

Condensed Consolidated Interim Financial Statements  
(Expressed in Canadian dollars)

## **CHANGFENG ENERGY INC.**

Three-month and six-month periods ended  
June 30, 2013 and 2012  
(Unaudited)

# CHANGFENG ENERGY INC.

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

	June 30, 2013	December 31, 2012
<b>Assets</b>		
Current assets:		
Cash	\$ 9,679,321	\$ 6,377,219
Trade and other receivables	3,153,250	3,230,906
Prepaid expenses and deposits (note 6)	680,383	626,499
Inventories (note 5)	949,868	730,506
Due from related parties (note 12)	21,938	341,338
<u>Total current assets</u>	<u>14,484,760</u>	<u>11,306,468</u>
Non-current assets:		
Long-term deposits and advances	1,628,875	1,518,572
Investment in associate	808,817	754,610
Property and equipment (note 7)	52,906,611	46,247,497
Intangible assets (note 8)	1,510,773	1,372,385
Due from related parties (note 12)	342,600	-
<u>Total non-current assets</u>	<u>57,197,676</u>	<u>49,893,064</u>
<u>Total assets</u>	<u>\$ 71,682,436</u>	<u>\$ 61,199,532</u>
<b>Liabilities and Equity</b>		
Current liabilities:		
Bank indebtedness (note 9(b))	\$ -	\$ 4,791,000
Trade and other payables	4,882,372	5,650,929
Deferred revenue	10,461,149	8,911,201
Interest payable	1,888,104	2,079,646
Current portion of long-term debt (note 9(a))	1,541,700	798,500
Due to related parties (note 12)	1,264,406	1,280,123
<u>Total current liabilities</u>	<u>20,037,731</u>	<u>23,511,399</u>
Non-current liabilities:		
Long-term debt (note 9(a))	24,347,281	14,106,431
Due to related parties (note 12)	6,852,000	6,388,000
Government grants	885,403	811,276
Deferred income tax liability	558,805	314,445
<u>Total non-current liabilities</u>	<u>32,643,489</u>	<u>21,620,152</u>
<u>Total liabilities</u>	<u>52,681,220</u>	<u>45,131,551</u>
Equity:		
Share capital (note 10)	11,880,364	12,121,808
Contributed surplus	2,042,890	2,042,890
Retained earnings	2,632,071	683,694
Accumulated other comprehensive income	1,869,225	591,636
<u>Total shareholders' equity</u>	<u>18,424,550</u>	<u>15,440,028</u>
Non-controlling interest	576,666	627,953
<u>Total equity</u>	<u>19,001,216</u>	<u>16,067,981</u>
Subsequent events (notes 9(b) and 10)		
<u>Total liabilities and equity</u>	<u>\$ 71,682,436</u>	<u>\$ 61,199,532</u>

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,	
	2013	2012	2013	2012
Revenue	\$ 9,190,026	\$ 7,122,117	\$ 18,812,868	\$ 14,487,210
Cost of sales	4,930,384	3,701,466	9,044,237	7,164,178
Gross margin	4,259,642	3,420,651	9,768,631	7,323,032
Other operating income	–	722,535	–	722,535
Expenses:				
General and administrative	1,852,458	1,524,811	3,605,316	2,739,861
Travel and business development	891,259	997,627	2,197,997	2,075,655
	2,743,717	2,522,438	5,803,313	4,815,516
Income from operations	1,515,925	1,620,748	3,965,318	3,230,051
Interest on long-term debt	437,246	387,126	879,231	773,584
Interest income	(9,202)	(1,498)	(18,242)	(4,303)
Equity loss on investment in associate	274	4,831	579	19,285
Income before income taxes	1,087,607	1,230,289	3,103,750	2,441,485
Income taxes	463,044	404,650	1,206,660	789,510
Net income	624,563	825,639	1,897,090	1,651,975
Other comprehensive income (loss):				
Exchange differences on translation of foreign operations	891,381	181,168	1,277,589	(85,497)
Total comprehensive income	\$ 1,515,944	\$ 1,006,807	\$ 3,174,679	\$ 1,566,478
Net income (loss) attributable to:				
Non-controlling interest	\$ (32,638)	\$ (11,793)	\$ (51,287)	\$ (18,976)
Common shareholders	657,201	837,432	1,948,377	1,670,951
	\$ 624,563	\$ 825,639	\$ 1,897,090	\$ 1,651,975
Total comprehensive income (loss) attributable to:				
Non-controlling interest	\$ (32,638)	\$ (11,793)	\$ (51,287)	\$ (18,976)
Common shareholders	1,548,582	1,018,600	3,225,966	1,585,454
	\$ 1,515,944	\$ 1,006,807	\$ 3,174,679	\$ 1,566,478
Earnings per share attributable to common shareholders (note 11):				
Basic	\$ 0.01	\$ 0.01	\$ 0.03	\$ 0.03
Diluted	0.01	0.01	0.03	0.03

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)

Six-month period ended June 30, 2013	Share capital	Contributed surplus	Retained earnings	Accumulated other comprehensive income	Non- controlling interest	Total
Balance, January 1, 2013	\$ 12,121,808	\$ 2,042,890	\$ 683,694	\$ 591,636	\$ 627,953	\$ 16,067,981
Share repurchase	(241,444)	–	–	–	–	(241,444)
Net income (loss)	–	–	1,948,377	–	(51,287)	1,897,090
Currency translation adjustment	–	–	–	1,277,589	–	1,277,589
<b>Balance, June 30, 2013</b>	<b>\$ 11,880,364</b>	<b>\$ 2,042,890</b>	<b>\$ 2,632,071</b>	<b>\$ 1,869,225</b>	<b>\$ 576,666</b>	<b>\$ 19,001,216</b>

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 (loss)	–	–	1,670,951	–	(18,976)	1,651,975
Currency translation adjustment	–	–	–	(85,497)	–	(85,497)
<b>Balance, June 30, 2012</b>	<b>\$ 12,121,808</b>	<b>\$ 1,863,374</b>	<b>\$ (153,411)</b>	<b>\$ 652,518</b>	<b>\$ 638,623</b>	<b>\$ 15,122,912</b>

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	
	2013	June 30, 2012	2013	June 30, 2012
<b>Cash flows from operating activities:</b>				
Net income	\$ 624,563	\$ 825,639	\$ 1,897,090	\$ 1,651,975
Items not involving cash:				
Deferred income taxes	36,555	79,000	222,649	188,146
Amortization	588,184	517,697	1,139,100	1,023,771
Prepaid rent expense	21,827	–	43,102	–
Share of loss of investment in associate	274	4,831	579	19,285
Current income taxes	426,489	325,650	984,011	601,364
Interest expense	437,246	402,817	879,231	789,275
Income taxes paid	(566,344)	(50,103)	(1,019,362)	(642,104)
Interest expense paid	(441,446)	(371,435)	(1,207,631)	(742,202)
Change in non-cash operating working capital	(173,388)	1,846,664	(333,639)	1,303,767
<b>Net cash flows from operating activities</b>	<b>953,960</b>	<b>3,580,760</b>	<b>2,605,130</b>	<b>4,193,277</b>
<b>Cash flows from financing activities:</b>				
Repurchase of shares	(105,520)	–	(241,444)	–
Net decrease in bank indebtedness	(1,684,000)	–	(4,926,000)	–
Net decrease in long-term debt	(410,500)	(239,250)	(410,500)	(477,300)
Net increase in long-term debt	936,500	–	9,852,000	–
Government grants	–	–	15,023	–
<b>Net cash flows from (used in) financing activities</b>	<b>(1,263,520)</b>	<b>(239,250)</b>	<b>4,289,079</b>	<b>(477,300)</b>
<b>Cash flows from investing activities:</b>				
Acquisition of property and equipment	(2,044,171)	(1,724,551)	(4,273,776)	(2,219,647)
Acquisition of intangible assets	(26,759)	(30,770)	(29,536)	(363,325)
Long-term deposits and advances	–	(127,600)	–	(127,600)
<b>Net cash flows used in investing activities</b>	<b>(2,070,930)</b>	<b>(1,882,921)</b>	<b>(4,303,312)</b>	<b>(2,710,572)</b>
Increase (decrease) in net cash	(2,380,490)	1,458,589	2,590,897	1,005,405
Effects of foreign exchange on cash balances	496,866	56,500	711,205	(38,011)
Net cash, beginning of period	11,562,945	4,513,822	6,377,219	5,061,517
<b>Net cash, end of period</b>	<b>\$ 9,679,321</b>	<b>\$ 6,028,911</b>	<b>\$ 9,679,321</b>	<b>\$ 6,028,911</b>

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, 2013 and 2012  
(Unaudited)

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## 1. Corporate information:

Changfeng Energy Inc. (the "Company" or "Changfeng") 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) 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 International Accounting Standards ("IAS") 34, Interim Financial Reporting.

These condensed consolidated interim financial statements should be read in conjunction with the Company's 2012 annual audited consolidated 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 2012 annual audited consolidated financial statements.

These condensed consolidated interim financial statements were authorized for issue by the Board of Directors on August 22, 2013.

# 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, 2013 and 2012  
(Unaudited)

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## 2. Basis of presentation (continued):

### (b) 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.

### (c) 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").

## 3. Significant accounting policies:

These condensed consolidated interim financial statements have been prepared in accordance with IFRS using the same accounting policies as were applied in the 2012 annual consolidated financial statements. In addition, the Company has adopted the following new accounting policies:

### Recent accounting pronouncements:

#### (a) Financial assets and liabilities:

The Company adopted certain amendments to IFRS 7, Financial Instruments - Disclosures ("IFRS 7"), on a retrospective basis. These amendments 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. As the Company is not offsetting financial instruments and does not have relevant offsetting arrangements, the retrospective adoption of these amendments to IFRS 7 had no impact on the disclosures of the Company.

# 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, 2013 and 2012  
(Unaudited)

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### 3. Significant accounting policies (continued):

#### (b) Consolidated financial statements:

The Company adopted IFRS 10, Consolidated Financial Statements ("IFRS 10"), on a retrospective basis. IFRS 10 replaces portions of IAS 27, Consolidated and Separate Financial Statements ("IAS 27"), that address consolidation, and supersedes Standing Interpretations Committee ("SIC") 12, Consolidation - Special Purpose Entities ("SPEs") ("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. The adoption of IFRS 10 had no impact on the Company.

#### (c) Joint arrangements:

The Company adopted IFRS 11, Joint Arrangements on a Retrospective Basis ("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. The adoption resulted in no impact on net income or on equity for the three and six-month periods ended June 30, 2013 or the year ended December 31, 2012.

#### (d) Disclosure of interests in other entities:

The Company adopted IFRS 12, Disclosure of Interests in Other Entities ("IFRS 12"). IFRS 12 contains annual disclosure requirements for companies that have interests in subsidiaries, joint arrangements, associates and unconsolidated structured entities. The new disclosure required by the adoption of this standard will be presented for the first time in the annual consolidated financial statements for the year ending December 31, 2013.



# 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, 2013 and 2012  
(Unaudited)

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### 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. The Company adopted IFRS 10, IFRS 11 and IFRS 12, and the amendments to IAS 27 and IAS 28 in its consolidated financial statements for the annual period beginning on January 1, 2013. The disclosure requirements are not required for condensed consolidated interim financial statements, unless significant events and transactions in the interim period require that they are provided. Accordingly, the Company will make any relevant disclosures in its annual statements for the year ending December 31, 2013.

(e) Fair value measurement:

The Company adopted IFRS 13, Fair Value Measurement ("IFRS 13"), on a prospective basis. IFRS 13 replaces the fair value measurement guidance contained in individual IFRSs 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 adoption of IFRS 13 had no impact on the fair value measurements carried out by the Company.

(f) Presentation of items of other comprehensive income:

The Company adopted the amendment to IAS 1, Presentation of Financial Statements, on a retrospective basis. The amendment requires 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 amendment had no impact on the financial results of the Company or on the presentation of its condensed consolidated interim statements of comprehensive income.

# 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, 2013 and 2012  
(Unaudited)

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### 3. Significant accounting policies (continued):

(g) 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 IAS 32, Financial Instruments - Presentation ("IAS 32"). 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 effective date for the amendments to IAS 32 is annual periods beginning January 1, 2014. The Company intends to adopt 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 to IAS 32 has not yet been determined.

### 4. Significant accounting estimates and judgments:

The preparation of the condensed consolidated interim financial statements in accordance with IFRS requires management to make estimates and judgments that affect the application of accounting policies and the reported amounts of assets, liabilities, revenue, 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)

Three-month and six-month periods ended June 30, 2013 and 2012  
(Unaudited)

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## 4. Significant accounting estimates and judgments (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) Revenue recognition:

Revenue from natural gas sales is recognized when the gas is delivered to the customer. The Company determines the quantity of natural gas delivered through its readings of customer gas consumption meters, and estimates the quantity delivered at each period end where the date of the meter reading is prior to the period-end date.

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. Revenue recognition is dependent upon estimating the stages of completion and the outcome of the contract.

### (b) 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, 2013 and 2012  
(Unaudited)

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## 4. Significant accounting estimates and judgments (continued):

### (c) 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 in 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.

### (d) 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.

# 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, 2013 and 2012  
(Unaudited)

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#### 4. Significant accounting estimates and judgments (continued):

(e) Impairment:

The Company assesses intangible assets with indefinite lives for impairment annually or when an event or change in circumstances may indicate impairment. This assessment includes a comparison of the carrying value of the indefinite life intangible asset to its estimated fair value to ensure that the fair value is greater than the carrying value. The Company calculates the estimated fair value using valuation methods such as discounted cash flow analysis. These valuation methods employ a variety of assumptions, including future revenue growth, expected earnings and earnings multiples. Estimating the fair value of an indefinite life intangible asset is a subjective process and requires the use of its best estimates. If its estimates or assumptions change from those used in its current valuation, Changfeng may be required to recognize impairment losses in future periods.

#### 5. Inventories:

	June 30, 2013	December 31, 2012
Construction materials	\$ 525,672	\$ 425,718
Gas appliances, meters and spare parts	373,535	271,049
Natural gas	50,661	33,739
	<u>\$ 949,868</u>	<u>\$ 730,506</u>

The amount of inventories recognized as an expense through cost of sales during the periods ended June 30, 2013 and June 30, 2012 was \$1,506,608 and \$1,121,853, respectively, which completely comprised raw material costs. There were no impairments of inventory or reversals of impairments recorded during the three- or six-month periods ended June 30, 2013 and June 30, 2012.

#### 6. Prepaid expenses and deposits:

Included in prepaid expenses and deposits is a deposit originally paid by the Company in 2010 to the existing shareholder of Hunan CNPC, Guangda Gas Co., Ltd. ("Guangda Gas"), which is being repaid to the Company by way of partially offsetting gas purchases made from Guangda Gas over a 10-month period starting in November 2012. As at June 30, 2013, \$34,260 (RMB 200,000) had not yet been repaid.

# 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, 2013 and 2012  
(Unaudited)

## 7. Property and equipment:

Cost	Buildings	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Leasehold improvements	Construction in progress	Total
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	–	678,397	306,880	239,561	523,999	210,805	3,365,754	5,325,396
Foreign currency translation	(31,564)	(497,603)	(14,083)	(17,048)	(56,745)	(4,979)	(4,250)	(626,272)
Balance, December 31, 2012	2,653,039	42,312,774	1,490,576	1,672,474	5,293,494	629,377	3,723,003	57,774,737
Additions	107,812	2,909,830	–	313,977	378,483	2,905	748,741	4,461,748
Foreign currency translation	192,707	3,099,977	107,584	121,482	384,499	45,715	271,110	4,223,074
Balance, June 30, 2013	\$ 2,953,558	\$ 48,322,581	\$ 1,598,160	\$ 2,107,933	\$ 6,056,476	\$ 677,997	\$ 4,742,854	\$ 66,459,559

Accumulated amortization	Buildings	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Leasehold improvements	Construction in progress	Total
Balance, December 31, 2011	\$ 37,962	\$ 7,616,225	\$ 338,747	\$ 564,893	\$ 1,114,190	\$ 39,203	\$ –	\$ 9,711,220
Amortization	50,347	1,405,866	23,582	176,530	248,183	23,006	–	1,927,514
Foreign currency translation	(446)	(86,862)	(3,983)	(6,642)	(13,100)	(461)	–	(111,494)
Balance, December 31, 2012	87,863	8,935,229	358,346	734,781	1,349,273	61,748	–	11,527,240
Amortization	39,770	762,116	17,421	116,252	235,084	24,404	–	1,195,047
Foreign currency translation	6,369	644,502	25,458	53,372	97,173	3,787	–	830,661
Balance, June 30, 2013	\$ 134,002	\$ 10,341,847	\$ 401,225	\$ 904,405	\$ 1,681,530	\$ 89,939	\$ –	\$ 13,552,948

Net book value	Buildings	Pipelines	Land use rights	Motor vehicles	Furniture and equipment	Leasehold improvements	Construction in progress	Total
December 31, 2012	\$ 2,565,176	\$ 33,377,545	\$ 1,132,230	\$ 937,693	\$ 3,944,221	\$ 567,629	\$ 3,723,003	\$ 46,247,497
June 30, 2013	2,819,556	37,980,734	1,196,935	1,203,528	4,374,946	588,058	4,742,854	52,906,611

# 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, 2013 and 2012  
(Unaudited)

## 7. Property and equipment (continued):

### (a) Capitalized interest:

Included in additions to property and equipment is capitalized interest of \$55,727 (RMB 325,317) (December 31, 2012 - \$44,686 (RMB 282,106)).

### (b) Pipeline construction and equipment:

The Company has signed contracts with several equipment suppliers and construction supervisors for a total amount of \$6,094,192 (RMB 35,576,134) (December 31, 2012 - \$5,523,792 (RMB 34,588,551)), of which \$2,882,153 (RMB 16,825,180) (December 31, 2012 - \$1,988,356 (RMB 12,450,567)) has been paid as at June 30, 2013 and was classified as construction in progress.

## 8. Intangible assets:

	Gas purchase contract and supply rights	Software	Total
<b>Cost</b>			
Balance, December 31, 2012	\$ 1,317,972	\$ 104,604	\$ 1,422,576
Additions	30,813	—	30,813
Foreign currency translation	119,022	7,598	126,620
Balance, June 30, 2013	\$ 1,467,807	\$ 112,202	\$ 1,580,009
<b>Accumulated amortization</b>			
Balance, December 31, 2012	\$ 50,191	\$ —	\$ 50,191
Amortization	9,789	5,610	15,399
Foreign currency translation	3,646	—	3,646
Balance, June 30, 2013	\$ 63,626	\$ 5,610	\$ 69,236
<b>Net book value</b>			
December 31, 2012	\$ 1,267,781	\$ 104,604	\$ 1,372,385
June 30, 2013	1,404,181	106,592	1,510,773

# 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, 2013 and 2012  
(Unaudited)

## 8. Intangible assets (continued):

### (a) Gas and Electricity Exchange Program (the "Program"):

In connection with the Program, as at June 30, 2013, construction of approximately \$1,094,373 (RMB 6,388,634) (December 31, 2012 - \$991,538 (RMB 6,208,754)) was completed by a local contractor. 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. For the remaining construction to be completed pursuant to the Program, the Company has signed contracts with the local contractor for a total amount of \$1,594,103 (RMB 9,305,914) (December 31, 2012 - \$1,400,569 (RMB 8,770,000)), of which \$972,560 (RMB 5,677,530) has been paid as at June 30, 2013.

### (b) Software:

During 2012, the Company implemented a new software system related to its natural gas distribution operations. In connection with this implementation, the Company capitalized \$112,202 (RMB 655,000) of costs that have been recognized as an intangible asset as at June 30, 2013.

## 9. Long-term debt and bank indebtedness:

### (a) Long-term debt:

	June 30, 2013	December 31, 2012
Term loan facility - Bank of China	\$ 15,845,250	\$ 15,171,500
Term loan facility - Bank of China (i)	3,426,000	–
Term loan facility - Bank of China (ii)	6,852,000	–
	26,123,250	15,171,500
Less unamortized transaction costs	234,269	266,569
	25,888,981	14,904,931
Less current portion	1,541,700	798,500
	\$ 24,347,281	\$ 14,106,431



# 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, 2013 and 2012  
(Unaudited)

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

- (i) As of June 30, 2013, the Company had withdrawn \$3,426,000 (RMB 20,000,000) (December 31, 2012 - nil) from its \$3,426,000 (RMB 20,000,000) term loan facility with the Bank of China (Pingxiang Branch).
- (ii) As of June 30, 2013, the Company had withdrawn \$6,852,000 (RMB 40,000,000) (December 31, 2012 - nil) from its \$8,565,000 (RMB 50,000,000) term loan facility with the Bank of China (Sanya Branch) ("BOC").

### (b) Bank indebtedness:

As at June 30, 2013, the Company had fully repaid its \$5,139,000 (RMB 30,000,000) (December 31, 2012 - \$4,791,000) (RMB 30,000,000) line of credit with BOC. Subsequent to quarter end, the Company renewed its line of credit with BOC for \$1,713,000 (RMB 10,000,000).

As at June 30, 2013, the Company was in compliance with all of its debt covenants.

Long-term loan principal payments are as follows:

	RMB	Cdn. \$
2013	2,500,000	428,250
2014	13,000,000	2,226,900
2015	18,000,000	3,083,400
2016	19,000,000	3,254,700
2017	27,000,000	4,625,100
Thereafter	73,000,000	12,504,900
	152,500,000	26,123,250

# 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, 2013 and 2012  
(Unaudited)

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## 10. Share capital:

Issued common shares:

	Number of shares	Amount
Balance, December 31, 2012	66,025,000	\$ 12,121,808
Repurchased and cancelled	(742,800)	(241,444)
Balance, June 30, 2013	65,282,200	11,880,364

Normal-course issuer bid:

During the first six months of 2013, the Company purchased for cancellation 742,800 of its common shares under its normal-course issuer bid (the "Bid") for cash proceeds of \$241,444. Subsequent to June 30, 2013, the Company purchased 138,500 shares pursuant to the Bid for cash proceeds of \$45,840.

On July 25, 2013, 200,000 options, originally issued on September 8, 2011, were exercised for \$0.23 per share, resulting in total proceeds of \$46,000.

## 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 number of shares outstanding 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 outstanding during the period adjusted for the effect of potentially dilutive stock options.

# 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, 2013 and 2012  
(Unaudited)

## 11. Earnings per share (continued):

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

	Three-month periods ended June 30,					
	2013			2012		
	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	\$ 657,201	65,444,827	\$ 0.01	\$ 837,432	66,025,000	\$ 0.01
Diluted	657,201	66,069,163	0.01	837,432	66,025,000	0.01

	Six-month periods ended June 30,					
	2013			2012		
	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	\$ 1,948,377	65,541,255	\$ 0.03	\$ 1,670,951	66,025,000	\$ 0.03
Diluted	1,948,377	66,199,996	0.03	1,670,951	66,025,000	0.03

## 12. Related party disclosures:

(a) Related party transactions:

- (i) As at June 30, 2013, Sanya Changkai Industrial Development Co. Ltd., 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 company.
- (ii) As at June 30, 2013, the Company had an outstanding loan of \$342,600 (RMB 2,000,000) due from the minority shareholder of Hunan Changfeng CNPC Energy Co., Ltd., which used the funds to contribute the capital it owed to that subsidiary.

# 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, 2013 and 2012  
(Unaudited)

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## 12. Related party disclosures (continued):

### (iii) Xiangtan Shin-Ko Energy Co., Ltd. ("Shin-Ko Energy"):

Included in current due to related parties as at June 30, 2013, is a required capital contribution of \$513,900 (RMB 3,000,000) (December 31, 2012 - \$479,100 (RMB 3,000,000 in long-term)) to be made to the Company's associate, Shin-Ko Energy, by October 24, 2013. Also, included in current due to related parties as at June 30, 2013, was \$218,759 (RMB 1,277,050) (December 31, 2012 - \$208,736 (RMB 1,307,050)) relating to a loan made to the Company by Shin-Ko Energy. The loan is interest-free and is not secured. It is payable on demand.

### (b) Transactions with key management personnel:

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the Company and/or its subsidiaries, directly or indirectly, including any external director of the Company and/or its subsidiaries. Key management personnel include: the Chief Executive Officer, the Chief Financial Officer, the Vice President, Corporate Development and the Company's directors.

(i) In 2007, a significant shareholder, who is also an officer and director of the Company, advanced loans in the aggregate amount of \$6,852,000 (RMB 40,000,000) (December 31, 2012 - \$6,388,000 (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. The Company has not made any repayments during the period ended June 30, 2013.

(ii) As at June 30, 2013, the Company owed an officer and director of the Company \$531,747 (December 31, 2012 - \$543,982) for unpaid salary and director's fees.

## 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, 2012.

# 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, 2013 and 2012  
(Unaudited)

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## **13. Financial instruments and risk management (continued):**

As at June 30, 2013, the Company had a working capital deficiency of \$5,552,971 (December 31, 2012 - \$12,204,931). The Company believes that this deficiency can be funded through projected operating cash flows from operations and through securing additional financing from third-party financial institutions. There are certain assumptions made by management in determining projected operating cash flow, such as temporary natural gas contracts from the government of China and continued growth in its operations.

While management believes that the assumptions included in its operating forecast are reasonable, there is no guarantee that they will materialize as planned. The Company may not be successful in obtaining additional financing on acceptable terms, on a timely basis, or at all, and projected operating cash flows may not materialize as planned.

As at June 30, 2013, 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. Seasonality of operations:**

Seasonality can impact the Company's natural gas distribution 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 the winter than the rest of the year. The Company's natural gas sales are higher during this high tourism season, as a large portion of the Company's natural gas sales are made to hotels and restaurants. Seasonality can also impact the Company's CNG retail station sales due to vehicles being in need of more gas during the warmer seasons for air conditioning.

## **15. Segmented reporting:**

The Company has two reportable segments: gas distribution utilities (the "utility") and compressed natural gas ("CNG") refuelling station. The utility provides gas pipeline connection services and delivers natural gas to commercial, industrial and residential customers through its pipeline networks and associated facilities. The Company's other segment is a CNG refuelling retail station, which is used primarily to supply gas for taxicab and public-transportation vehicles. The performance of each segment is measured by income from operations.

# 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, 2013 and 2012  
(Unaudited)

## 15. Segmented reporting (continued):

There were no significant intercompany transactions between segments. No single customer accounted for more than 10% of the Company's sales or trade and other receivables in 2013 and 2012.

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

Three-month period ended June 30, 2013:

	Gas distribution utilities	CNG refuelling station	Consolidated
Revenue	\$ 7,160,697	\$ 2,029,329	\$ 9,190,026
Cost of sales	3,493,188	1,437,196	4,930,384
	3,667,509	592,133	4,259,642
Expenses:			
General and administrative	1,741,330	111,128	1,852,458
Travel and business development	879,898	11,361	891,259
	2,621,228	122,489	2,743,717
Income from operations	\$ 1,046,281	\$ 469,644	\$ 1,515,925

Three-month period ended June 30, 2012:

	Gas distribution utilities	CNG refuelling station	Consolidated
Revenue	\$ 5,938,063	\$ 1,184,054	\$ 7,122,117
Cost of sales	2,718,220	983,246	3,701,466
	3,219,843	200,808	3,420,651
Other operating income	722,535	–	722,535
Expenses:			
General and administrative	1,409,564	115,247	1,524,811
Travel and business development	977,973	19,654	997,627
	2,387,537	134,901	2,522,438
Income from operations	\$ 1,554,841	\$ 65,907	\$ 1,620,748

# 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, 2013 and 2012  
(Unaudited)

## 15. Segmented reporting (continued):

Six-month period ended June 30, 2013:

	Gas distribution utilities	CNG refuelling station	Consolidated
Revenue	\$ 15,107,545	\$ 3,705,323	\$ 18,812,868
Cost of sales	6,338,868	2,705,369	9,044,237
	8,768,677	999,954	9,768,631
Expenses:			
General and administrative	3,304,483	300,833	3,605,316
Travel and business development	2,174,949	23,048	2,197,997
	5,479,432	323,881	5,803,313
Income from operations	\$ 3,289,245	\$ 676,073	\$ 3,965,318
Acquisition of property and equipment	\$ (4,252,393)	\$ (21,383)	\$ (4,273,776)
Acquisition of intangible assets	(29,536)	–	(29,536)
Total assets, June 30, 2013	\$ 68,551,381	\$ 3,131,055	\$ 71,682,436
Total assets, December 31, 2012	58,509,028	2,690,504	61,199,532

Six-month period ended June 30, 2012:

	Gas distribution utilities	CNG refuelling station	Consolidated
Revenue	\$ 12,306,014	\$ 2,181,196	\$ 14,487,210
Cost of sales	5,404,550	1,759,628	7,164,178
	6,901,464	421,568	7,323,032
Other operating income	722,535	–	722,535
Expenses:			
General and administrative	2,512,876	226,985	2,739,861
Travel and business development	2,043,507	32,148	2,075,655
	4,556,383	259,133	4,815,516
Income from operations	\$ 3,067,616	\$ 162,435	\$ 3,230,051

# 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, 2013 and 2012  
(Unaudited)

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## 15. Segmented reporting (continued):

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, 2013 and 2012, there is no significant individual customer from which sales amounted to more than 10% of the Company's revenue.