

Condensed Consolidated Interim Financial Statements
(Expressed in Canadian dollars)

CHANGFENG ENERGY INC.

Three-month and six-month periods ended
June 30, 2012 and 2011
(Unaudited)

CHANGFENG ENERGY INC.

Condensed Consolidated Interim Balance Sheets
(Expressed in Canadian dollars)
(Unaudited)

	June 30, 2012	December 31, 2011
Assets		
Current assets:		
Cash	\$ 6,028,911	\$ 5,061,517
Trade and other receivables	2,628,314	2,567,215
Prepaid expenses and deposits (note 6)	422,820	596,331
Inventories (note 5)	930,665	729,413
Due from related parties (note 12)	342,738	323,200
Total current assets	10,353,448	9,277,676
Non-current assets:		
Long-term deposits and advances	1,952,951	1,888,889
Investment in associate	762,504	787,821
Property and equipment (note 9)	44,310,527	43,364,393
Intangible assets (note 7)	664,263	299,181
Total non-current assets	47,690,245	46,340,284
Total assets	\$ 58,043,693	\$ 55,617,960
Liabilities and Equity		
Current liabilities:		
Bank indebtedness (note 10(b))	\$ 4,812,000	\$ 4,848,000
Trade and other payables	4,165,251	4,882,747
Deferred revenue	8,075,059	6,069,457
Interest payable	2,088,762	2,104,388
Current portion of long-term debt (note 10)	1,523,800	1,616,000
Due to related parties (note 12)	492,468	427,843
Total current liabilities	21,157,340	19,948,435
Non-current liabilities:		
Long-term debt (note 10)	14,538,614	15,022,232
Due to related parties (note 12)	6,897,200	6,948,800
Deferred income tax liability	327,627	142,059
Total non-current liabilities	21,763,441	22,113,091
Total liabilities	42,920,781	42,061,526
Equity:		
Share capital	12,121,808	12,121,808
Contributed surplus	1,863,374	1,863,374
Deficit	(153,411)	(1,824,362)
Accumulated other comprehensive income	652,518	738,015
Total shareholders' equity	14,484,289	12,898,835
Non-controlling interest	638,623	657,599
Total equity	15,122,912	13,556,434
Going concern (note 2(a))		
Subsequent events (note 17)		
Total liabilities and equity	\$ 58,043,693	\$ 55,617,960

See accompanying notes to condensed consolidated interim financial statements.

On behalf of the Board:

"Graham Warren" _____ Director

"Wencheng Zhang" _____ Director

CHANGFENG ENERGY INC.

Condensed Consolidated Interim Statements of Comprehensive Income
(Expressed in Canadian dollars)
(Unaudited)

	Three-month periods ended June 30,		Six-month periods ended June 30,	
	2012	2011	2012	2011
Revenue	\$ 7,122,117	\$ 6,776,117	\$ 14,487,210	\$ 13,310,429
Cost of sales	3,701,466	4,945,620	7,164,178	7,946,035
Gross margin	3,420,651	1,830,497	7,323,032	5,364,394
Other operating income (note 8)	722,535	–	722,535	–
Expenses:				
General and administrative	1,524,811	1,159,487	2,739,861	2,198,199
Travel and business development	997,627	534,088	2,075,655	1,290,241
	2,522,438	1,693,575	4,815,516	3,488,440
Income from operations	1,620,748	136,922	3,230,051	1,875,954
Interest on long-term debt	387,126	340,099	773,584	635,279
Interest income	(1,498)	(3,200)	(4,303)	(4,482)
Equity loss on investment in associate	4,831	–	19,285	–
Income (loss) before income taxes	1,230,289	(199,977)	2,441,485	1,245,157
Income taxes	404,650	100,013	789,510	434,699
Net income (loss)	825,639	(299,990)	1,651,975	810,458
Other comprehensive income (loss):				
Exchange differences on translation of foreign operations	181,168	58,714	(85,497)	(138,089)
Total comprehensive income (loss)	\$ 1,006,807	\$ (241,276)	\$ 1,566,478	\$ 672,369
Net income (loss) attributable to:				
Non-controlling interest	\$ (11,793)	\$ (2,476)	\$ (18,976)	\$ (7,632)
Common shareholders	837,432	(297,514)	1,670,951	818,090
	\$ 825,639	\$ (299,990)	\$ 1,651,975	\$ 810,458
Total comprehensive income (loss) attributable to:				
Non-controlling interest	\$ (11,793)	\$ (2,476)	\$ (18,976)	\$ (7,632)
Common shareholders	1,018,600	(238,800)	1,585,454	680,001
	\$ 1,006,807	\$ (241,276)	\$ 1,566,478	\$ 672,369
Earnings (loss) per share attributable to common shareholders:				
Basic and diluted (note 11)	\$ 0.013	\$ (0.005)	\$ 0.025	\$ 0.012

See accompanying notes to condensed consolidated interim financial statements.

CHANGFENG ENERGY INC.

Condensed Consolidated Interim Statements of Changes in Equity
(Expressed in Canadian dollars)
(Unaudited)

Three-month period ended June 30, 2012	Share capital	Contributed surplus	Retained earnings (deficit)	Accumulated other comprehensive income	Non- controlling interest	Total
Balance, March 31, 2012	\$ 12,121,808	\$ 1,863,374	\$ (990,843)	\$ 471,350	\$ 650,416	\$ 14,116,105
Net income	–	–	837,432	–	(11,793)	825,639
Currency translation adjustment	–	–	–	181,168	–	181,168
Balance, June 30, 2012	\$ 12,121,808	\$ 1,863,374	\$ (153,411)	\$ 652,518	\$ 638,623	\$ 15,122,912

Three-month period ended June 30, 2011	Share capital	Contributed surplus	Deficit	Accumulated other comprehensive loss	Non- controlling interest	Total
Balance, March 31, 2011	\$ 12,121,808	\$ 1,762,168	\$ (2,093,743)	\$ (260,565)	\$ 666,288	\$ 12,195,956
Loss for the period	–	–	(297,514)	–	(2,476)	(299,990)
Currency translation adjustment	–	–	–	58,714	–	58,714
Balance, June 30, 2011	\$ 12,121,808	\$ 1,762,168	\$ (2,391,257)	\$ (201,851)	\$ 663,812	\$ 11,954,680

Six-month period ended June 30, 2012	Share capital	Contributed surplus	Retained earnings (deficit)	Accumulated other comprehensive income	Non- controlling interest	Total
Balance, January 1, 2012	\$ 12,121,808	\$ 1,863,374	\$ (1,824,362)	\$ 738,015	\$ 657,599	\$ 13,556,434
Net income	–	–	1,670,951	–	(18,976)	1,651,975
Currency translation adjustment	–	–	–	(85,497)	–	(85,497)
Balance, June 30, 2012	\$ 12,121,808	\$ 1,863,374	\$ (153,411)	\$ 652,518	\$ 638,623	\$ 15,122,912

Six-month period ended June 30, 2011	Share capital	Contributed surplus	Retained earnings (deficit)	Accumulated other comprehensive loss	Non- controlling interest	Total
Balance, January 1, 2011	\$ 12,121,808	\$ 1,762,168	\$ (3,209,347)	\$ (63,762)	\$ 671,444	\$ 11,282,311
Net income	–	–	818,090	–	(7,632)	810,458
Currency translation adjustment	–	–	–	(138,089)	–	(138,089)
Balance, June 30, 2011	\$ 12,121,808	\$ 1,762,168	\$ (2,391,257)	\$ (201,851)	\$ 663,812	\$ 11,954,680

See accompanying notes to condensed consolidated interim financial statements.

CHANGFENG ENERGY INC.

Condensed Consolidated Interim Statements of Cash Flows
(Expressed in Canadian dollars)
(Unaudited)

	Three-month periods ended		Six-month periods ended	
	2012	June 30, 2011	2012	June 30, 2011
Cash flows from operating activities:				
Net income (loss)	\$ 825,639	\$ (299,990)	\$ 1,651,975	\$ 810,458
Items not involving cash:				
Deferred income taxes	79,000	33,506	188,146	36,165
Amortization	517,697	415,346	1,023,771	900,438
Share of loss of investment in associate	4,831	–	19,285	–
Current income taxes	325,650	66,507	601,364	398,534
Interest expense	402,817	340,099	789,275	635,279
Income taxes paid	(50,103)	(536,440)	(642,104)	(933,503)
Interest expense paid	(371,435)	(325,427)	(742,202)	(605,846)
Change in non-cash operating working capital (note 14)	1,846,664	(694,256)	1,303,767	(1,991,643)
Net cash flows from (used in) operating activities	3,580,760	(1,000,655)	4,193,277	(750,118)
Cash flows from financing activities:				
Long-term debt	(239,250)	1,340,100	(477,300)	4,111,400
Net cash flows from (used in) financing activities	(239,250)	1,340,100	(477,300)	4,111,400
Cash flows from investing activities:				
Acquisition of property and equipment	(1,724,551)	(842,439)	(2,219,647)	(2,932,465)
Acquisition of intangible assets (note 7)	(30,770)	–	(363,325)	–
Long-term deposits and advances	(127,600)	(44,670)	(127,600)	(44,670)
Net cash flows used in investing activities	(1,882,921)	(887,109)	(2,710,572)	(2,977,135)
Increase (decrease) in net cash	1,458,589	(547,664)	1,005,405	384,147
Effects of foreign exchange on cash balances	56,500	14,805	(38,011)	(37,861)
Net cash, beginning of period	4,513,822	3,549,258	5,061,517	2,670,113
Net cash, end of period	\$ 6,028,911	\$ 3,016,399	\$ 6,028,911	\$ 3,016,399

See accompanying notes to condensed consolidated interim financial statements.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

1. Corporate information:

Changfeng Energy Inc. (the "Company") was incorporated under the Canada Business Corporations Act on May 4, 2006. Through its subsidiaries, the Company's core business activity is the distribution of natural gas for industrial, commercial and residential users in the People's Republic of China ("China" or "PRC"). The registered office of the Company is located at 25 Adelaide Street East, Suite 1612, Toronto, Ontario, M5C 3A1, and the principal operations of its business are in China.

The ability to build and operate gas pipeline infrastructure and distribute piped gas in China is established by concession rights obtained from the applicable municipal and provincial governments. Natural gas distribution operations in China are subject to certain government regulations regarding the purchase and sale of natural gas, including pricing.

2. Basis of presentation:

(a) Going concern:

The Company's condensed consolidated interim financial statements have been prepared on the basis of accounting principles applicable to a going concern, which contemplate the realization of assets and the satisfaction of liabilities and commitments in the normal course of business. As at June 30, 2012, the Company had a working capital deficiency of \$10,803,892.

Included in the working capital deficiency is \$2,088,762 of interest payable and a \$4,812,000 one-year line of credit. Deferred revenue relates to gas connection fees which are deferred when the Company receives the payments from customers, and are recognized on the percentage-of-completion method, measured by reference to the value of work carried out during the period. Interest payable is due on demand to Sanya State Assets Management Corporation (a state-owned company) and originated in years prior to 2007. Sanya State Assets Management Corporation has not requested payment for more than four years and the Company believes that it will not seek repayment in 2012 or the first two quarters of 2013. The Company's line of credit has historically been a one-year facility which requires annual renewals or replacement when it becomes due and the Company believes that it will be able to renew the line of credit when it becomes due. Excluding the two items above, the Company's adjusted working capital deficit as at June 30, 2012 was \$3,903,130 (December 31, 2011 - \$3,718,371). The Company continues to explore various sources of financing opportunities such as long-term debt and/or equity financing to support its operations.

While management believes that sustainable operating cash could be generated in the short and long term to provide liquidity, there is no guarantee that they will materialize as planned. Furthermore, there is no guarantee that the interest payable to Sanya State Assets Management Corporation will not be required to be repaid within the next 12 months, or that the renewal of the line of credit in future periods will be successful.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

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2. Basis of presentation (continued):

Furthermore, the Company may not be successful in obtaining additional financing on acceptable terms, on a timely basis, or at all, if the interest payable must be paid, if the line of credit is not renewed in future periods and/or projected operating cash flows do not materialize as planned.

The above conditions have resulted in a material uncertainty that may cast significant doubt over the Company's ability to finance its operations to permit it to continue as a going concern. These condensed consolidated interim financial statements do not reflect adjustments that would be necessary if the going concern basis of presentation was not appropriate. If the going concern basis of presentation was not appropriate for these condensed consolidated interim financial statements, then adjustments would be necessary to the carrying value of assets and liabilities, the reported net income for the period and the balance sheet classifications used.

(b) Statement of compliance:

The condensed consolidated interim financial statements have been prepared in compliance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), including IAS 34, Interim Financial Reporting.

The condensed consolidated interim financial statements should be read in conjunction with the Company's 2011 annual audited financial statements which have been prepared in accordance with IFRS as issued by the IASB.

The condensed consolidated interim financial statements have been prepared using accounting policies consistent with those used in the Company's 2011 annual audited consolidated financial statements.

These condensed consolidated interim financial statements were authorized for issue by the Board of Directors on August 27, 2012.

(c) Basis of measurement:

The condensed consolidated interim financial statements have been prepared on a historical cost basis for all its recognized assets and liabilities, except for certain financial instruments measured at fair value.

(d) Presentation and functional currencies:

The condensed consolidated interim financial statements are presented in Canadian dollars. The functional currencies of the Company's subsidiaries include the Canadian dollar and the Chinese Renminbi ("RMB").

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

3. Significant accounting policies:

The condensed consolidated interim financial statements should be read in conjunction with the Company's 2011 annual audited consolidated financial statements. These condensed consolidated interim financial statements have been prepared in accordance with IFRS using the same accounting policies as were applied for the 2011 annual consolidated financial statements, except for the following:

(a) Government grants:

Government grants are recognized where there is reasonable assurance that the grant will be received and that the Company will comply with all necessary conditions to earn the grant. Where the grant relates to an asset, it is recognized as deferred income and released to income in equal amounts over the expected useful life of the related asset. Where the grant relates to expenses or losses already incurred, it is recognized in the condensed consolidated statement of comprehensive income of the period in which it becomes receivable.

(b) Recent accounting pronouncements:

(i) Financial instruments - recognition and measurement:

In October 2010, the IASB published amendments to IFRS 9, Financial Instruments ("IFRS 9 (2010)"), which provide added guidance on the classification and measurement of financial liabilities. IFRS 9 (2010) supersedes IFRS 9 (2009) and is effective for annual periods beginning on or after January 1, 2015, with early adoption permitted. For annual periods beginning before January 1, 2015, either IFRS 9 (2009) or IFRS 9 (2010) may be applied. The Company intends to adopt IFRS 9 (2010) in its financial statements for the annual period beginning on January 1, 2015. The extent of the impact of adoption of IFRS 9 (2010) has not yet been determined.

(ii) Financial assets and liabilities:

In December 2011, the IASB published amendments to International Accounting Standard 32, Financial Instruments: Presentation ("IAS 32"), and issued new disclosure requirements in IFRS 7, Financial Instruments: Disclosures ("IFRS 7"). The effective date for the amendments to IAS 32 is annual periods beginning on or after January 1, 2014. Certain of the amendments to IFRS 7 were adopted by the Company during the first quarter of 2012 and had no material impact; the remainder of the amendments are to be adopted for annual periods beginning on or after January 1, 2013. These amendments are to be applied retrospectively.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
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3. Significant accounting policies (continued):

The amendments to IAS 32 clarify when an entity has a legally enforceable right to offset, as well as clarify, when a settlement mechanism provides for net settlement, or gross settlement that is equivalent to net settlement. The amendments to IFRS 7 contain new disclosure requirements for financial assets and liabilities that are offset in the balance sheet or subject to master netting arrangements or similar arrangements. The Company intends to adopt the amendments to IFRS 7 in its financial statements for the annual period beginning on January 1, 2013, and the amendments to IAS 32 in its financial statements for the annual period beginning January 1, 2014. The extent of the impact of adoption of the amendments has not yet been determined.

(iii) Consolidated financial statements:

In May 2011, the IASB issued IFRS 10, Consolidated Financial Statements ("IFRS 10"). IFRS 10 replaces portions of IAS 27, Consolidated and Separate Financial Statements ("IAS 27"), that addresses consolidation, and supersedes SIC-12, Consolidation - Special Purpose Entities ("SPE") ("SIC-12"), in its entirety. IFRS 10 provides a single model to be applied in the analysis of control of all investees, including entities that currently are SPEs in the scope of SIC-12. In addition, the consolidation procedures specified in IFRS 10 are carried forward substantially unmodified from IAS 27.

(iv) Joint arrangements:

In May 2011, the IASB issued IFRS 11, Joint Arrangements ("IFRS 11"). IFRS 11 supersedes IAS 31, Interest in Joint Ventures, and SIC-13, Jointly Controlled Entities - Non-Monetary Contributions by Venturers. Through an assessment of the rights and obligations in an arrangement, IFRS 11 establishes principles to determine the type of joint arrangement, which are classified as either joint operations or joint ventures, and provides guidance for financial reporting activities required by the entities that have an interest in arrangements that are controlled jointly. Investments in joint ventures are required to be accounted for using the equity method.

As a result of the issuance of IFRS 10 and IFRS 11, IAS 28, Investments in Associates and Joint Ventures ("IAS 28"), has been amended to correspond to the guidance provided in IFRS 10 and IFRS 11.

(v) Disclosure of interests in other entities:

In May 2011, the IASB issued IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12"), which contains disclosure requirements for companies that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

3. Significant accounting policies (continued):

IFRS 10, IFRS 11 and IFRS 12, and the amendments to IAS 27 and IAS 28 are all effective for annual periods beginning on or after January 1, 2013. Early adoption is permitted, so long as IFRS 10, IFRS 11 and IFRS 12, and the amendments to IAS 27 and IAS 28 are adopted at the same time.

However, entities are permitted to incorporate any of the disclosure requirements in IFRS 12 into their financial statements without early adopting IFRS 10, IFRS 11, amendments to IAS 27 and IAS 28. The Company intends to adopt IFRS 10, IFRS 11 and IFRS 12 and the amendments to IAS 27 and IAS 28 in its financial statements for the annual period beginning on January 1, 2013. The extent of the impact of adoption of IFRS 10, IFRS 11 and IFRS 12 and the amendments to IAS 27 and IAS 28 has not yet been determined.

(vi) Fair value measurement:

In May 2011, the IASB published IFRS 13, Fair Value Measurement ("IFRS 13"), which is effective prospectively for annual periods beginning on or after January 1, 2013. IFRS 13 replaces the fair value measurement guidance contained in individual IFRS with a single source of fair value measurement guidance. The standard also establishes a framework for measuring fair value and sets out disclosure requirements for fair value measurements. The Company intends to adopt IFRS 13 prospectively in its financial statements for the annual period beginning on January 1, 2013. The extent of the impact of adoption of IFRS 13 has not yet been determined.

(vii) Presentation of financial statements:

In June 2011, the IASB published amendments to IAS 1, Presentation of Financial Statements: Presentation of Items of Other Comprehensive Income, which are effective for annual periods beginning on or after July 1, 2012 and are to be applied retrospectively. Early adoption is permitted. These amendments require that a company present separately the items of other comprehensive income that may be reclassified to profit or loss in the future from those that would never be reclassified to profit or loss. The Company intends to adopt these amendments in its financial statements for the annual period beginning on January 1, 2013. The extent of the impact of adoption of these amendments has not yet been determined.

4. Significant accounting judgments, estimates and assumptions:

The preparation of the condensed consolidated interim financial statements in accordance with IFRS requires management to make judgments, estimates and assumptions that affect the application of accounting policies and the reported amounts of assets, liabilities, income and expenses. Actual results may differ from those estimates.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

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(Unaudited)

4. Significant accounting judgments, estimates and assumptions (continued):

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the periods in which the estimates are revised and in any future periods affected. Information about significant areas of estimation and critical judgments in applying accounting policies that have significant effects on the amounts recognized in the condensed consolidated interim financial statements is included in the following notes:

(a) Allowance for doubtful accounts:

The Company establishes a provision for doubtful receivables when there is objective evidence that the Company will not be able to collect all amounts due to it. The allowance is based on management's best estimates of specific losses on individual exposures, as well as a provision on historical trends of collections. The provision is recorded against the trade and other receivables balance, with a corresponding charge recorded in the consolidated statements of comprehensive income. Actual amounts received may differ from management's estimate.

(b) Revenue recognition:

Revenue from natural gas sales is recognized when the gas is delivered to the customer.

Gas connection revenue is deferred and recognized only when the outcome of a contract can be estimated reliably and the stage of completion at the consolidated balance sheet dates can be measured reliably. Revenue from gas connection contracts is recognized using the percentage-of-completion method, measured by reference to the value of work carried out during the periods.

When it is probable that total contract costs will exceed contract revenue, the expected loss is recognized as an expense in the period in which the expected loss is identified.

(c) Amortization expense:

The Company's long-lived assets are amortized over their estimated useful economic lives on a straight-line basis. Useful lives are based upon management's estimates of the length of time that the assets will generate revenue, which is reviewed at least annually for appropriateness. Changes to these estimates can result in variations in the amounts charged for amortization and in the assets' carrying amounts.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
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4. Significant accounting judgments, estimates and assumptions (continued):

(d) Income taxes:

Provisions for income taxes are based on domestic and international statutory income tax rates and tax planning opportunities available to the Company in the jurisdictions in which it operates. Significant judgment is required determining income tax provisions and the recoverability of deferred tax assets. The calculation of current and deferred income tax balances requires management to make estimates regarding the carrying values of assets and liabilities that include estimates of future cash flows and income related to such assets and liabilities, the interpretation of income tax legislation in the jurisdictions in which the Company operates, and the timing of reversal of temporary differences. The Company establishes additional provisions for income taxes when, despite management's opinion that tax positions are fully supportable, there is sufficient complexity or uncertainty in the application of legislation that certain tax positions may be reassessed by tax authorities. The Company adjusts these additional accruals in light of changing facts and circumstances.

(e) Share-based payments:

The Company measures the cost of equity-settled transactions with employees by reference to the fair value of the equity instruments at the dates at which they are granted. Determining fair value for share-based payment transactions requires the use of the most appropriate valuation model, which is dependent on the terms and conditions of the grant. The determination of fair value requires estimating the expected life of the share option, volatility and dividend yield.

5. Inventories:

	June 30, 2012	December 31, 2011
Construction materials	\$ 548,197	\$ 459,582
Gas appliances, meters and spare parts	359,149	236,895
Natural gas	23,319	32,936
	<u>\$ 930,665</u>	<u>\$ 729,413</u>

The amount of inventories recognized as an expense through cost of sales during the six-month period ended June 30, 2012 was \$1,121,853 (2011 - \$1,520,035), which comprised entirely raw material costs. There were no impairments of inventory or reversals of impairments recorded during the six-month period ended June 30, 2012 (2011 - nil).

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
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6. Gas prepayment:

Included in prepaid expenses and deposits is a payment of \$66,204 (RMB 412,745) (December 31, 2011 - nil) made to the Company's 24 million cubic meters gas supplier as a prepayment for gas to be purchased in future periods. The prepayment is expected to be used to fund purchases of gas during the third quarter of 2012.

7. Intangible assets:

On February 22, 2012, the Company entered into a Gas and Electricity Exchange Program (the "Program") with the Local Power Bureau and China National Offshore Oil Yacheng Operation Co., Ltd., which will secure an additional annual supply of natural gas totalling approximately 5 million cubic meters until 2015. In exchange for this gas supply, the Company will fund the building of infrastructure to link certain of the supplier's operations to the provincial power grid, although it will not own the constructed assets. The total anticipated capital expenditure related to the Program is \$1,604,000 (RMB 10,000,000). This additional gas supply is expected to be available to the Company by late 2012 once approximately \$1,087,153 (RMB 6,777,759) of the first phase of construction work is completed.

In connection with the Program, for the six months ended June 30, 2012, the Company prepaid approximately \$377,207 (RMB 2,351,664) to a local contractor for work to be performed in 2012. This amount has been recorded as an intangible asset on the condensed consolidated interim balance sheets, on which amortization will begin once the construction on the first phase is completed and the exchanged gas is available to the Company.

Cost

Balance, December 31, 2011	\$ 331,501
Additions	377,207
Foreign currency translation	(3,199)
Balance, June 30, 2012	\$ 705,509

Accumulated amortization

Balance, December 31, 2011	\$ 32,320
Amortization	9,166
Foreign currency translation	(240)
Balance, June 30, 2012	\$ 41,246

Net book value

December 31, 2011	\$ 299,181
June 30, 2012	664,263

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
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8. Government grant:

On June 27, 2012, the Company received \$722,535 (RMB 4,530,000) as a government grant from the municipal government of Sanya City, Hainan Province, China to partially compensate the Company for certain gas purchases made at unfavourable prices in 2011 to satisfy customer demand in the Sanya City region. This government grant was recognized as other income for the quarter ended June 30, 2012.

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Notes to Condensed Consolidated Interim Financial Statements (continued)
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(Unaudited)

9. Property and equipment:

	Buildings	Pipelines	Land use rights (a)	Motor vehicles	Furniture and equipment	Leasehold improvements	Construction in progress (b)	Total
Cost								
Balance, January 1, 2011	\$ 55,019	\$ 36,981,648	\$ 1,118,471	\$ 1,236,937	\$ 2,712,768	\$ 395,506	\$ 2,186,813	\$ 44,687,162
Additions (transfers)	2,625,683	2,528,041	–	125,316	1,921,116	–	(1,980,379)	5,219,777
Foreign currency translation	3,901	2,622,291	79,308	87,708	192,356	28,045	155,065	3,168,674
Balance, December 31, 2011	2,684,603	42,131,980	1,197,779	1,449,961	4,826,240	423,551	361,499	53,075,613
Additions	–	–	–	81,123	28,834	627	2,104,133	2,214,717
Foreign currency translation	(19,935)	(314,275)	(8,894)	(10,767)	(35,839)	(3,145)	(2,684)	(395,539)
Balance June 30, 2012	\$ 2,664,668	\$ 41,817,705	\$ 1,188,885	\$ 1,520,317	\$ 4,819,235	\$ 421,033	\$ 2,462,948	\$ 54,894,791
Accumulated amortization								
Balance, January 1, 2011	\$ 13,497	\$ 5,884,453	\$ 286,608	\$ 356,639	\$ 805,289	\$ 23,073	\$ –	\$ 7,369,559
Amortization	23,508	1,329,044	31,816	182,965	251,800	16,756	–	1,835,889
Foreign currency translation	957	402,728	20,323	25,289	57,101	(626)	–	505,772
Balance, December 31, 2011	37,962	7,616,225	338,747	564,893	1,114,190	39,203	–	9,711,220
Amortization	22,088	706,743	15,790	77,038	111,205	10,597	–	943,461
Foreign currency translation	(373)	(49,033)	(2,516)	(4,195)	(14,009)	(291)	–	(70,417)
Balance, June 30, 2012	\$ 59,677	\$ 8,273,935	\$ 352,021	\$ 637,736	\$ 1,211,386	\$ 49,509	\$ –	\$ 10,584,264
Net book value								
January 1, 2011	\$ 41,522	\$ 31,097,195	\$ 831,863	\$ 880,298	\$ 1,907,479	\$ 372,433	\$ 2,186,813	\$ 37,317,603
December 31, 2011	2,646,641	34,515,755	859,032	885,068	3,712,050	384,348	361,499	43,364,393
June 30, 2012	2,604,991	33,543,770	836,864	882,581	3,607,849	371,524	2,462,948	44,310,527

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

9. Property and equipment (continued):

(a) Land use rights:

As at June 30, 2012, the Company held five land use rights certificates. They all have a 50-year term and expire in 2051.

(b) Pipeline construction and equipment:

The Company has signed contracts with several equipment suppliers and construction supervisors for a total amount of \$4,123,339 (RMB 25,706,604) (December 31, 2011 - \$3,470,049 (RMB 21,473,076)), of which \$1,846,474 (RMB 11,511,686) (December 31, 2011 - \$2,139,222 (RMB 13,237,762)) has been paid as at June 30, 2012 and was classified as construction in progress.

10. Long-term debt and bank indebtedness:

	June 30, 2012	December 31, 2011
Term loan facility - China Development Bank (a)	\$ 320,800	\$ 808,000
Term loan facility - Bank of China (b)	15,741,614	15,830,232
	16,062,414	16,638,232
Less current portion	1,523,800	1,616,000
	\$ 14,538,614	\$ 15,022,232

(a) The Company made payments in the amount of \$481,200 (RMB 3,000,000) on its term loan from the China Development Bank in accordance with the quarterly repayment provisions of the loan.

(b) Included in current portion of bank loan was \$4,812,000 (RMB 30,000,000) of a one-year line of credit (the "Credit Line") with the Bank of China.

On March 16, 2012, the Credit Line was renewed by the Bank of China for an additional year, for which principal repayments are due one year from the date of withdrawal. As part of the renewal, the Company is subject to a financial covenant that requires the Company's subsidiary Sanya Changfeng Offshore Natural Gas Distribution Co., Ltd.'s debt-to-total-assets ratio to be maintained below 80%. All other terms remain unchanged.

The Company had drawn \$4,812,000 (RMB 30,000,000) against the Credit Line, of which \$3,208,000 (RMB 20,000,000) will be due on March 28, 2013, and \$1,604,000 (RMB 10,000,000) will be due on June 20, 2013.

As at June 30, 2012, the Company was in compliance with all of its debt covenants.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

10. Long-term debt and bank indebtedness (continued):

Long-term loan principal payments are as follows:

	RMB	Cdn. \$
2012	7,000,000	\$ 1,122,800
2013	5,000,000	802,000
2014	10,000,000	1,604,000
2015	10,000,000	1,604,000
2016	10,000,000	1,604,000
Thereafter	60,000,000	9,624,000
	102,000,000	\$ 16,360,800

11. Earnings per share:

Basic earnings per share ("EPS") amounts are calculated by dividing the net income attributable to common shareholders of the Company by the weighted average of shares issued during the period. Diluted EPS amounts are calculated by dividing the net income attributable to common shareholders of the Company by the weighted average number of shares issued during the period, adjusted for the effect of potentially dilutive stock options.

The following tables set forth the calculation of basic and diluted EPS:

	Three-month periods ended June 30,					
	2012		2011			
	Net income attributable to common shareholders	Weighted average number of shares	EPS	Loss for the period attributable to common shareholders	Weighted average number of shares	EPS
Basic and diluted	\$ 837,432	66,025,000	\$ 0.013	\$ (297,514)	66,025,000	\$ (0.005)

	Six-month periods ended June 30,					
	2012		2011			
	Net income attributable to common shareholders	Weighted average number of shares	EPS	Net income attributable to common shareholders	Weighted average number of shares	EPS
Basic and diluted	\$ 1,670,951	66,025,000	\$ 0.025	\$ 818,090	66,025,000	\$ 0.012

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

11. Earnings per share (continued):

At June 30, 2012 and 2011, there were no potentially dilutive stock options outstanding; however, these options may be dilutive in future periods.

12. Related party disclosures:

- (a) As at June 30, 2012 and December 31, 2011, a company controlled by a significant shareholder, who is also an officer and director of the Company, owed the Company a total of \$21,938 for various expenditures paid by the Company on behalf of this corporation.
- (b) As at June 30, 2012 and December 31, 2011, the Company had an outstanding loan of \$320,800 (RMB 2,000,000) due from the minority shareholder of Hunan Changfeng CNPC Energy Co., Ltd. ("Hunan CF CNPC"), which used the funds to contribute the capital it owed to that subsidiary. The loan is unsecured and non-interest bearing. The minority shareholder has waived its right to any future profit that it would otherwise be allocated until the loan is repaid. The Company will begin recording this shareholder's profit allocation prospectively at the time the loan has been repaid. On May 4, 2012, the Company entered into supplementary agreements with this minority shareholder. Pursuant to the supplementary agreements, the loan will be due on June 8, 2015, secured by this minority shareholder's 40% equity interest in Hunan CF CNPC and bearing interest at 120% five-year term loan prescribed by the People's Bank of China.
- (c) In 2007, a significant shareholder, who is also an officer and director of the Company, advanced loans in the aggregate amount of \$6,416,000 (RMB 40,000,000) (December 31, 2011 - \$6,464,000 (RMB 40,000,000)) to the Company, through wholly owned corporations, in accordance with a Subordination and Forbearance Agreement dated April 27, 2007, Consignment Loan Agreements dated May 23, 2007 and June 26, 2007, and other ancillary documentation. These loans are unsecured, non-interest bearing, subordinate to the claims of all other creditors, including unsecured creditors of the Company, and were due on demand only after April 27, 2010.

On April 27, 2010, these loans were renewed for another three years with the same terms and conditions and are due on demand only after April 27, 2013. The significant shareholder extended the date on which these loans are due on demand to April 27, 2015.

- (d) As at June 30, 2012, the Company owed a significant shareholder, who is also an officer and director of the Company, \$492,468 (December 31, 2011 - \$427,843) for unpaid salary.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

13. Financial instruments and risk management:

The Company is exposed to foreign exchange risk, interest rate risk, credit risk, liquidity risk and regulatory risk and uncertainty. The Company has policies for managing these risks that are aligned with its overall objectives to maintain a simple and cost-effective capital structure that supports a long-term growth strategy and maximizes operating flexibility. There have been no material changes to the Company's risk and risk management activities since December 31, 2011.

As at June 30, 2012, the carrying amounts for cash, trade and other receivables, trade and other payables and interest payable on the condensed consolidated interim balance sheets approximate fair values because of the limited term to maturity of these financial instruments.

14. Change in non-cash operating working capital:

	Three-month periods ended June 30,	
	2012	2011
Trade and other receivables and due from related parties	\$ (263,475)	\$ (298,558)
Prepaid expenses and deposits	812,754	(341,969)
Inventories	8,482	103,395
Trade and other payables and due to related parties	45,750	(110,039)
Deferred revenue	1,243,153	(47,085)
	<u>\$ 1,846,664</u>	<u>\$ (694,256)</u>

	Six-month periods ended June 30,	
	2012	2011
Trade and other receivables and due from related parties	\$ (20,351)	\$ (12,786)
Prepaid expenses and deposits	75,717	(333,303)
Inventories	(204,436)	(215,603)
Trade and other payables and due to related parties	(582,337)	(809,298)
Deferred revenue	2,035,174	(620,653)
	<u>\$ 1,303,767</u>	<u>\$ (1,991,643)</u>

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

15. Seasonality of operations:

Seasonality can impact the Company's pipeline natural gas sales. The Company's current operations are primarily located in Sanya City, an international tourist destination in the PRC's only tropical province. Sanya City attracts more tourists in winter and spring than the rest of the year. The Company's natural gas sales are higher during the high tourism seasons of winter and spring as a large portion of the Company's natural gas sales are made to hotels and restaurants.

16. Segmented reporting:

The Company has three reportable segments: gas connection, pipeline gas sales and compressed natural gas ("CNG") refuelling sales. Two of these segments (gas connection and pipeline sales) combine to form a gas distribution utility, which is currently the Company's primary operation. The utility delivers natural gas to commercial, industrial and residential customers through its pipeline networks and associated facilities. The Company's third business segment is a CNG refuelling retail station which is mainly used to supply gas for taxicab and public vehicles. The performance of each segment is measured by income from operations.

Transactions between reportable segments, namely the transfer of certain pipeline assets from the gas connection segment to the pipeline gas sales segment, have been accounted for based on the carrying values of the assets transferred. There were no significant intercompany transactions between the business segments.

Geographic information:

The Company's revenue is wholly generated from China and the majority of its assets are located in China. For the six-month periods ended June 30, 2012 and 2011, there is no significant individual customer from which sales amounted to more than 10% of the Company's revenue.

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

16. Segmented reporting (continued):

Summarized financial information concerning the reportable segments is shown in the following tables:

Three-month period ended June 30, 2012:

	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	\$ 2,620,240	\$ 3,317,823	\$ 1,184,054	\$ 7,122,117
Cost of sales	1,173,436	1,544,784	983,246	3,701,466
	1,446,804	1,773,039	200,808	3,420,651
Other operating income	–	722,535	–	722,535
Expenses:				
General and administrative	390,448	1,019,116	115,247	1,524,811
Travel and business development	371,162	606,811	19,654	997,627
	761,610	1,625,927	134,901	2,522,438
Income from operations	\$ 685,194	\$ 869,647	\$ 65,907	\$ 1,620,748
Acquisition of property and equipment	\$ 69,751	\$ 1,636,865	\$ 17,935	\$ 1,724,551
Long-term deposits and advances	–	127,600	–	127,600
Intangible assets	–	30,770	–	30,770
Total assets June 30, 2012	\$ 4,106,851	\$ 51,710,033	\$ 2,226,809	\$ 58,043,693

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

16. Segmented reporting (continued):

Three-month period ended June 30, 2011:

	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	\$ 2,503,342	\$ 3,732,841	\$ 539,934	\$ 6,776,117
Cost of sales	1,704,661	2,751,769	489,190	4,945,620
	798,681	981,072	50,744	1,830,497
Expenses:				
General and administrative	344,235	736,507	78,745	1,159,487
Travel and business development	204,766	308,450	20,872	534,088
	549,001	1,044,957	99,617	1,693,575
Income (loss) from operations	\$ 249,680	\$ (63,885)	\$ (48,873)	\$ 136,922
Acquisition of property and equipment	\$ 73,360	\$ 749,633	\$ 19,446	\$ 842,439
Total assets June 30, 2011	\$ 2,852,894	\$ 41,937,779	\$ 2,469,834	\$ 47,260,507

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

16. Segmented reporting (continued):

Six-month period ended June 30, 2012:

	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	\$ 4,243,029	\$ 8,062,985	\$ 2,181,196	\$ 14,487,210
Cost of sales	2,050,245	3,354,305	1,759,628	7,164,178
	2,192,784	4,708,680	421,568	7,323,032
Other operating income	–	722,535	–	722,535
Expenses:				
General and administrative	749,674	1,763,202	226,985	2,739,861
Travel and business development	648,274	1,395,233	32,148	2,075,655
	1,397,948	3,158,435	259,133	4,815,516
Income from operations	\$ 794,836	\$ 2,272,780	\$ 162,435	\$ 3,230,051
Acquisition of property and equipment	\$ 70,529	\$ 2,117,916	\$ 31,202	\$ 2,219,647
Long-term deposits and advances	–	127,600	–	127,600
Intangible assets	–	363,325	–	363,325
Total assets June 30, 2012	\$ 4,106,851	\$ 51,710,033	\$ 2,226,809	\$ 58,043,693

CHANGFENG ENERGY INC.

Notes to Condensed Consolidated Interim Financial Statements (continued)
(Expressed in Canadian dollars, unless otherwise indicated)

Three-month and six-month periods ended June 30, 2012 and 2011
(Unaudited)

16. Segmented reporting (continued):

Six-month period ended June 30, 2011:

	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	\$ 4,086,378	\$ 8,279,401	\$ 944,650	\$ 13,310,429
Cost of sales	2,704,259	4,389,906	851,870	7,946,035
	1,382,119	3,889,495	92,780	5,364,394
Expenses:				
General and administrative	645,555	1,408,544	144,100	2,198,199
Travel and business development	467,128	694,014	129,099	1,290,241
	1,112,683	2,102,558	273,199	3,488,440
Income (loss) from operations	\$ 269,436	\$ 1,786,937	\$ (180,419)	\$ 1,875,954
Acquisition of property and equipment	\$ 75,693	\$ 2,736,846	\$ 119,926	\$ 2,932,465
Total assets June 30, 2011	\$ 2,852,894	\$ 41,937,779	\$ 2,469,834	\$ 47,260,507

17. Subsequent events:

- On July 13, 2012, the Company granted 1,200,000 options (the "Options"), exercisable at a price of \$0.24 for five years from the date of grant, to its newly elected director and certain members of management who serve in the subsidiaries in China. This grant was made pursuant to the Company's stock option plan. The terms and conditions of the Options are subject to the approval of the TSX Venture Exchange.
- On July 19, 2012, the Company received a government grant in amount of \$802,000 (RMB 5,000,000) to fund construction of certain items of property and equipment for the Company's operation in Sanya City, Hainan Province, China.
- On August 26, 2012, the Company prepaid \$641,600 (RMB 4,000,000) for the purchase of natural gas in the amount of 4 million cubic meters with a fixed contractual price, which will be fully delivered before December 31, 2012. The total purchase cost is \$1,914,107 (RMB 11,933,333) and will be fully paid in three installments before October 2012, regardless of actual amount of gas consumed.