncertainties in the estimation of proved reserves and in the projection of future rates of production;
- Timing and amount of production;
- The availability of, and our ability to raise additional capital resources and provide liquidity to meet cash flow needs;
- Fluctuations in foreign currency exchange rates and interest rates;
- Our ability to find, acquire, lease, develop, and produce from new properties; and
- The other risks and uncertainties which are described below under “RISK FACTORS.”

### Overview

We are engaged in the exploration and production of crude oil in Northern China. We have an arrangement with PetroChina to sell our crude oil production for use in the China marketplace. We currently operate 254 producing wells located in four oilfields in Northern China and have plans for additional drilling projects.

In particular, through two of our subsidiaries, Song Yuan City Yu Qiao Oil and Gas Development Co. Ltd. (“Yu Qiao”) and Chang Ling Longde Oil and Gas Development Co. Ltd. (“LongDe”), we have entered into binding sales agreements with the PetroChina Group, whereby we sell our crude oil production for use in the China marketplace.

We currently operate 4 oilfields located in Northern China, which include:

Details of Oil and Gas Properties and Activities			
Field	Acreage	Producing wells #	Proven Reserves (bbls)
Qian112	5,115	222	5,292,591
Da34	2,298	7	13,240
Gu31	1,779	7	95,729
He301	2,471	18	52,232
Total	11,663	254	5,453,792

The flowing chart illustrates our company's organizational structure:

### Organizational History

We were incorporated in the State of Nevada on August 20, 1999 under the name Draco Holding Corporation. On March 29, 2004, we executed an Agreement for Share Exchange with Hong Xiang Petroleum Group Limited, a corporation organized and existing under the laws of the British Virgin Islands ("Hong Xiang"), and the individual shareholders owning 100% of the outstanding common shares of Hong Xiang (the "Hong Xiang Shareholders").

Pursuant to the Agreement for Share Exchange, we issued 18,700,000 shares of our common stock to the Hong Xiang Shareholders in exchange for all of the shares of capital stock of Hong Xiang owned by the Hong Xiang Shareholders at closing, and Hong Xiang became our wholly-owned subsidiary. On June 28, 2004, we changed our name to China North East Petroleum Holdings Ltd.

During 2004, we acquired a 100% ownership in Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd. ("Hong Xiang Technical"), and Hong Xiang Technical in turn acquired a 100% interest in Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Ltd. ("Hong Xiang Oil Development"), which was engaged in the exploration and production of crude oil in the Jilin region of the PRC.

As a result of the Yu Qiao acquisition discussed below, all operations, assets and liabilities of the Company's subsidiary Hong Xiang Oil Development were transferred to Yu Qiao on March 19, 2007. Since Hong Xiang Oil Development and Hong Xiang Technical were no longer necessary elements of the Company's corporate structure, and they were liquidated and dissolved.

### PetroChina Oil Leases

Pursuant to a 20-year exclusive Cooperative Oil Lease (the "Oil Lease"), among PetroChina Group, Yu Qiao and the Company, entered into in May 2002, the Company has the right to explore, develop and produce oil at Qian'an 112 Oilfield. Pursuant to the Oil Lease, (i) PetroChina is entitled to 20% of the Company's oil production for the first ten years of the Oil Lease term and 40% of the Company's oil production for the remaining ten years of the Oil Lease term; and (ii) Yu Qiao is entitled to 2% of the Company's oil production as a management fee. The payment of management fee was stopped following the acquisition of Yu Qiao by the Company.

LongDe is a party to a 20-year contract with PetroChina Group entered into in May 2003, pursuant to which LongDe has the right to explore, develop and produce oil at the Hetingbao 301 oilfield in the PRC. Pursuant to such between PetroChina and LongDe, PetroChina is entitled to 20% of LongDe's output in the first ten years and 40% of LongDe's output thereafter until the end of the contract.

As the controlling shareholder of Yu Qiao, the Company has the rights to extract and develop Qian'an 112 and other oil fields under contracts that Yu Qiao has entered into with PetroChina. These oilfields include the Daan 34 oilfield and Gudian 31 oilfield in Jilin Province.

### Song Yuan Technical Joint Venture

On July 26, 2006, the Company entered into a joint venture agreement with Wang Hong Jun (“Mr. Wang”), the president and a stockholder of the Company and Ju Guizhi (“Ms. Ju”), mother of Mr. Wang, to contribute to the increased registered capital of Song Yuan North East Petroleum Technical Service Co. Ltd. (“Song Yuan Technical”). The purpose of Song Yuan Technical is to acquire oil and gas properties and to engage in the exploration of crude oil in the PRC. The Company owns a 90% equity interest in Song Yuan Technical, and Ms. Ju owns the remaining 10% equity interest in Song Yuan Technical.

### Acquisition of LongDe

In order to comply with certain PRC laws relating to foreign entities’ ownership of oil and gas company in the PRC, prior to March 17, 2008, Song Yuan Technical directly owned a 70% equity interest in LongDe, while Sun Peng and Ai Chang Shan, respectively, owned 10% and 20% of the equity interests in Long De in trust for Song Yuan Technical. On March 17, 2008, Song Yuan Technical additionally acquired an additional 20% equity interest in LongDe, of which it acquired a 10% of the equity interest in LongDe from Sun Peng, and 10% of the equity interest in LongDe from Ai Chang Shan. Accordingly, Song Yuan Technical now owns directly 90% of the equity interests in LongDe, with Ai ChangShan holding the remaining 10% in trust for Song Yuan Technical. The acquisition of LongDe was made pursuant to the laws of the PRC. As a 90% owner of Song Yuan Technical, the Company effectively controls LongDe.

### Acquisition of Yu Qiao

On January 26, 2007, the Company, through its 90% owned subsidiary Song Yuan Technical, acquired beneficial ownership of all of the interests in Yu Qiao from Ms. Ju. In consideration for such acquisition, the Company issued to Ms. Ju an aggregate of 10 million shares of its common stock (the “Acquisition Shares”), having a market value of approximately U.S.\$3.1 million. However, on June 29, 2007, the Company, Mr. Wang and Ms. Ju entered into an agreement pursuant to which, among other things, all of the Acquisition Shares were contributed to the Company.

In order to comply with certain PRC laws relating to foreign entities’ ownership of oil and gas company in the PRC, the former owners of Yu Qiao, Wang Pingwu and Meng Xiangyun, held 10%, and 20% of the equity interests, respectively, in Yu Qiao in trust for the benefit of Song Yuan Technical. The laws of the PRC govern the agreements by which the Company acquired Yu Qiao and by which the former owners of Yu Qiao hold equity interests in trust. See “Regulations Affecting Our Business” under “Risk Factors.” Subsequently, on March 17, 2008, Song Yuan Technical acquired from Meng Xiangyun the 20% equity interest which he had held in Yu Qiao. Accordingly, Song Yuan Technical currently directly holds a 90% equity interest in Yu Qiao, while Wang Hongjun holds a 10% equity interest in Yu Qiao in trust for the benefit of Song Yuan Technical. Thus the Company, through Song Yuan Technical, currently effectively controls 90% of the equity interests in Yu Qiao, while the remaining 10% equity interests in Yu Qiao is effectively controlled by Ms. Ju.

### Listing on the NYSE Amex LLC.

On June 15, 2009, the Company’s common stock commenced trading on the NYSE Amex LLC (“AMEX”). Upon trading on AMEX, the Company changed its ticker symbol from “CNEH.OB” to “NEP”.

### Oil and Gas Properties and Activities

As of June 30, 2009, the Company had a total of 254 producing wells, including 222 producing wells at the Qian’an 112 oilfield, 18 producing wells at the Hetingbao 301 oilfield, 7 producing wells at the Daan 34 oilfield and 7



producing wells at the Gudian 31 oilfield.

All of the Company's crude oil production is sold to the PetroChina Group. The approximate distance of each of the Company's oil fields from the Jilin Refinery is as follows: the Qian'an 112 oilfield is four kilometers away, the Hetingbao 301 oilfield is three kilometers away, the Daan 34 oilfield is fifteen kilometers away and the Gudian Oilfield 31 is thirty kilometers away.

PetroChina pays the Company a price per barrel equal to the monthly mean price calculated from the Mean of Platts Singapore ("MOPS") daily price for sour, heavy Indonesian crude, as measured during the previous month. Platts is a leading global provider of energy and metals information that collects and publishes pricing data on a wide range of petroleum and non-petroleum commodity types. An independent provider, Platts serves the oil, natural gas, electricity, emissions, nuclear power, coal, petrochemical, shipping, and metals markets from 17 offices worldwide. price paid to the Company is FOB at the local Jilin Province PetroChina oil storage depot.

PetroChina pays the Company monthly in arrears, on approximately the 15th day after the end of each month. The amount paid to the Company in the first two months of each calendar quarter is decreased by the amount of oil surcharge tax the Company will owe to the PRC government at the end of that calendar quarter. PetroChina holds those amounts back from the Company until the end of each calendar quarter, and then pays those amounts to the Company with the balance due for oil deliveries in the final month of the quarter. For this reason, the Accounts Receivable balance at the end of each quarter is larger than the prior month's oil sales revenue, because it includes the oil surcharge tax amounts the Company owes for the first two months of the quarter.

### Operating Performance

Our operating performance is influenced by several factors, the most significant of which are the price we receive for our oil and the quantities of oil that we are able to produce. Global oil prices are the most important factor affecting the price that we receive for our oil production. The prices received for different grades of oil are based upon the world price of oil, which is then adjusted based upon the particular grade. Typically light oil is sold at a premium, while heavy grades of crude (such as the type we produce from the four fields we operate) are discounted.

Our oil development and acquisition activities require substantial and continuing capital expenditures. Historically, the sources of financing to fund our capital expenditures have included:

- Cash flow from operations;
- Sales of equity securities;
- Loans from shareholders and third parties; and
- Extension of credit from our suppliers, including particularly our suppliers of well drilling and completion services.

For the three months ended June 30, 2009 (the "Current Quarter"), the sale price we received for our crude oil production averaged \$50.27 per barrel, compared with \$105.08 per barrel for the three months ended June 30, 2008 (the "Comparable Quarter"). For the six months ended June 30, 2009, the sale price we received for our crude oil production averaged \$45.16 per barrel, compared with \$99.59 per barrel for the same period ended a year ago.

Our oil producing activities are accounted for using the full cost method of accounting. Under this accounting method, we capitalize all costs incurred in connection with the acquisition of oil properties and the exploration for and development of oil reserves. These costs include lease acquisition costs, geological and geophysical expenditures, costs of drilling productive and non-productive wells (to date, all of the wells we have drilled have been productive wells), conversion of productive wells into production support infrastructure such as water-injection wells, and overhead expenses directly related to land and property acquisition and exploration and development activities. Proceeds from the disposition of oil properties are accounted for as a reduction in capitalized costs, with no gain or loss recognized unless a disposition involves a material change in the relationship between capitalized costs and reserves, in which case the gain or loss is recognized.

Depreciation of the capitalized costs of oil properties, including estimated future development costs, is based upon estimates of proved oil reserves and production. Unproved oil properties are not amortized, but are individually assessed for impairment. The cost of any impaired property is transferred to the balance of oil properties being depleted. Reserve values are calculated annually, at our fiscal year-end, by a third-party geological consulting company, and are estimated in accordance with Statement of Financial Accounting Standards No. 19 ("FAS 19") – Financial Accounting and Reporting by Oil and Gas Producing Companies (as amended), SEC Regulation S-K and Regulation S-X under the Securities Act of 1933 and the Securities Exchange Act of 1934, and the SEC's Industry Guide 2.



## Production, Average Sales Prices, and Production Costs

Our business operations are characterized by frequent, and sometimes significant, changes in the price we receive for the crude oil we produce and in the volumes of crude oil we produce. The following table shows selected operating data for the three and six months ended June 30, 2009 and June 30, 2008.

	Three months ended June 30		Six months ended June 30	
	2009	2008	2009	2008
Oil Output (Bbl)	225,043	135,194	447,134	250,056
Avg. Sale Price (\$/bbl)	\$ 50.27	\$ 105.08	\$45.16	\$99.59
Operating Revenue	\$ 11,351,405	\$ 14,167,538	\$20,250,628	\$24,991,512
Operating Expenses				
Production Costs	\$ 1,152,199	\$ 782,972	\$1,666,599	\$1,495,277
Depreciation	\$ 2,833,995	\$ 2,506,302	\$5,458,249	\$4,380,994
Amortization	\$ 2,982	\$ 2,926	\$5,961	\$5,768
Oil Surcharge	\$ 580,375	\$ 3,173,380	\$618,167	\$5,384,700
Gross Profit	\$ 6,781,854	\$ 7,701,958	\$12,501,652	\$13,724,773

## RESULTS OF OPERATIONS

## Three Months Ended June 30, 2009 Compared To Three Months Ended June 30, 2008

**Revenues.** Revenues for the Current Quarter were \$11,351,405 compared to \$14,167,538 for the Comparable Quarter, a decrease of \$2,816,133, or 20%. This decrease was due to a decrease in the average price we received for our crude oil. The average oil price for the Current Quarter was \$50.27, a 52% decrease from \$105.08 for the Comparable Quarter. Our output of crude oil for the Current Quarter was 225,043 barrels compared to 135,194 barrels for the Comparable Quarter, an increase of 66.5%, which substantially offset the impact of lower oil prices. This increase in production was mainly due to: (i) an increase in the number of producing wells from 188 in the Comparable Quarter to 254 in the Current Quarter; (ii) refracturing and other technical improvements made to the existing wells; and (iii) implementation of a water injection network, which helped to maintain production levels at certain of our existing wells.

**Cost of sales.** Cost of sales decreased by 29%, from \$6,465,580 for the three months ended June 30, 2008 to \$4,569,551 for the three months ended June 30, 2009. The decrease in cost of sales resulted primarily from a decrease in the oil surcharge paid to the PRC government, due to the decline in oil prices generally. For the Current Quarter, the Company paid an oil surcharge of \$580,375 to the PRC government as compared to \$3,173,380 paid for the Comparable Quarter. Under a regulation introduced in June 2006, a surcharge of 20% is imposed on the portion of the selling price of crude oil which exceeds \$40 per barrel and a surcharge of 40% is imposed on the portion of the selling price of crude oil which exceeds \$60 per barrel. This government oil surcharge tax is paid by the Company on a quarterly basis, following the end of each quarter.

**Operating Expenses.** Operating expenses totaled \$1,516,882 for the Current Quarter, compared to \$1,093,552 for the Comparable Quarter, an increase of 39%. This increase is primarily a result of an increase of approximately \$322,423 in selling, general and administrative costs ("SG&A"). SG&A costs increased largely due to non-cash charges associated with stock and option grants made to Directors and certain key employees in the second and third quarters of 2008, as well as an increase in professional fees from \$39,818 in the Comparable Quarter to \$153,032 in the

Current Quarter as a result of recent business development activities.

Other Income (Expense). Other expenses decreased from \$322,716 for the Comparable Quarter to \$294,673 for the Current Quarter. This decrease is primarily the result of decrease in other expense which decreased from \$105,601 in the Comparable Quarter to \$1,008 in the current quarter.

Net Income. Net income decreased by 27%, from \$3,872,049 for the Comparable Quarter to \$2,817,577 for the Current Quarter, primarily as a result of the decrease in average selling price and increased non-cash expenses as described above.

#### Six Months Ended June 30, 2009 Compared To Six Months Ended June 30, 2008

Revenues. Revenues for the six months ended June 30, 2009 were \$20,250,628 compared to \$24,991,512 for the six months ended June 30, 2008, a decrease of \$4,740,884, or 19%. This decrease was due to a decrease in the average price we received for our crude oil. The average oil price for the six months ended June 30, 2009 was \$45.16, a 54.7% decrease from \$99.59 for the same period in 2008. Our output of crude oil for the six months ended June 30, 2009 was 447,134 barrels compared to 250,056 barrels for the same period in 2008, an increase of 78.8%, which substantially offset the impact of lower oil prices. This increase in production was mainly due to: (i) an increase in the number of producing wells, (ii) refracturing and other technical improvements made to the existing wells; and (iii) implementation of a water injection network, which helped to maintain production levels at certain of our existing wells.

Cost of sales. Cost of sales decreased by 31%, from \$11,266,739 for the six months ended June 30, 2008 to \$7,748,976 for the six months ended June 30, 2009. The decrease in cost of sales resulted primarily from a decrease in the oil surcharge paid to the PRC government, due to the decline in oil prices generally. For the six months ended June 30, 2009, the Company paid an oil surcharge of \$618,167 to the PRC government as compared to \$5,384,700 paid for the same period in 2008. Under a regulation introduced in June 2006, a surcharge of 20% is imposed on the portion of the selling price of crude oil which exceeds \$40 per barrel and a surcharge of 40% is imposed on the portion of the selling price of crude oil which exceeds \$60 per barrel. This government oil surcharge tax is paid by the Company on a quarterly basis, following the end of each quarter.

Operating Expenses. Operating expenses totaled \$2,854,818 for the six months ended June 30, 2009, compared to \$1,729,501 for the six months ended June 30, 2008, an increase of 65%. This increase is primarily a result of an increase of approximately \$637,412 in selling, general and administrative costs. SG&A costs increased largely due to non-cash charges associated with stock and option grants made to Directors and certain key employees in the second and third quarters of 2008. Amortization of the discount on the debenture was recognized for only four month of the Comparable Quarter, versus the full six months of the Current Quarter, which accounts for the increase. And also the increased professional fee from \$97,330 in the Comparable Quarter to \$225,048 in the Current Quarter which results from the recent business development activities.

Net Income. Net income decreased by 30% from \$7,247,064 for the six months ended June 30, 2008 to \$5,088,930 for the six months ended June 30, 2009, primarily as a result of the decrease in average selling price and increased non-cash expenses as described above.

#### LIQUIDITY AND CAPITAL RESOURCES

Our capital resources consist primarily of cash flows from our oil producing properties. Our level of earnings and cash flows depend upon many factors, including the price we receive for crude oil we produce.

As of June 30, 2009, the Company had cash and cash equivalents of \$22,675,024, other current assets of \$5,593,811 and current liabilities of \$22,122,293. For the six months ended June 30, 2009, our primary sources of liquidity were \$9,223,992 provide by operating activities and \$1,177,742 in cash provided by financing activities. This cash balance of \$22,675,024 represents an increase of \$3,065,896 over our cash balance as of March 31, 2009 and an increase of \$9,435,811 over our cash balance as of December 31, 2008.

Net cash provided by operating activities was \$9,223,992 for the six months ended June 30, 2009 compared to net cash provided by operating activities of \$859,024 for the same period in 2008. The increase in net cash provided by operating activities was the result of a number of significant changes in our operating accounts. Cash from operating activities decreased due to a reduction in net income and higher cash payments of income and other taxes. However, this was more than offset by increased operating cash flows resulting from an increase in the non-cash benefit arising from Depreciation of oil and gas properties in the Current Period, and from a slight increase in the level of our accounts payable during the Current Period compared to a large reduction in accounts payable in the Comparable Period.

Net cash used in investing activities was \$948,526 for the six months ended June 30, 2009 compared to \$9,498,032 for the same period in 2008. This decrease is primarily due to the significant decrease in purchase of oil and gas properties of \$7,548,843 during the six months ended June 30, 2009.

Net cash provided by financing activities was \$1,177,742 for the six months ended June 30, 2009 as compared to \$12,363,517 for the same period in 2008. This was primarily a result of the financing by Lotusbox Investments Limited completed in the first quarter of 2008, whilst the current period net cash provided by financing activities resulted principally from a loan from a shareholder of \$2,998,194 and the repayment of the secured debenture to Lotusbox Investments Limited of \$1,770,000.

The Company has paid for the development of its producing oil wells and oil wells under construction with cash from operations as well as by funds raised as a result of the financing by Lotusbox Investments Limited. To fully implement the Company's business plan and growth strategy the Company may require additional resources. The Company is continually evaluating opportunities to expand production and grow the Company's operations, including via acquisition of additional leased oil fields or expansion into related businesses such as the provision of oil field services. The Company's ability to obtain additional capital to achieve certain of these expansion goals will depend on market conditions, national and global economies and other factors beyond its control. We cannot assure you that the Company will be able to implement or capitalize on various financing alternatives or otherwise obtain required capital, the need for which could be substantial given the Company's business and development goals. However, the Company anticipates that cash flows from operations will be sufficient to fund continued development at the four oil fields it currently operates.

#### Capital Commitments

As of June 30, 2009, the Company had commitments for capital expenditure of \$10,519,000 with a contractor to complete the drilling of 48 oil wells.

#### Crude Oil Price Trends

Changes in crude oil prices significantly affect our revenues, financial condition and cash flows. Markets for crude oil have historically been volatile and we expect this trend to continue. Prices for crude oil typically fluctuate in response to relatively minor changes in supply and demand, market uncertainty, seasonal, economic, political and other factors beyond our control. Although we are unable to accurately predict the prices we receive for our oil, any significant or sustained decline in oil prices may materially adversely affect our financial condition, liquidity, ability to obtain future debt or equity financing and operating results.

#### Production Trends

Like all other oil exploration and production companies, we experience natural production declines at existing wells. We recognize that oil production from a given well naturally decreases over time and that a downward trend in our overall production could occur unless the natural declines are offset by additional production from new wells, investment in measures to increase the production from existing wells (such as CO<sub>2</sub> and water injection), or acquisitions of producing properties. If any production declines we experience are other than a temporary trend, and if we cannot economically replace our reserves, our results may be materially adversely affected and our stock price may decline. Our future growth will depend upon our ability to continue to add oil reserves in excess of our production at a reasonable cost.

We have achieved increased production and revenue from our four oilfields as a result of our significant investments in these areas. As of June 30, 2009, we have drilled 254 wells out of the 675 wells that we believe can be drilled in



our four oilfields. Of these, 254 are produced oil in the Current Quarter. We anticipate that we will continue to drill new wells and increase production in these areas. We are also actively seeking additional oil fields that we can lease and operate.

#### Operating Expense Trends

Costs associated with oil well drilling, improvement (e.g. fracturing and water injection), and maintenance in the northeastern Chinese oil fields where we operate have remained relatively constant over the past year. Similarly, service rates charged by oil field service companies have remained relatively constant over the past year. We are also generally somewhat buffered from changes in world oil prices due to the impact of the government oil surcharge tax. When prices rise, the amount of oil surcharge tax that we are required to pay increases; conversely price declines reduce the amount of oil surcharge tax. In the Current Quarter, the approximate amount of oil surcharge tax we paid was \$1.38 per barrel, as compared to \$21.53 per barrel in the Comparable Quarter.

## CRITICAL ACCOUNTING POLICIES

**Proved Reserves.** Proved oil and gas reserves, as defined by SEC Regulation S-X Rule 4-10(a) (2i), (2ii), (2iii), (3) and (4), are the 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, i.e., prices and costs as of the date the estimate is made. Prices include consideration of changes in existing prices provided only by contractual arrangements, but not on escalations based upon future conditions.

The Company's estimates of proved reserves are made using available geological and reservoir data as well as production performance data. These estimates, made by the Company's engineers, are reviewed annually and revised, either upward or downward, as warranted by additional data. Revisions are necessary due to changes in, among other things, reservoir performance, prices, economic conditions and governmental restrictions. Decreases in prices, for example, may cause a reduction in some proved reserves due to reaching economic limits sooner.

**Properties and Equipment.** The Company uses the full cost method of accounting for exploration and development activities as defined by the SEC. Under this method of accounting, the costs of unsuccessful, as well as successful, exploration and development activities are capitalized as properties and equipment. This includes any internal costs that are directly related to exploration and development activities but does not include any costs related to production, general corporate overhead or similar activities. Gain or loss on the sale or other disposition of oil and gas properties is not recognized, unless the gain or loss would significantly alter the relationship between capitalized costs and proved reserves of oil and natural gas attributable to a country. The application of the full cost method of accounting for oil and gas properties generally results in higher capitalized costs and higher DD&A rates compared to the successful efforts method of accounting for oil and gas properties.

## RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") issued SFAS No. 157 "Fair Value Measurements". Effective January 1, 2008, the Company adopted the measurement and disclosure other than those requirements related to nonfinancial assets and liabilities in accordance with guidance from FASB Staff Position 157-2 "Effective Date of FASB Statement No. 157", which delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually), until the beginning of fiscal year 2009. In April 2009, the FASB issued Staff Position No. FAS 157-4 "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FSP FAS No. 157-4"). FSP FAS No. 157-4 clarifies the methodology used to determine fair value when there is no active market or where the price inputs being used represent distressed sales. FSP FAS No. 157-4 also reaffirms the objective of fair value measurement, as stated in SFAS No. 157 "Fair Value Measurements", which is to reflect how much an asset would be sold for in an orderly transaction. It also reaffirms the need to use judgment to determine if a formerly active market has become inactive, as well as to determine fair values when markets have become inactive. FSP FAS No. 157-4 is effective for interim and annual reporting periods ending after June 15, 2009 and will be applied prospectively. The adoption of SFAS No. 157 did not have a material impact on the financial statements.

On December 31, 2008, the SEC published the revised rules and interpretations updating its oil and gas reporting requirements. Many of the revisions are updates to definitions in existing oil and gas rules to make them consistent with the petroleum resources management system, which is a widely accepted standard for the management of petroleum resources that was developed by several industry organizations. Key revisions include the ability to include nontraditional resources in reserves, the use of new technology for determining reserves, permitting disclosure of probable and possible reserves, and changes to the pricing used in determining reserves. To determine reserves companies must use a 12-month average price. The Company is required to comply with the amended disclosure

requirement for registration statements filed after January 1, 2010, and for annual reports for fiscal years ending on or after December 15, 2009. Early adoption is not permitted. The Company is currently assessing the impact that the adoption will have on the Company's disclosures, operating results, financial position and cash flows.

In December 2008, the FASB issued Staff Position No. FAS 132(R)-1 "Employers' Disclosures about Postretirement Benefit Plan Assets" ("FSP FAS 132(R)-1"). FSP FAS 132(R)-1 requires more detailed disclosures about employers' plan assets in a defined benefit pension or other postretirement plan, including employers' investment strategies, major categories of plan assets, concentrations of risk within plan assets, and inputs and valuation techniques used to measure the fair value of plan assets. FSP FAS 132(R)-1 also requires, for fair value measurements using significant unobservable inputs (Level 3), disclosure of the effect of the measurements on changes in plan assets for the period. The disclosures about plan assets required by FSP FAS 132(R)-1 must be provided for fiscal years ending after December 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In April 2009, the FASB issued Staff Position No. FAS 107-1 and APB No. 28-1 “Interim Disclosures about Fair Value of Financial Instruments” (“FSP FAS No. 107-1 and APB Opinion No. 28-1”). FSP FAS No. 107-1 and APB Opinion No. 28-1 requires fair value disclosures for financial instruments that are not reflected in the condensed consolidated balance sheets at fair value. Prior to the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the fair values of those assets and liabilities were disclosed only once each year. With the issuance of FSP FAS No. 107-1 and APB Opinion No. 28-1, the Company will now be required to disclose this information on a quarterly basis, providing quantitative and qualitative information about fair value estimates for all financial instruments not measured in the condensed consolidated balance sheets at fair value. FSP FAS No. 107-1 and APB Opinion No. 28-1 are effective for interim reporting periods that end after June 15, 2009. As this pronouncement is only disclosure-related, it does not have an impact on the financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165 “Subsequent Events” (“SFAS 165”). SFAS 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for the interim report and annual periods that end after June 15, 2009. The adoption of SFAS 165 has no impact on the financial statements as management has already followed a similar approach prior to the adoption of this standard.

In June 2009, the FASB issued SFAS No. 166 “Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140” (“SFAS 166”). SFAS 166 amends various provisions of SFAS No. 140 “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125” by removing the concept of a qualifying special-purpose entity and removes the exception from applying FIN 46(R) to variable interest entities that are qualifying special-purpose entities; limits the circumstances in which a transferor derecognizes a portion or component of a financial asset; defines a participating interest; requires a transferor to recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer accounted for as a sale; and requires enhanced disclosure; among others. SFAS 166 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 166 on the financial statements.

In June 2009, the FASB issued SFAS No. 167 “Amendments to FASB Interpretation No. 46(R)” (“SFAS 167”). SFAS 167 amends FASB Interpretation No. 46 (Revised December 2003) “Consolidation of Variable Interest Entities—an interpretation of ARB No. 51” (FIN 46(R)) to require an enterprise to perform an analysis to determine whether the enterprise’s variable interest or interests give it a controlling financial interest in a variable interest entity; to require ongoing reassessments of whether an enterprise is the primary beneficiary of a variable interest entity; to eliminate the quantitative approach previously required for determining the primary beneficiary of a variable interest entity; to add an additional reconsideration event for determining whether an entity is a variable interest entity when any changes in facts and circumstances occur such that holders of the equity investment at risk, as a group, lose the power from voting rights or similar rights of those investments to direct the activities of the entity that most significantly impact the entity’s economic performance; and to require enhanced disclosures that will provide users of financial statements with more transparent information about an enterprise’s involvement in a variable interest entity. SFAS 167 will be effective as of the beginning of each reporting entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period, and for interim and annual reporting periods thereafter. Management is currently evaluating the potential impact of SFAS 167 on the financial statements.

In June 2009, the FASB issued SFAS No. 168 “The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162” (“SFAS 168”). SFAS 168 replaces SFAS No. 162 and establishes the FASB Accounting Standards Codification (“Codification”) as the source of authoritative accounting principles recognized by the FASB to be applied by nongovernmental entities in the preparation of financial statements in conformity with GAAP. Rules and interpretive releases of the SEC under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The FASB will no longer issue new standards in the form of Statements, FASB Staff Positions, or EITF Abstracts; instead the FASB will issue Accounting Standards Updates. Accounting Standards Updates will not be authoritative in their own right as they will only serve to update the Codification. The issuance of SFAS 168 and the Codification does not change GAAP. SFAS 168 will be effective for interim and annual periods that end after September 15, 2009. Management has determined that the adoption of SFAS 168 will not have an impact on the financial statements.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

Not required.

### ITEM 4T. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date"). The purpose of this evaluation is to determine if, as of the Evaluation Date, our disclosure controls and procedures were operating effectively such that the information, required to be disclosed in our Securities and Exchange Commission ("SEC") reports (i) was recorded, processed, summarized and reported within the time periods specified in SEC rules and forms, and (ii) was accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were operating effectively.

#### Changes in Internal Control over Financial Reporting

There have been no changes in our internal controls over financial reporting that occurred during the second quarter of fiscal year 2009 that have materially affected, or are reasonably likely to materially affect our internal controls over financial reporting.

## PART II - OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

On August 17, 2007, the Company filed a complaint in the Third Judicial District Court in and for Salt Lake County, State of Utah, naming Topworth Assets Limited ("Topworth") as the principal defendant. The Company asserted conversion, unjust enrichment, breach of warranty, fraud, and for declaratory relief causes of action. The actions arise out of the issuance of 3,715,000 shares of the Company's stock to Topworth in or about early 2004. The Company was able to recover from Topworth 2,715,000 of these shares shortly after their issuance, and now contends it is entitled to recover the remaining 1,000,000 shares because Topworth received all the stock by fraud. The Company sought and obtained an injunction preventing Topworth's transfer of this disputed stock.

In response to the Company's complaint and the issuance of the injunction against it, Topworth filed an answer to the complaint and a counterclaim against the Company, Wei Guo Ping, and Wang Hong Jun on December 11, 2007. Topworth asserts various legal theories that contend it performed consulting services to the Company; was entitled to all of the disputed stock as compensation for services; and was improperly required to return some of the disputed stock to the Company.

On March 5, 2009, the Company and Topworth entered into a Settlement and Release Agreement (the "Settlement") whereby the Company and Topworth agreed to mutually release each other from any and all claims they have against each other, including any and all claims and counterclaims pending in the action brought by the Company in the Third District Court, State of Utah, Civil Case Number 070911868 (the "Action"). Under the Settlement, the parties' shall

dismiss the Company's complaint and Topworth's counterclaim. The 627,360 shares of common stock in the Company held in the name of Topworth (the "Shares") that were a subject of dispute in the Action shall be disposed of on the following material terms: Topworth shall deliver all certificates representing the Shares to a designated custodian; the custodian shall hold the certificates until at least June 26, 2009; and, thereafter, the custodian shall release 100,000 of the Shares to Topworth each month until November 30, 2009, when Topworth will be entitled to receive all of the remaining Shares. The custodian shall release the Shares without any restriction on Topworth's ability transfer or sell the Shares imposed by the Company subject to restrictions under the Securities Act of 1933, as amended. The Shares have been held in Topworth's name and have been included in the Company's outstanding shares; as such the Shares will not have an additional dilutive effect on the Company's shareholders. Subsequently, the case was dismissed with prejudice on March 27, 2009.

We know of no other material, active or pending legal proceedings against our Company, and, other than as disclosed above, we are not involved as a plaintiff in any other material proceeding or pending litigation. There are no proceedings in which any of our directors, officers or affiliates, or any registered or beneficial shareholder, is an adverse party or has a material interest adverse to our interest.

#### ITEM 1A. RISK FACTORS

There has been no material change in the Company's risk factors as previously disclosed in the Company's Annual Report on Form 10-K filed with the SEC on March 30, 2009.

#### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

#### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

None.

#### ITEM 5. OTHER INFORMATION

None.

#### ITEM 6. EXHIBITS

Exhibit No.	Description of Exhibit
31.1	Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certifications pursuant to Rule 13a-14(a) or 15d-14(a) under the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certifications pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.



SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

China North East Petroleum Holdings  
Limited

August 14, 2009

By: /s/ Wang Hongjun  
Wang Hongjun  
President  
(Principal Executive Officer)

August 14, 2009

/s/ Zhang Yang  
Zhang Yang  
Chief Financial Officer  
(Principal Financial and  
Accounting  
Officer)