CNE PETROLEUM HOLDINGS LTD. (CNEH - OTC:BB)

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Recent Price: $0.400
Target Price: $1.200

SPECULATIVE STRONG BUY RATING

Main Headquarters

China North East Petroleum Holdings Limited.
20337 Rimview Place
Walnut, CA 91789
Unites States of America

Tel: (909) 468 2840

China Northeast Petroleum Holdings Limited.			
(all figures in Millions)			
52 Week Hi/Lo Range		1.00/0.19	
Fiscal Year End		31-Dec	
Shares Outstanding (05/07/2006)		18.5	
Float (approximately)		4.9	
Share price (05/8/2006)		0.40	
Market Capitalization		7.4	
Average Volume (3 months)		NA	
Insider Ownership		75%	
Institutional Ownership		NA	
Enterprise Value		10.15	
Total Debt (12-31-05)		2.750	
Total Cash (12-31-05)		0.007	
		12/31/2005	12/31/2006
		FY2005 E	FY2006 E
Earnings Per Share (EPS)		-0.04	0.04
Reserve Value/share*		1.99	
(less liabilities and cash)			
		FY2005 E	FY2006 E
Total Revenue		1.412	3.804
Cost of Sales		0.378	0.752
Gross Profit/Loss		1.034	3.052
Operating expenditures		1.302	1.823
Net Pre-Tax Profit/Loss		-0.420	1.229
Tax Expense		0.249	0.418
Net Income		-0.669	0.811
NA = Not applicable/Not Available.			
A = Actual Reported figures		E = Estimates	
Mining Reserves			Barrels
Proven Reserves - Qian 112 Field (millions)			1.25
Oil Price ($/barrel)			65.0
Reserve $ Valuation			81.4
Present Value of reserves @ 10% over 15 yrs			39.6
Capital Structure			
Authorized Common Stock	50 000 000		
Authorized Preferred Stock	50 000 000		
Issued Preferred Stock	None		

Unexploited Chinese E&P Play in the Oil-Drilling Boom

Company Overview

China North East Petroleum Holdings Ltd. (OTC BB: CNEH) is engaged in the ownership, acquisition and management of mineral properties and the exploration and development of oil drilling projects and the production of crude oil in Northern China. The company sells all its produced crude oil to PetroChina, Jilin Refinery directly. CNE Petroleum currently owns and operates the Qian112 Oilfield, which is located within the Qian'an oilfield in the Jilin Province in Northeastern China.

- CNE Petroleum believes it has competitive advantages due to its **experienced management team, good relationships** with the local government, and **relatively low operating costs.**
- The company currently operates **20 producing wells** in Northern China and generates approximately 380 barrels of high quality crude oil per day. By the end of year 2007, CNE Petroleum plans to finish the **project of drilling another 82 wells, as result the total oil well number will reach 102.**
- The **proven geological reserve of the Qian112 field is 1,252,000 barrels** (based on 20 current producing wells in compliance with the SEC Oil and Gas Proven Reserve Regulations--Rule 4-10(a)(4) of Regulation S-X). For the FY2005, the company produced **27,537 barrels Crude Oil** in total for which the company received an average price of **$53 per barrel**.
- The company awarded a contract to Rising Sun Oil Exploration & Production for part of 2006 **Oil Drilling program involving the drilling of 20 wells in the 5115-acre Qian 112 oilfield expected to commence in June**. Rising Sun offered the best technical package and their recent success in Songyuan will bring huge benefits to CNE Petroleum.
- A total of 40 new wells are planned to be drilled throughout 2006, the **total number of operational wells** will increase to **60 wells by the start of FY2007**.
- FY2005 production declined over FY2004 due to flooding caused by a longer raining season and oil-field wide maintenance during Q2 & Q3. All maintenance was complete by the end of 2005. The **production is expected to be back to the normal level**.
- The **forecasted total oil production for FY2006 will be 55,130 barrels**. At an average crude oil price of $69/bbl, we arrive at a FY2006 revenue estimate for CNEH of **$3.8 million** and an initial revenue estimate of **$12.2 million for FY2007**.
- Given the E&P and Drilling program, shareholders of CNE Petroleum enjoys meaningful **upside leverage.** Assuming 60 producing wells at a rate of 10 barrels per day per well for 20 production days a month, in a year, CNEH will be **able to produce 144,000 barrels of oil in FY2007** for total revenue of $10.5 million at current oil prices.
- **We believe the upside potential in the shares substantially outweighs the downside risks and when considered in light of our computed adjusted reserve value per share. When the PV of proven reserves is obtained and stripping out the effects of debt and cash, CNEH appears attractive. Based on the distinct balance of probabilities that such wide discount will begin to narrow as CNEH exhibits further organic growth and continued E&P operations, whilst adding new producing wells. When taken together with our outlook for firm backdrop of higher-trending crude oil prices to persist, we classify the shares in our SPECULATIVE STRONG BUY rating category. Our 12-month target price is pegged between the [0.7 x our Adjusted Reserve Valuation per share metric of $1.99] and discounting for 1 year at the required rate of return and the price derived from our PE methodology. This target price of $1.20 implies a forward PE of 8.0x our FY 2007 EPS forecast of 15c.** **See INVESTMENT THESIS & RECOMMENDATION for more in-depth discussion (Page 8-10)**

See Appendix A-1 for Analyst Certification and Important Disclosures.

THE COMPANY

China North East Petroleum Holdings Limited. (OTC BB: CNEH), is a US Corporation with oil development and production located in Northeast China and was incorporated in the state of Nevada on August 20,1999 under the name Draco Holding Corporation.

On March 29, 2004, Draco executed a Plan of Exchange with all the stockholders of Hong Xiang Petroleum Group, to exchange 18,700,000 shares of common stock of Draco for 100% of the outstanding shares of Hong Xiang Petroleum Group, an investment holding company that owns 100% of Hong Xiang Petroleum Technical Services Co., Ltd. Who provides technical advisory services to oil and gas exploration companies in the PRC. The Agreement was consummated on April 30, 2004 as a reverse acquisition transaction since the stockholders of Hong Xiang Petroleum Group obtained control of the consolidated entity (CNEH). On June 28, 2004, the Articles of Incorporation of Draco were amended to change its name to China North East Petroleum Holdings Limited and to increase its authorized shares of common stock from 20 million (Draco Entity) to 50 million.

Through its wholly owned subsidiary, Song Yuan City Yu Qiao Qianan Hong Xiang Oil and Gas Development Co., Limited, the company engages in the exploration and production of crude oil in Jilin oil region, China. The oil field is located at 9 kilometers southwest of Qian'an city with an exploration area of 20.7 square kilometers. The oil produced by the company is guaranteed to be purchased by the nearby state owned oil refinery – Jilin Refinery of PetroChina for use in China market. CNEH has guaranteed sales at the market price – FOB (free on board) price at the 1st day of each month in the Singapore crude oil market.

The company also provides technical advisory services to oil and gas exploration companies in China, through its other subsidiary, Song Yuan City Hong Xiang Petroleum Technical Services Co., Ltd.

China North East Petroleum Holdings is based in Walnut, California and its principle headquarters are located in Song Yuan City, in the People's Republic of China. CNEH currently employs 66 people, 25 of which are management and 41 are site workers. All employees are located in North China. Most of them are highly educated, including senior engineers and specialists with bachelors or masters degrees. According to the company, CNE Petroleum is the only Chinese non-governmental US publicly traded oil company as at year-end year 2005.

INDUSTRY

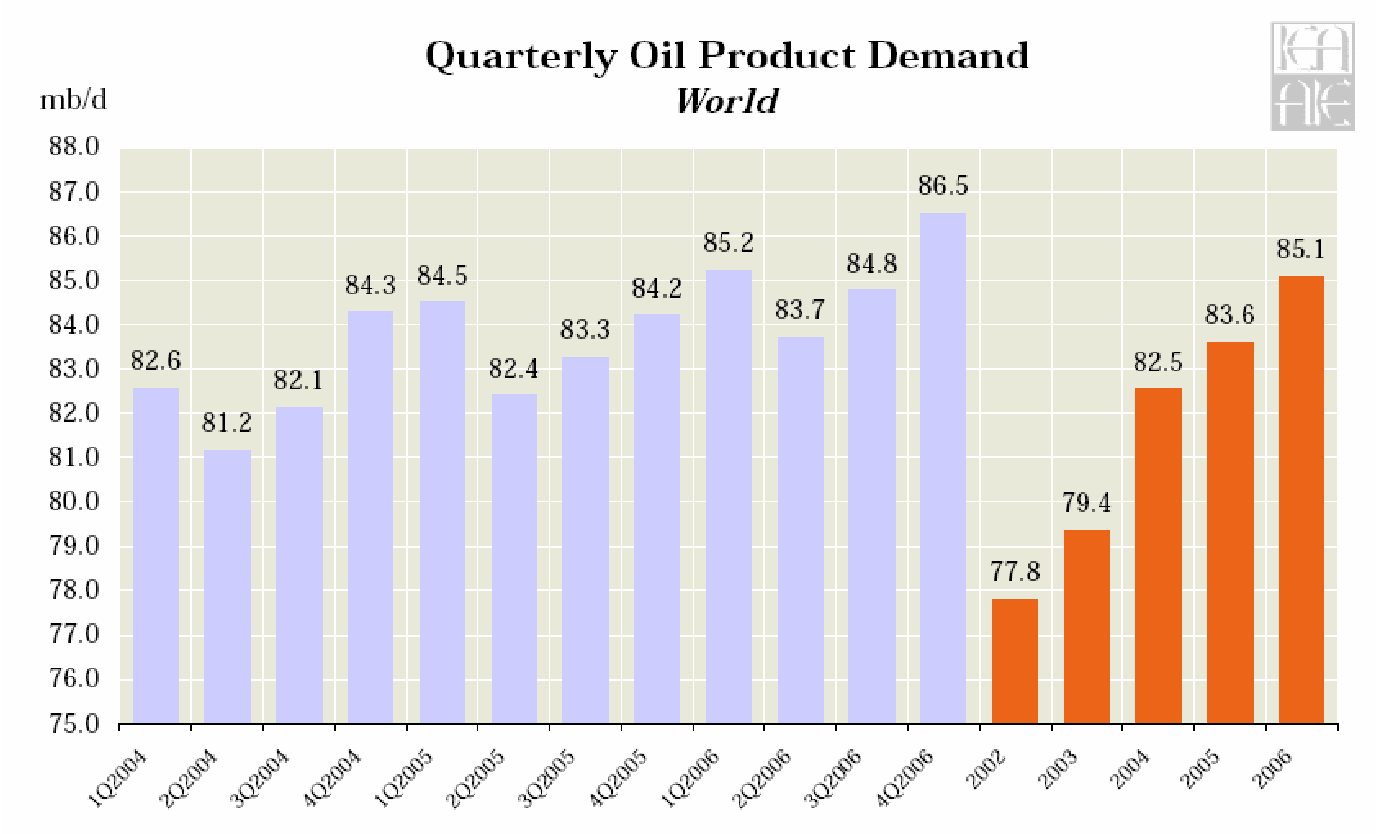
Against a backdrop of low spare production capacity, NYMEX crude futures breached $75/bbl in April. The move was led by sharply higher gasoline prices, ongoing Nigerian supply disruptions and stronger political rhetoric from Iran. Speculative length and open interest on the NYMEX WTI contract rose dramatically. Prices briefly weakened to $70/bbl in early May in reaction to an unanticipated build in US gasoline stocks.

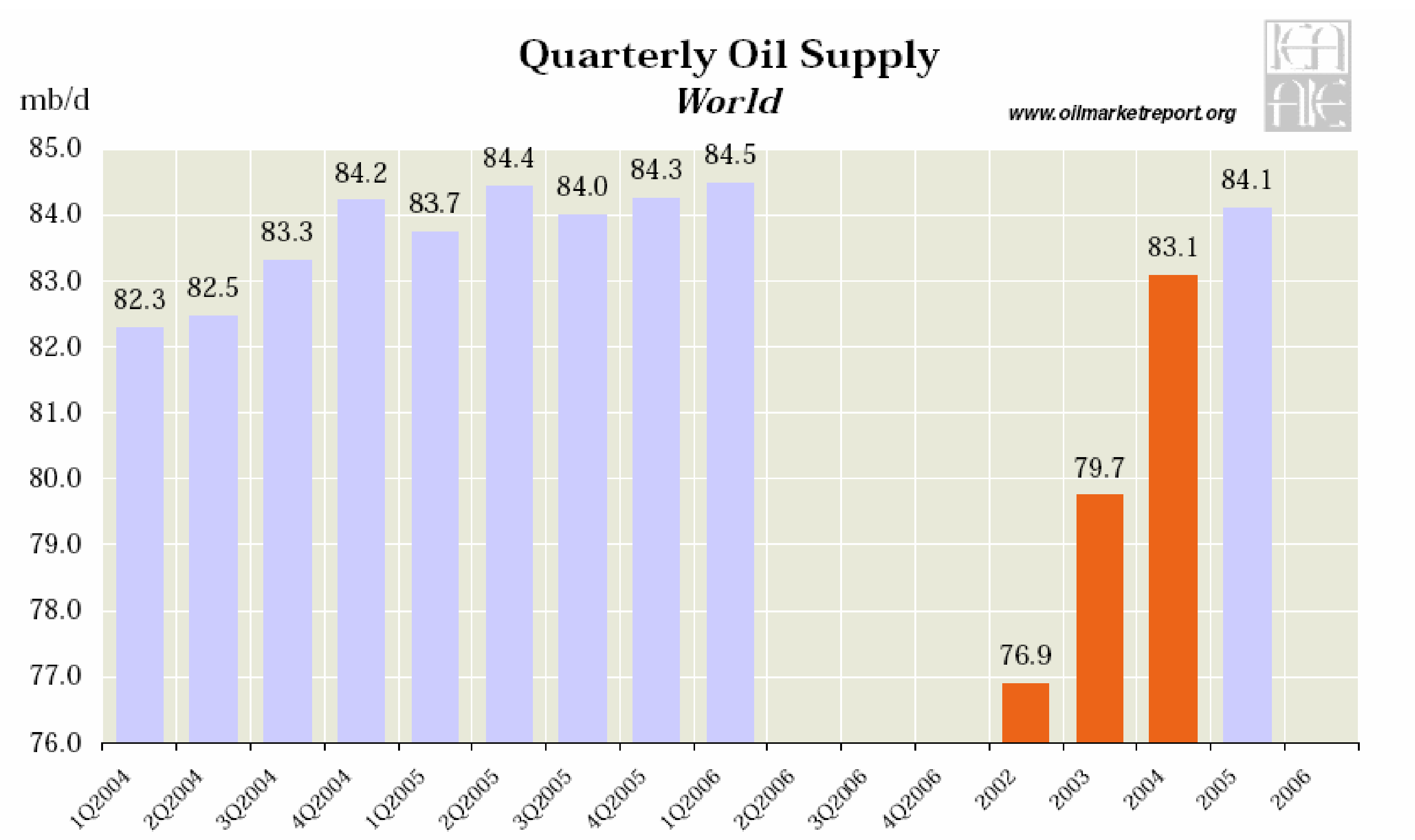
Since 2004, the emerging China market kept stimulating the growth of crude oil demand and was affected by the production cut in OPEC's oil supply. As such, the price of crude oil kept rising. In mid 2005, some large cities in China were forced to reduce or cease the use of gasoline due to a national oil supply shortage. Therefore, the market demand is expected to remain strong and the supply situation is anticipated remain tight for the foreseeable future. China has been instrumental in pushing up demand for oil and hence aiding price rises in oil, given its change in status from net exporter of oil in 2002 to net importer of oil by 2004.

The International Energy Agency, in its most recent monthly report released on Friday May 12, cut its global demand growth view to 1.25 million barrels a day from 1.47 million barrels, citing mild first-quarter temperatures and sustained high oil prices. **It tallied total world oil demand at 84.8 million barrels per day**. **World oil supply** in April rose by 485 kb/d to **85.1 mb/d which is only marginally ahead of demand**. With effective OPEC spare capacity measured at 1.7 mp/d in April 2006, any supply disruption or strong unforeseen added pressure from the demand side of the equation can tilt the scales to such a degree that fuel an upward price squeeze in crude oil prices, even from present elevated levels above $70 per barrel for NYMEX light sweet crude. Note from the current indicated figures on the demand and supply charts that are included from the IEA, the possibility exists that supply and demand could intersect in 2006 and demand may even outstrip supply at certain times of this year, which is enough to make most observers concerned about a future supply/demand imbalance developing.

For readers interested in more detail on oil market conditions are directed to the following link, **http://omrpublic.iea.org/,** where a comprehensive monthly Oil Market Report (OMR) is available, that is provided by the Paris based International energy Agency (IEA).

In summary, our assessment is that **the macro-level outlook for oil, which is based on thin cushions of spare capacity, rather than actual or forecast inventory changes, remains bullish** and is unlikely to change unless global economic growth begins to wane meaningfully.





IEA Monthly Oil Market Report dated 12 April 2006

COMPETITION

Based on the intense demand for oil products in China, CNE Petroleum believes it has competitive advantages due to its experienced management team, good relationships with the local government, and relatively low operating costs.

There are some other oil production companies in northeast China, however, the demand for crude oil has been rising since 2004 and many economic experts and financial analysts in the oil industry predict and believe that the demand will remain at intense levels. Therefore, the competition in China's oil industry is minor and will not have strong effects on the company's operations at this point in its production and company life cycle.

PRODUCTION HISTORY & GROWTH PLAN

Throughout most of 2005, the company had 20 producing wells. One well went off-line during the third quarter of 2005. There are 13 traditional sucker-rod pumping machines in operation. Since the oil reserve level may vary in different oil wells, the combination of these pumping machines allows CNEH to increase pumping efficiency.

China North East Petroleum currently sells its entire crude oil production to the Jilin Refinery of PetroChina, which is approximately four kilometers from the pumping site at Qian'an 112. PetroChina pays the company a price per barrel equal to the Singapore crude oil spot market price on the first day of every month.

The price is determined as FOB the Jilin Refinery. In the Chinese market, crude oil per barrel averaged $42 for the three months ended March 30, 2005; $54 for the three months ended June, 2005, $57 for the three months ended September, 2005, and $52.87 for the final quarter of 2005. As of May 2006, crude oil per barrel is trading above $70. **With production capacity of 19 barrels per well per day, in the full operative condition, the total production capacity with 20 wells in dollars is seen at $26,600 per day** (with oil price @ $70 per barrel).

The table below indicates actual historic production figures of CNEH and includes our estimates for FY 2006 and FY 2007.

	FY 2003 A	FY 2004 A	FY 2005 A	FY 2006 E	FY 2007 E
Production (in barrels)	30404	40725	27536	55115	144000
Average Price ($/bbl)	29	37	53	69	85
Production Cost ($/bbl)	8.56	9.81	8.19	NA	NA
Revenue (millions)	0.868	1.43	1.412	3.803	12.24

A=Actual E=Estimate

Note: *The company's oil production decreased in FY 2005 as a result of two factors**: deferred oil well maintenance**, which accounted for approximately 30% of the decrease; and a longer **rainy season with heavier than normal rainfall in Q2 and Q3** of 2005, which accounted for approximately 70% of the decrease. All maintenance was complete by the end of 2005. The production of existing wells is expected to revert back to normality.*

GROWTH PLAN

- **40 new wells are planned to be drilled throughout 2006**, the total number of operational well will increase to **60 wells in total**. The company has identified 33 proved undeveloped locations, each assigned to approximately 300 square meters or 21.6 acres.
- The forecasted **total oil production for 2006 will be 55,130 barrels** which represents exactly 100% jump over 2005 barrels produced. This production number was estimated by on historical production and the management's best knowledge.
- CNE Petroleum is actively seeking opportunities to **expand its operations and oil reserves in the regions, including acquisitions and mergers** of business and assets and leases of more oil reserves.

OIL PROJECTS

The company has the right to explore for, develop and pump oil at Qian'an 112, pursuant to a **20-year exclusive cooperative exploration contract (Oil Lease)** among PetroChina Group, Song Yuan City Yu Qiao Oil and Gas Exploration Limited Corp and CNE Petroleum. In accordance with this Oil Lease, PetroChina is entitled to 20% of the company's oil production for the first 10 years of the Oil Lease term and 40% of the company's oil production for the remaining 10 years of the Lease term; and Yu Qiao is entitled to 2% of the company's oil production as a management fee.

Qian 112 Oilfield

The Qian'an oilfield is located at northeast of Songliao basin in the Jilin province in Northeastern China. The Qian112 area is within the Qian'an oilfield and firstly started exploration in 1985, and in 2003 CNE petroleum acquired the exclusive drilling and production rights to such area. The proven geological oil reserve is 3.55 million tons (or 29.5 million barrels).

Currently CNE petroleum operates 21 wells in the Qian112 area. Qian112 is located southeast of Qian'an. Its nose-shaped construction is inclined from north to southwest. Qian112 has middle and lower oil containing combination, industrial oil found in Fuyu oil layer and Gaotaizi oil layer. The main layer is Gaotaizi oil layer for the production wells. The top elevation of Gaotaizi oil layer is -1350 to -1450 meters and faults have not developed in the area. The Gaotaizi oil layer is a target-exploiting layer in this area distributed in No.3 black segment stratum of Cretaceous system. The thickness of stratum is 350-410 meters, and oil reserve depth is 1600-2075 meters. Average oil-containing well segment is 120 meters and average effective thickness is 4.9 meters. CNE petroleum plans to embark on an active drilling program and ultimately finish the drilling project with 102 wells in total in FY2007. Each well is designed and proven to have the average production capacity of 19 barrels per day. **All of the produced crude oil is guaranteed purchased by local state owned refinery company, the PetroChina Jilin Refinery**, under the exclusive business contract and be tank-truck transferred to the nearby refinery facilities which are all located within 10 miles from the oilfield.

According to a reserve report, the 20.7 sq km exploration area includes a proved oil deposit area of 10.9 sq km and a possible oil deposit area of 9.8 sq km. The proved developed and undeveloped oil reserves are 6.2 million barrels. The **proven geological reserve is 1,252,000 barrels** (based on current 20 producing wells in compliance with the SEC Oil and Gas Proven Reserve Regulations -- Rule 4-10(a)(4) of Regulation S-X).

RESERVES

Qian'an 112 has proved reserves of approximately 1.25 million barrels of crude oil attributable to the company. **Proved reserve estimates were made as of December 31, 2005 by R.A. Lenser & Associates, an independent worldwide petroleum consultant.** R.A. Lenser & Associates conducted a reserve study of Qian'an 112 in accordance with generally accepted petroleum engineering and evaluation principles in conformity with SEC definitions and guidelines.

For purposes of calculating an Adjusted Reserve Valuation per share we used an oil price assumption of $65 per barrel to the proven reserve estimate of 1.25 million barrels to arrive at a total reserve dollar valuation of $81.4 million. **Assuming annual production of 80 000 barrels over 15 year period and discounting at a rate of 10%, we arrive at a present value of reserve amount valued at $39.6 million.** Allowing for effects of debt and cash we calculate and **adjusted reserve value per share of $1.99.**

2006 Drilling Program:

Each of the company's wells is assigned to approximately 300 square meters or 21.6 acres. The 2006 drilling program provides for the **drilling of 20 wells in the Qian112 oilfield** to a depth of approximately 2020 meters. If all 20 wells are drilled during the program period, the drilling program could be extended for up to 20 additional wells. The anticipated duration of the 2006 drilling program is 8 months, but it may be extended if necessary. It is currently expected that the 2006 drilling operations will commence during May 2006. The 2006 drilling program is the first stage of a planned multi-well drilling and seismic testing program to be conducted in the Qian112 oilfield**. By the end of 2007, China North East Petroleum Holdings, Limited plans to drill up to 82 additional wells, which, if completed, would bring the number of wells operated by the company to 102.**

Rising Sun Exploration and Production Limited Rising Sun was awarded the Drilling Contract through a competitive tendering process initiated by the Company during February 2006. Rising Sun has shown the technical competence necessary with its recent Songyuan experience (Qian 112 is located in Songyuan, Jilin Province, PRC) and its comprehensive project management proposal. Another key factor in awarding the contract to Rising Sun was the near immediate availability of a drilling rig in a fiercely competitive rig market. The rig will be available to CNEH immediately after the completion of another drilling program currently being conducted by Rising Sun. Rising Sun anticipates completing its current project during May 2006 and will start preparatory work immediately on CNEH drilling site to facilitate a prompt mobilization.

The company drilled no new exploratory or production wells in 2005. CNE Petroleum's drilling program focused solely on maintaining the 20 producing wells in the Quian'an 112 oil tract.

FINANCIALS

The company filed Form 10-KSB, containing all financial statements until December 2005, with the SEC on April 14, 2006. As of March 27, CNEH had approximately 104 registered shareholders on record and 18,524,080 shares outstanding. The cost of net revenues consists of cost of labor, well service and repair, location maintenance, power and fuel, transportation, oil and gas disposal fees, costs related to underpit operations and production related general and administrative costs. G&A expense consist primarily of salaries and related expenses for executive, finance, accounting, information technology, facilities and human resources personnel, recruiting expenses, professional fees and costs associated with expanding information systems.

As a result of the terms of the Exploration Contract and Yu Qiao's failure to forward payments to CNEH (see next section), CNEH has lacked liquidity. As a result the company was forced to defer oil well maintenance, which reduced oil production in 2005 by approximately 30% over production levels in 2004, causing FY2005 revenues to decrease slightly to $1.412 million from $1.430 million in FY2004. Cost of sales decreased by 34% from $569,913 in FY2004 to $377,654 in FY2005 resulting primarily from lower production. Operating expenses increased by 142% from $538,545 in FY2004 to $1.302 million in FY2005. The increase in operating expenses resulted primarily from increased professional fees, including legal fees, incurred in connection with being a U.S. publicly traded company and the non-cash payment of consulting fees. No deferred compensation or long-term incentive plan awards were issued or granted to the management of CNEH during the years ended December 31, 2005, 2004 or 2003. No employee, director, or executive officer has been granted any options as part of remuneration. The company suffered at net loss for FY2005 of $0.670 million which resulted in a comprehensive loss of $0.753 million after deduction of $83,899 of foreign currency translation losses. Basic loss per share on both basic and diluted basis was 3.6c in FY2005.

Oil and Gas properties stated on a net basis on the balance sheet as at 31 December, 2005 totaled $4.546 million. Total Current assets were $401,654 consisting mostly of accounts receivable. Total current liabilities stood at $4.241 million as at Year-end FY 2005. $2.75 million of this amount consisted of Loans due or loans and notes payable. Total Shareholders interest was reflected at $917,241 with a retained deficit of roughly $500,000. During calendar 2005 the company reduced its common stock outstanding amount from 20.089 million in the beginning of 2005 to 18.274 million at the end of the year. CNEH issued 900,000 shares of common stock for consulting services rendered in total during the year. The stock was valued at the closing price on the date of grant, or at $1.08 and $0.92 per share respectively. Also a stockholder of the company returned 2.715 million shares of common stock to the company for cancellation during the year. Cash paid during FY2005 for interest expenses came to $14,257. North East Petroleum had net operating loss carry forwards for income taxes amounting to approximately $1.358 million as at December 31, 2005 which may be available to reduce future years' taxable income. These carry forwards, will expire, if not utilized, commencing in 2024. Hong Xiang Technical and Hong Xiang Oil Development were incorporated in the PRC and are subject to PRC income tax which is computed according to the relevant laws and regulations in the PRC. The applicable tax rate has been 33% and no tax benefit is expected from the tax credits in the future and an income tax expense for PRC purposes of $249,245 was charged against pre-tax income/loss of CNEH in the FY2005 income statement.

Noteworthy financial and per share statistics are listed in the table found on page 1 of this report.

Liquidity and Capital Resources

As of December 31, 2005, Cash and cash equivalents stood at $6,461, with other current assets of $0.395 million and current liabilities of approximately $4.2 million. To date CNEH has financed it operations primarily by advances from related parties and bank borrowings. As of December 31, 2005, CNEH owed approximately $2.3 million to these individuals. As of December 31, 2005 and March 31, 2006, Yu Qiao owed the company approximately $1.05 million in total, for oil revenues paid to Yu Qiao by PetroChina. On April 12, 2006, CNEH and Yu Qiao entered into a settlement agreement pursuant to which Yu Qiao agreed to pay all amounts owed to the company as of March 31, 2006 by May 30, 2006. A related party has guaranteed this obligation. In addition, the Company is currently negotiating with PetroChina an amendment to the Exploration Contract (expected to be completed by Q3 FY 2006) that would require PetroChina to make all payments for crude oil sales directly to CNEH.

In addition, CNE Petroleum secured two bank loans in the amounts of $247,831 and $123,916, respectively on July 15, 2005 and September 22, 2005. In February, 2006, CNEH negotiated a 6 month extension of the loan originally due in January 2006. As a result of the lack of liquidity to date, the company has deferred oil well repair and maintenance, which has had a negative impact on the company's oil production and revenues. As cash flows improve, CNEH expects to use a significant portion of its cash for costs and expenses necessary to maintain continued operations as well as repayment of outstanding debt. In addition, the company expects to use internally generated net cash provided by operation activities to construct new wells at Qian'an 112.

Cash provided by operations decreased to $723,282 in 2005 from $813,554 in 2004 as a result of decreased oil production. Cash used in investing activities decreased to $60,871 in 2005 from $128,049 in 2004 primarily as a result of the disposal of fixed assets in the amount of $182,005. Cash used in financing activities was $572,838 as compared to $692,417 used in 2004 as a result of the repayment of advances made by a related party. The company has no outstanding commitments for capital expenditures, but in order to develop additional wells, it may also consider a number of different financing opportunities. Adequate funds may not be available on terms acceptable to the company. If additional funds are raised through the issuance of equity securities, dilution to existing stockholders may result. If funding is insufficient at any time in the future, it will restrict either in part or in full, the company's ability to develop additional oil wells, take advantage of other business opportunities or respond to competitive pressures, any of which could have a material adverse effect on its financial position or financial results.

RISK FACTORS / CONCERNS

The business model, and longer term consistency of revenue and income potential, remain uncertain and is not fully proven. CNEH is **substantially dependent on the expertise of its management team and directors**, the loss of which could materially adversely affect future anticipated results. The company is still considered to be a **development stage company** and has generated limited revenues. The company may not be able to generate or obtain sufficient funds to operate its business which, could harm results and force the company to curtail or cease plans for expanding operations. There can be **no assurance the company will be successful in its effort to secure additional financing** to support operations that will necessitate achievement of near and medium term goals.

There are several risks associated with doing business in China. Changes in the political leadership of the PRC may have a significant effect on laws and policies related to the current economic reforms program, other policies affecting business and the general political, economic and social environment in the PRC, including the introduction of measures to control inflation, changes in the rate or method of taxation, the imposition of additional restrictions on currency conversion and remittances abroad, and foreign investment. These effects could substantially impair CNEH business, profits or prospects in China. There is exchange rate risk inherent in investing in CNEH, since future **fluctuation in the value of the Renminbi (Yuan) may negatively affect the company's ability to convert its return on operations to U.S. dollars in a profitable manner and its sales globally.**

The **oil production and exploration industry is inherently subject to changing conditions** that can affect levels of production and production costs for varying lengths of time and can result in decreases in profitability. There is a direct risk due to exposure to commodity prices related to input prices such as that of bentonite (volcanic ash used in drilling), rig and drilling equipment rates and exploration and maintenance costs most of which are not within control of the company. In addition, weather conditions in North East China, equipment replacement or repair costs, floods, variations in thickness of the drilling layer other geological conditions can be expected in the future to have, a significant impact on operating results. Prolonged disruption of production at any well would result in a decrease in revenues and profitability, which could be material.

All revenues are **subject to the prevailing worldwide price for crude oil and spot prices.** Prices received for oil and gas production have been and remain volatile and unpredictable. If oil prices decline significantly, even if only for a short period of time, CNEH's revenues and cash flows would be materially adversely affected. The reserve information, such as proven reserves included in Form 10-KSB represents estimates prepared by internal engineers and examined by independent petroleum consultants. Readers should note that the estimation of reserves is not an exact science. Estimates of economically recoverable oil and natural gas reserves and of future net cash flows necessarily depend upon a number of variable factors and assumptions, any of which may cause these estimates to vary considerably from actual results.

Other factors affecting the production of oil that could result in decreases in profitability of CNEH include problems arising at production sites due to company delaying and deferring maintenance due to lack of liquidity; changes in laws or regulations, including permitting requirements; litigation; work stoppages or other labor difficulties; any labor shortages; changes in the worldwide oil market and/or general economic conditions. Financial performance relies substantially on CNEH ability to exploit oil reserves at competitive costs**. Replacement reserves may not be available** when required or, if available, may not be capable of being drilled at costs comparable to those characteristics of the depleting oil field. CNEH may in the future acquire oil reserves from third parties and may not be able to accurately assess the geological characteristics of any reserves being acquired, which may adversely affect its profitability and financial condition.

Trading in the shares will continue to be subject to major fluctuations for the foreseeable future. The stock is thinly traded at prices around $1.00 and selling of small positions could have a negative impact on the share price in absence of sufficient liquidity. The reverse is true if one or more large investors decide to acquire a block of CNEH shares that would result in demand outstripping supply and result in an upward squeeze in the price given the scant liquidity and daily trading volume.

We caution that historical volume activity on CNEH has been noticeably light and we are unable to determine if trading volumes to will improve in the coming months with any degree of certainty. Major dilution of common stock can occur if company issues large blocks of common stock or convertible debt are converted/warrants exercised into common stock, that can negatively impact on the value of the shares either theoretically, or if sold outright in the open market.

The Articles of Incorporation **authorizes the issuance of up to 50 million shares of preferred stock** and constitutes what is commonly referred to as "blank check" preferred stock. To date, no shares of preferred stock have been issued. This type of preferred stock allows the Board of Directors to divide the preferred stock into series, to designate each series, to fix and determine separately for each series any one or more relative rights and preferences and to issue shares of any series without further stockholder approval. It also allows the Board of Directors to fend off attempts to gain control of CNEH through a merger, tender offer at a control premium price, proxy contest or otherwise. The preferred stock could entrench the present management. In addition, the market price of CNEH common stock could be materially and adversely affected by the existence of the preferred stock. Also it should be noted that management together **owns 75% of the outstanding common stock of CNEH** and therefore exercises control over key decisions and voting rights.

NASD and SEC Regulations covering rules on Penny Stocks apply for CNEH, subjecting NASD broker-dealers to additional sales practice and disclosure requirements. For further elaboration we advise readers to refer to risk factors included in Form 10-KSB filed with the SEC on April 14, 2006.

MANAGEMENT

Peng Chong Yao - General Manager

Mr. Peng Chong Yao graduated from Shanghai Fu Dan University where he earned his Masters Degree in population and international economy. In 1998, Mr. Yao was awarded senior economic manager. He has served in Enterprise's coordinated management and economy plan in Song Yuan City Council for 13 years. He worked as leader of Outside Investment Inviting Delegation for Song Yuan City Council. As a population and economic expert, he was retained as a general manager's assistant by an American proprietorship -- Shenzhen Chang Xing Industrial Limited Company. Mr. Yao has published more than 20 theses at national-level publications and wrote two books with the content of dialectical relations between population development and economic scale. In order to standardize the operation of local enterprise run by the local people, he was appointed by the government to CNE Petroleum and serves as General Manager.

Hong Jun Wang - President

Mr. Hong Jun Wang graduated in petroleum exploration and production from Tai Quin Petroleum Institution of Jilin Province, China. From 1989 to 1992, he was a Researcher at the State Economy Faculty of Jilin University. And from 1992 to 2003, Mr. Wang worked for Jilin Oilfield and Drilling Company as an executive and was responsible for overseeing the operation and coordination of various projects. Mr. Wang served as vice president in Hong Xiang Petroleum Group Ltd in 2003. Since December, 2004, Mr. Wang was appointed as President of CNE Petroleum.

Xin Chang Ma - Chief General Engineer

Mr. Xin Chang Ma graduated from Jilin Petroleum College and majored in reservoir engineering. He then received the training of enterprise's management and administration in Jilin University. Mr. Ma has accumulated tremendous experiences in various fields within the petroleum industry. He has served in Supervisory management, technical management and administrative management in Jilin oilfield Xin Li Oil recovery factory and Xin Da Company for 28 years. In 1993, Mr. Ma was awarded senior engineer. He invented three patented technologies along with more technological achievements during his work in Xin Li Oil recovery factory and Xin Da Company; two of them were related to petroleum technology. He has served as a technician, well testing team leader, oil recovery team leader, management minister, chief of craft institute, enterprise management section chief, etc. Currently, Mr. Ma is the chief general engineer of the CNE Petroleum.

Ming Yang Zhu - Chief Accountant

Mr. Ming Yang Zhu graduated from Jilin Agricultural University where he majored in Economic Management. Mr. Zhu has experience in various fields of the economic management, financial costs accounting, financial management, budget of capital construction of the project and auditing management. He has engaged in statistical work as deputy chief of finance section for Jilin Province oilfield administration bureau for 14 years, of which 8 years were in budget arrangement and 6 were in auditing. He has attended PetroChina Cadre's management college for management training. In 1992, Mr. Zhu was awarded senior economic manager. Mr. Zhu's three theses have been issued at the academic seminar held by China Petroleum Ministry in Guangzhou, Daqing and Beidaihe and were published in the collection of theses of China Petroleum Ministry. Currently, he is engaged as a Chief Accountant of CNE Petroleum.

INVESTMENT THESIS AND RECOMMENDATION

Our analysis suggests that China North East Petroleum Holdings Ltd. is an **interesting speculative play** among micro-cap companies offering **exposure** to the investor on the **commodity related boom** spurred by Chinese economic growth together with the firming demand and the persisting strong pricing conditions for crude oil. For stone-cold U.S. investors, the obvious play here is to simply tag along by taking positions in foreign and domestic companies supplying the Chinese juggernaut.

Both operating and financial risk involved in investing in a young oil E&P company are typically high and should be considered by investors. In this case the operational risks associated with exploration and production include, risks associated with weather conditions, technical breakdowns, future reserve depletion, rising drilling and exploration costs and others. There is no assurance that the production rates and past financial results achieved will be sustained with the same quality and grades in future to satisfy orders. Furthermore our recommendation and financial estimates assumes that the company can add 20-40 new wells in the coming 12-18 months which can all produce at least 10 barrels of crude oil per day. This is roughly 50% of the anticipated full capacity of the current producing wells. Most input costs are relatively fixed and cannot be influenced or determined by management, which can have an adverse effect on profitability. Readers should understand that there c**an be no assurance that the company will be able to fast-track its intended path towards raising production** above 4500 barrels level per month at Qian112 and also develop and/or acquire other oil interests, that will flow through directly to the top and or bottom line to build a consistent longer term profitable track record to enrich shareholder value. The future spot price of crude oil ore is one of the biggest unknowns and does and will play a material role in the financial performance of CNEH in the short, medium and long term.

We therefore only recommend investors that have a **high tolerance for risk** that are able and willing to forfeit either most or all of their capital in search for extraordinary returns, to consider investing in the shares. Also, in our view investors willing to commit capital to CNEH should do so with **absolute minimum 2 year investment horizon**, but preferably longer, to allow ample opportunity for growth to emerge until broader price discovery can materialize within the investment community that will **allow the value behind additional production to follow from near term drilling projects and Chinese client relationships be unlocked**. Short term we expect CNEH stock to continue to build a base around $0.40, before starting an ascent towards our 12 month price target of $1.20. **In the medium term a major risk factor may involve that additional capital raising or stock offering may be needed to fund acquisition-based growth and enable to company to embark on its full drilling program and complete its deferred maintenance programs.**

One of the core reasons which is pivotal to our bullish argument for upside in CNEH, follows from our interpretation of the financial data and analysis of the consolidated **proven reserve position** (1.25 million barrels) at Qian 112 that have been studied geologically. **Our assessment is that the large discount between the adjusted present value (PV) of reserves valuation (less liabilities plus cash) (at $39.6 million)** and the **market capitalization of CNEH ($7.4 million)** presents the investor with an undeniable **value opportunity,** assuming that crude oil prices can average at or above $60 per barrel and that the company is able to successfully continue its present operations and implement its drilling program successfully. The value was calculated assuming 80,000 barrels of oil produced annually at an average price of $65 per barrel, discounted back into present value terms over a 15 year period, at a **rate of 10%** that is **present SEC reporting convention**. **Depending on the flow rates and present daily production rates at existing wells that can be realized, and the faster CNEH is able to commercialize new wells, the greater the scope to exceed the present gross daily revenue guidance of $26,600 which will make the future return prospects from taking a stake in this company at a steep discount to reserves even more compelling.**

Based on recent results and management's guidance, we expect financial performance to gain pace and production levels to rise during the latter half of the coming financial year (FY2006) and show an even more profound improvement in FY2007. Under the assumption that **capital raising activity is well-managed and expecting revenue in 2006, positive cash flow from operations to be generated in FY 2006** as more progress is made to boost production levels back to pre-2005 levels and for its drilling program to bear fruit, while strong Chinese and worldwide demand for crude oil prevails**,** we are of the opinion that CNEH stock has major upside potential. Given managements and our own independent forecasts, we **are of the opinion that revenue potential of $3.8 million is achievable for FY 2006, followed by revenue in excess of $10 million in FY 2007.**

Using our own gross margin and operating cost assumptions that are placed in a range consistent with past performance, we estimate a FY 2006 EPS of 4c (assuming 18.5 million weighted number of shares outstanding). We have made allowance for tax applying an effective tax rate of 34%.

Using our FY 2006 EPS forecasts we deduce that the shares are presently trading at a forward PE multiple of 10.0x which is not demanding when compared with the industry mean current PE of 24.6. Using like margin assumptions and other revenue estimates for FY2007 we obtain an EPS forecast of 15c for FY2007. Given these calculations and our bottom up analysis which is more qualitative in nature, **we set a 12 month target price for the security of $1.20.**

This number was arrived by a blended approach using the average of the adjusted reserve valuation per share and the PE methodology in the table below:

We apply a 6 month forward PE ratio of 12.5x (a discount to the industry mean trailing 12 month PE ratio of 26.4x due to size and liquidity risk associated with CNEH) to our FY 2006 EPS estimate of 4c, which yields $0.59 per share and follow the same procedure for FY 2007 that yields $1.36. The average of these forward share prices is then discounted at a rate of 12.5% (k) (SEE TABLE BELOW) to arrive at a present value of the share price of $1.02 per share, where k is a function of the beta coefficient, the risk-free rate, and expected return of the market.

Secondly we use the adjusted reserve valuation per share of $1.99 and assume the discount can narrow to only 30% within 12 months and obtain (0.7x$1.99=$1.39) which is then discounted by 12.5% risk free rate of return for 1 year to arrive at a present value point estimate of $1.24. Using the first valuation number of $1.02 and our second valuation number of $1.24 we set a 12 month price target of $1.20 for CNE Petroleum. All factors considered, we anticipate a stake in CNEH still has compelling upside potential in the coming 12-24 months in light of the fact that negligible value is assigned to possible added value and incremental production benefit that will be realized when the new commercial wells start production.

		Forward PE multiple	EPS Growth	PEG Multiple	Forward Price	Discount Rate (k)	Present Value
FY 2006 EPS	0.04	12.5	NA	NA	0.50	13%	0.47
FY 2007 EPS	0.15	12.5	275%	0.08	1.88	13%	1.57
Average							1.02
Price to Book	0.05			Assumptions	Beta	1.25	
Price to Sales	5.25				R_f	5.0%	
Current PE	NA				R_m	11.0%	
Forward PE	9.1				k	12.5%	
(FY 2006 EPS)							
EV	10.15			$k=R_f+(R_m-R_f)*Beta$			
EBITDA*	-0.16						
EV/EBITDA	NA						

Our assessment is that the current share price rating (as measured by reserve value per share, Price to Sales, Forward PE and Relative PE) and valuation is poor (using all 4 metrics) and most likely associated with skepticism of operational risk and liquidity concerns and possible delays of planned commercialization of new wells start-ups in the next 6-12 months following the drilling program. A second factor could be concerns about capital constraints that need to be resolved to meet business plan and production goals.

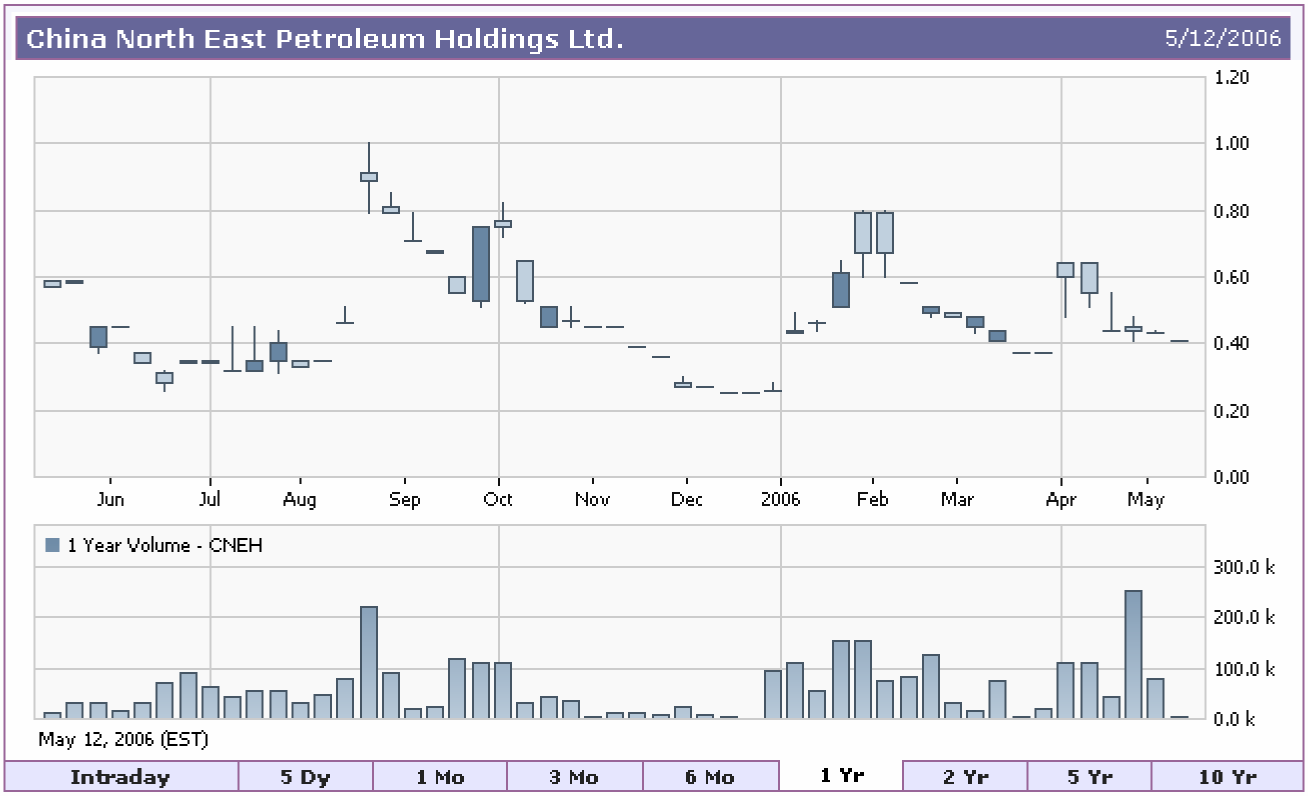
We HIGHLIGHT to the reader that our bullish view and forecasts for CNEH is made under the assumption that the Qian 112 drilling program and maintenance progresses smoothly and production targets are attained. It is also made assuming CNEH can attain our FY2006 revenue expectation of $3.8 million and a minimum of $0.81 million after tax income. Moreover, we believe that the present market for CNEH shares is far from efficient, does not fully reflect the leverage possible from new potential acquisitions and developments that can result in higher reserves and production that can enhance productivity if new oil assets are added in a strategic manner, which can be done in synergistic fashion.

We regard the present market capitalization as extremely modest in light of the fact that current production will rise sharply from under 30 000 barrels in 2005 to over 100 000 barrels in 2007, and will then still be well below present supply arrangements that are available from customers seeking oil shipments from CNEH to meet demand and if this materializes in conjunction with rising oil prices will cause a startling spike in both revenues and the bottom line of this niche Chinese E&P company.

Under these assumptions we initiate coverage on CNEH with a SPECULATIVE STRONG BUY rating. *Risk to our recommendation include amongst other: failure of new drilling projects to come on-stream as projected, unforeseen production difficulties in the near or medium term from flooding or other factors, a slowdown in production or failure to operate wells at pre-2005 flow rates an unexpected decline in oil prices that will lead to a contraction in forward PE multiple assumptions and dampen the reserve valuation, a steep rise in drilling and production costs or unanticipated problems obtaining production equipment or drill rigs, new fees and/or any adverse regulatory changes in the markets it serves. New competition in its regional market by other larger oil producers, tax expense accounting changes, any inability to obtain necessary financing from capital markets when needed, to continue its business projects and/or major share dilution that can occur, if large quantities of shares are issued to extinguish debt or paid for services, are some additional factors that will counteract price appreciation potential or cause shares to decline in value.*

We would caution that given the size of the company (microcap) and risks involved, overall we advise positions be limited below 5% of the client's total portfolio size.

See Appendix A-1 for Analyst Certification and Important Disclosures.



ANALYST CERTIFICATIONS APPENDIX-A1

The research analyst, who upon request wrote this report, certifies that the views expressed in this research report, accurately reflects his personal view about the subject company. The analyst also certifies that he does not own or have any beneficial interest in shares of the covered company, also that no part of his compensation was, is or will be directly or indirectly related to the specific recommendation or view expressed in this report. Based on the facts that were provided, the industry trends present and sources of information used to produce this report, it is my best opinion and reflection of what the company's rating and share appreciation potential could be once research coverage is widely adopted. Investors are urged to consider this report as only a single factor in making their investment decision. Information, opinions or recommendations contained in this report or research note are submitted solely for advisory and information purposes and we also do not accept any obligation to provide updates to this report in future.

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