
CANADA ENERGY PARTNERS INC.

INTERIM FINANCIAL STATEMENTS
FOR THE NINE MONTHS ENDED
January 31, 2011

(Expressed in Canadian Dollars)
(Unaudited – Prepared by Management)

UNAUDITED INTERIM FINANCIAL STATEMENTS

The accompanying unaudited interim financial statements of Canada Energy Partners Inc. for the nine months ended January 31, 2011, have been prepared by management and are the responsibility of the Company's management. These statements have not been reviewed by the Company's external auditors.

CANADA ENERGY PARTNERS INC.
INTERIM BALANCE SHEETS
(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)

	January 31, 2011	April 30, 2010
	<u>\$</u>	<u>\$</u>
A S S E T S		
CURRENT ASSETS		
Cash and cash equivalents	2,759,712	6,386,141
Accounts receivable, prepaids, and deposits	109,739	99,435
	<u>2,869,451</u>	<u>6,485,576</u>
INVESTMENT (Note 6)	946,788	955,479
OIL and GAS INTERESTS (Note 3)	88,134,433	85,533,420
	<u>91,950,672</u>	<u>92,974,475</u>
LIABILITIES		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	177,404	141,255
Bank loan (Note 6)	1,376,126	1,376,126
	<u>1,553,530</u>	<u>1,517,381</u>
ASSET RETIREMENT OBLIGATION (Note 4)	272,916	257,468
FUTURE INCOME TAX LIABILITY	11,906,968	11,906,968
	<u>13,733,414</u>	<u>13,681,817</u>
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 5)	79,713,638	79,997,590
CONTRIBUTED SURPLUS (Note 5)	9,265,147	5,422,838
DEFICIT	<u>(10,761,527)</u>	<u>(6,127,770)</u>
	<u>78,217,258</u>	<u>79,292,658</u>
	<u>91,950,672</u>	<u>92,974,475</u>

NATURE OF OPERATIONS (Note 1)
COMMITMENTS (Note 3 and Note 11)

APPROVED BY THE DIRECTORS

“John Proust” , Director “Ben Jones” , Director

The accompanying notes are an integral part of these interim financial statements.

CANADA ENERGY PARTNERS INC.
INTERIM STATEMENTS OF OPERATIONS, COMPREHENSIVE LOSS AND DEFICIT
(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011 \$	2010 \$	2011 \$	2010 \$
GENERAL AND ADMINISTRATIVE EXPENSES				
Administrative and management services (Note 7)	131,869	104,932	364,054	353,105
Accretion and depreciation	5,149	5,423	15,448	16,270
Advertising	1,013	302	13,338	11,736
Audit and accounting	15,700	20,200	56,486	58,129
Corporate development	-	23,541	4,000	69,509
Filing and regulatory	14,662	5,831	30,255	19,914
General exploration	41,581	12,169	72,740	74,115
Legal	27,778	4,760	64,311	47,528
Office and miscellaneous	50,500	29,643	118,824	99,525
Professional fees	26,164	29,983	45,166	55,796
Rent	20,102	19,370	61,480	82,347
Stock-based compensation	-	-	3,723,465	267,800
Travel	41,092	11,626	77,195	33,310
	<u>375,610</u>	<u>267,780</u>	<u>4,646,762</u>	<u>1,189,084</u>
LOSS BEFORE OTHER ITEMS	(375,610)	(267,780)	(4,646,762)	(1,189,084)
OTHER INCOME/(EXPENSES)				
Interest	5,427	4,331	12,992	(22,012)
Foreign exchange	(1)	(6)	13	(1,255)
	<u>5,426</u>	<u>4,325</u>	<u>13,005</u>	<u>(23,267)</u>
NET LOSS AND COMPREHENSIVE LOSS	(370,184)	(263,455)	(4,633,757)	(1,212,351)
DEFICIT - BEGINNING OF PERIOD	(10,391,343)	(6,373,149)	(6,127,770)	(5,424,253)
DEFICIT - END OF PERIOD	<u>(10,761,527)</u>	<u>(6,636,604)</u>	<u>(10,761,527)</u>	<u>(6,636,604)</u>
LOSS PER SHARE - BASIC AND DILUTED				
	<u>(0.00)</u>	<u>(0.00)</u>	<u>(0.06)</u>	<u>(0.01)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED				
	<u>82,255,784</u>	<u>82,128,501</u>	<u>82,347,661</u>	<u>82,240,867</u>

The accompanying notes are an integral part of these interim financial statements.

CANADA ENERGY PARTNERS INC.
INTERIM STATEMENTS OF CASH FLOWS
(Unaudited – Prepared by Management)
(Expressed in Canadian Dollars)

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2011 \$	2010 \$	2011 \$	2010 \$
CASH PROVIDED FROM (USED FOR)				
OPERATING ACTIVITIES				
Net loss for the period	(370,184)	(263,455)	(4,633,757)	(1,212,351)
Items not affecting cash:				
Stock-based compensation	-	-	3,723,465	267,800
Accretion and depreciation	5,149	5,423	15,448	16,270
Interest received from investment	3,079	7,382	8,691	31,077
Changes in non-cash working capital balances:				
Accounts receivable, prepaids and deposits	(25,024)	48,172	(36,688)	280,450
Accounts payable and accrued liabilities	71,376	37,890	50,289	(87,378)
	<u>(315,604)</u>	<u>(164,588)</u>	<u>(872,552)</u>	<u>(704,132)</u>
FINANCING ACTIVITIES				
Issuer bid share repurchase	-	(211,750)	(165,108)	(273,045)
INVESTING ACTIVITIES				
Oil and gas interests	<u>(359,360)</u>	<u>(247,795)</u>	<u>(2,588,769)</u>	<u>(1,952,461)</u>
DECREASE IN CASH DURING THE PERIOD	(674,964)	(624,133)	(3,626,429)	(2,929,638)
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	<u>3,434,676</u>	<u>7,975,088</u>	<u>6,386,141</u>	<u>10,280,593</u>
CASH AND CASH EQUIVALENTS - END OF PERIOD	<u><u>2,759,712</u></u>	<u><u>7,350,955</u></u>	<u><u>2,759,712</u></u>	<u><u>7,350,955</u></u>

Supplemental disclosure with respect to cash flows (Note 8)

The accompanying notes are an integral part of these interim financial statements.

CANADA ENERGY PARTNERS INC.
NOTES TO INTERIM FINANCIAL STATEMENTS
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(Expressed in Canadian Dollars)

1. NATURE OF OPERATIONS

Canada Energy Partners Inc. (“the Company”) is an independent natural gas exploration and development company primarily focused on unconventional resource opportunities in northeast British Columbia. The Company was formed on May 18, 2006, by Certificate of Incorporation and Notice of Articles pursuant to the provisions of the Business Corporations Act (British Columbia).

The amounts shown as oil and gas interests represent exploration and development expenditures incurred to date and acquisition costs for the working interests in the Company’s prospects and do not necessarily represent present or future values. The underlying value of oil and gas interests is entirely dependent on the existence of economically recoverable reserves, securing and maintaining title and beneficial interest in the Company’s prospects, the ability of the Company to obtain the necessary financing to complete its share of the development, and future profitable production.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The interim period financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles (“Canadian GAAP”) for the preparation of interim financial statements. These interim periods financial statements do not include all disclosures required for annual financial statements and should be read together with the April 30, 2010, audited financial statements and the accompanying notes. The significant accounting policies applied in preparation of these interim financial statements are consistent with those in the audited annual financial statements. All financial summaries included are presented on a comparative and consistent basis showing the figures for the preceding period. In the opinion of the Company, its unaudited interim statements contain all adjustments necessary in order to present a fair statement of the results of the interim periods presented.

As for most oil and gas exploration companies, the Company raises financing for its activities using a variety of sources. The Company will require additional capital to fund its future exploration and development programs. These financial statements do not include any adjustments to the amounts and classification of assets and liabilities that might be necessary should the Company be unable to continue business.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amount expenses during the reporting period.

The amounts recorded for the future asset retirement obligation costs, amortization, and accretion are based on estimates of cash flows required to settle the asset retirement obligation, inflation factors, credit adjusted discount rates, and other relevant assumptions. The fair value of the Company’s long-term investments is determined based on management estimates of premium yields required by investors.

These estimates are subject to measurement uncertainty, and the impact of changes in such estimates on the financial statements of future periods could be material.

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3. OIL and GAS INTERESTS

For the nine months ended January 31, 2011	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
Acquisition costs				
Leases acquisitions and rental costs	1,963,140	27,732	10,347	2,001,219
Balance, beginning of period	56,593,657	1,849,696	693,274	59,136,627
Balance, end of the period	58,556,797	1,877,428	703,621	61,137,846
Exploration costs				
Drilling and completion	327,605	300	-	327,905
Geological and consulting	44,927	39,977	-	84,904
Reports and other	37,805	5,501	1,201	44,507
	410,337	45,778	1,201	457,316
Balance, beginning of period	9,620,967	4,536,513	54,263	14,211,743
Balance, end of period	10,031,304	4,582,291	55,464	14,669,059
Development costs				
Drilling and completion	119,157	-	-	119,157
Gas plant	24,658	-	-	24,658
Gas revenue	(1,337)	-	-	(1,337)
	142,478	-	-	142,478
Balance, beginning of period	12,185,050	-	-	12,185,050
Balance, end of period	12,327,528	-	-	12,327,528
Total deferred oil and gas interests	80,915,629	6,459,719	759,085	88,134,433

Included in the acquisition costs is \$107,000 security bond held by the Company in favour of the regulatory agency to ensure that the Company can complete the reclamation, including shut-down, closure, and post-closure. The security will be released back to the Company once the reclamation has been completed according to the plan and the site is returned to an acceptable state.

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3. OIL and GAS INTERESTS (continued)

For the year ended April 30, 2010	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
Acquisition costs				
Leases acquisitions and rental costs	1,428,365	22,648	-	1,451,013
Balance, beginning of year	55,165,292	1,827,048	693,274	57,685,614
Balance, end of the year	56,593,657	1,849,696	693,274	59,136,627
Exploration costs				
Asset retirement costs	14,590	-	-	14,590
Drilling and completion	15,290	21,004	-	36,294
Geological and consulting	55,780	64,557	1,543	121,880
Reports and other	35,605	7,314	439	43,358
	121,265	92,875	1,982	216,122
Balance, beginning of year	9,499,702	4,443,638	52,281	13,995,621
Balance, end of year	9,620,967	4,536,513	54,263	14,211,743
Development costs				
Drilling and completion	951,376	-	-	951,376
Gas plant	353,926	-	-	353,926
Less: net revenue received in development stage	(182,795)	-	-	(182,795)
	1,122,507	-	-	1,122,507
Balance, beginning of year	11,062,543	-	-	11,062,543
Balance, end of year	12,185,050	-	-	12,185,050
Total deferred oil and gas interests	78,399,674	6,386,209	747,537	85,533,420

Peace River Project, British Columbia

The Company has working interests in the oil and gas leases located in Peace River area near Hudson's Hope in northeast British Columbia. Peace River Project consists of shallow rights (from the surface to the base of Gething formation) and deep rights (from the base of Gething to the basement).

Shallow rights

Shallow rights include Peace River coalbed methane "CBM" Project and Moosebar Shale rights. The Company owns 50% working interest and an additional 3.71% after payout working interest in the Peace River CBM Project. The operator of the Peace River CBM Project is GeoMet, Inc. The Company's interest in the Peace River CBM Project is subject to Crown royalties and for certain acreage to geological overriding royalties of up to 0.05%. The Company owns a net 0.75% overriding royalty, payable by the Company's Joint Venture Partner in the CBM Project, on a portion of the Company's Shallow Rights acreage.

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3. OIL and GAS INTERESTS (continued)

In November 2008, Canada Energy entered into a farm-in agreement (the "Agreement") with GeoMet, Inc. for Moosebar Shale shallow rights on its Peace River Project. The Company drilled an initial Moosebar horizontal test well and has earned an 87.5% interest in 2 sections (approximately 2 square miles), subject to final completion or plug and abandonment. The Company has relinquished further drilling rights under the Agreement. The Company's interest in the Moosebar Shale is subject to Crown royalties and for certain acreage to geological overriding royalties of up to 0.05%.

Deep rights

The Company owns 50% working interest in the deep rights of the Peace River Project. Crew Energy Inc. ("Crew") is the operator and owns the other 50% working interest. The Company's interest in the deep rights of the Peace River Project will be subject to Crown royalties, geological overriding royalties of up to 0.85% and back-in interest of 6.6% after project payout plus \$2,000,000 on approximately 3,500 acres. The Company owns a net 0.75% overriding royalty, payable by the Company's Joint Venture Partner on a portion of the Company's Deep Rights acreage.

Monias Prospect, British Columbia

The Company owns 100% working interest in the shallow rights in 7 sections, 70% working interest in the shallow rights on 2 sections, and a 35% interest in the shallow rights of one section.

Deep rights on the Monias Prospect were subject to the joint venture agreement with West Energy Ltd. ("West"). Under the original terms of the joint venture agreement, West, a company acquired by Daylight Energy Ltd. ("Daylight") in May 2010, had the option to earn a 65% interest in the eight sections comprising the Monias Prospect. During the nine-month period ended January 31, 2011, the Company and Daylight have mutually settled the legal dispute over the joint venture agreement. Under the terms of the settlement, Daylight will be deemed to have earned a 60% working interest in four sections and the wellbore in the well previously drilled with the Company retaining a 40% working interest in the four sections and the wellbore. Daylight will have no further earning rights and the Company will retain a 100% interest in three remaining sections and a 35% interest in an eighth section, with Terra Energy owning the remainder.

The Company's interest in the deep rights of the Monias Prospect will be subject to Crown royalties, geological overriding royalties of up to 1% and back-in interest of 12.5% after project payout plus \$2,000,000. The Company's interest in the shallow rights of the Monias Prospect will be subject to Crown royalties, one section is subject to a 10% royalty on gas, a 5% - 10% royalty on oil production and two sections are subject to a back-in interest of 4.375% after project payout plus \$2,000,000.

Moberly Prospect, British Columbia

The Company owns 100% working interest subject to a joint venture agreement with Crew. According to the joint venture agreement, Crew operates the prospect and will earn a 50% working interest in two sections upon completion of the initial test well which has been drilled and cased. The initial program consisted of drilling of one exploratory well (drilled).

The Company's interest in the Moberly Prospect will be subject to Crown royalties, geological overriding royalties of 0.93% and back-in interest of 10.5% after project payout plus \$1,000,000.

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4. ASSET RETIREMENT OBLIGATION

Total future asset retirement obligations were estimated by management based on the Company's working interest in its wells and facilities, estimated costs to remediate, reclaim, and abandon the wells and facilities, and the estimated timing of the costs to be incurred in future periods. The Company estimated the total undiscounted amount of cash flows required to settle the asset retirement obligation to be approximately \$698,629 which will be incurred from 2019 to 2036. To calculate the net present value of its asset retirement obligations, the Company used a credit-adjusted risk free rate of 8% and an inflation rate of 2%. The credit-adjusted risk free rate of 8% was based on the cost of borrowing for similar companies in the industry. The following table summarizes the Company's asset retirement obligations:

	\$
Balance, beginning of period	257,468
Liabilities incurred	-
Accretion expense	15,448
Balance, end of period	272,916

The present value of the reclamation liability may be subject to change in future periods. Such changes will be recorded in the accounts of the Company as they occur.

5. SHARE CAPITAL AND CONTRIBUTED SURPLUS

	Number of shares	Amount, \$	Contributed Surplus, \$
Authorized			
Unlimited common shares without par value			
Unlimited preferred shares without par value			
Issued common shares			
As at April 30, 2009	82,356,284	79,974,557	4,932,872
Stock-based compensation	-		267,800
Shares issued for royalty interest acquisition	800,000	616,000	-
Issuer bid share repurchases	<u>(609,000)</u>	<u>(592,967)</u>	<u>222,166</u>
As at April 30, 2010	82,547,284	79,997,590	5,422,838
Issuer bid share repurchases	(291,500)	(283,952)	118,844
Stock-based compensation	<u>-</u>	<u>-</u>	<u>3,723,465</u>
As at January 31, 2011	82,255,784	79,713,638	9,265,147

During the period ended January 31, 2011, the Company:

- a) received approval from the TSX Venture Exchange (the "Exchange") to commence a normal course issuer bid (the "Bid") to purchase up to 4,121,664 of its common shares ("Shares"), representing 5% of the Company's 82,433,284 issued and outstanding Shares, as at May 28, 2010. Under the Exchange's policies, the Bid commenced on June 4, 2010, and will end on the earlier of June 3, 2011, or at such time as the Bid has been completed or the Bid is terminated at the Company's discretion. The price paid by the Company for any acquired shares will be the market price at the time of acquisition. All shares purchased under the Bid will be cancelled. Funding for the "Bid" will be from the Company's working capital.

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5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

- b) purchased 291,500 common shares for \$165,108 under a normal course issuer bid. The price paid by the Company for the acquired shares was the market price at the time of acquisitions. All shares purchased under the Bid are cancelled. The difference between the average equity cost of the Company's shares on the repurchase date and the repurchase price was recorded as an increase to contributed surplus.

Stock options and stock-based compensation

The Company grants stock options in accordance with the policies of the TSX Venture Exchange ("TSXV"). Under the plan up to 10% of outstanding Common Shares are reserved for the issuance of stock options to directors, officers, employees and consultants. The terms of the option, including the vesting terms and the option price are fixed by the directors at the time of grant subject to the price not being less than the market price of the Company's stock on the date of grant. The stock options granted are exercisable for a period of five years.

A summary of the status of the Company's stock options as at January 31, 2011, and changes during the period then ended are presented below:

	Number of Options	Weighted Average Exercise Price, \$
Balance, outstanding – April 30, 2010	5,337,500	1.08
Cancelled	(4,787,500)	1.15
Expired	(550,000)	0.51
Issued	7,667,500	0.63
Balance outstanding – January 31, 2011	7,667,500	0.63

On October 8, 2010, the Company granted incentive stock options for the purchase of up to 7,667,500 common shares of the Company at a price of \$0.63 per share for a five year period to certain directors, employees and consultants of the Company. The stock-based compensation of \$3,723,465 (\$0.49 per option) was charged to operations and credited to shareholder's equity to reflect the fair value of stock options granted and vested during the period.

The fair value of stock options granted is estimated on the dates of grants using the Black-Scholes option pricing model with the following assumptions used for the grants made during the period:

Risk-free interest rate	1.66%
Expected life	5 years
Annualized volatility	105%
Dividend rate	0.00%

Option pricing models require the use of estimates and assumptions including the expected volatility. Changes in the underlying assumptions can materially affect the fair value estimates.

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5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

Stock options outstanding and exercisable as at January 31, 2011, are as follows:

Number of Options Outstanding and Exercisable	Weighted Average Exercise Price, \$	Expiry Date
7,667,500	0.63	October 8, 2015

Warrants

There are no warrants outstanding as at January 31, 2011. There were no warrants exercised or expired during the period ended January 31, 2011.

6. INVESTMENT AND BANK LOAN

At January 31, 2011, long-term investments included Master Asset Vehicle II notes received in exchange for Canadian third-party asset backed commercial paper (“ABCP”) held by the Company. When the ABCP matured but was not redeemed in 2007, it became the subject of a restructuring process that replaced the ABCP with long-term asset backed securities. These investments were designated as held-for-trading and are accounted for at their fair value.

The table below summarizes the Company’s valuations of these investments at January 31, 2011, and April 30, 2010:

Notes	January 31, 2011		April 30, 2010		Expected maturity ⁽¹⁾
	Face value \$	Fair value \$	Face Value \$	Fair Value \$	
MAV II Class A-1	1,437,261	1,015,005	1,437,261	1,015,005	July 15, 2056
MAV II Class C	44,594	4,459	44,594	4,459	July 15, 2056
MAV II Class 13 (Ineligible Asset Tracking Notes)	226,263	22,626	226,263	22,626	March 20, 2014
Interest received	-	(95,302)	-	(86,611)	
Total	1,708,118	946,788	1,708,118	955,479	

⁽¹⁾ Maturity date reflects legal maturity date.

The fair value of the Class A-1 notes was established using a discounted cash flow approach based on the following inputs: the notes will pay interest at a rate 0.5% less than the bankers’ acceptance (“BA”) rate, prospective buyers of these notes estimated to require premium yields 5% over the BA rate, maturity of Class A -1 Notes estimated to be 6.5 years. The Class C notes are viewed as highly speculative with regard to ultimate payment of principal at maturity. Accordingly, it is expected that Class C notes will trade at approximately 10% of face par value. The fair value of the sub-prime backed Class 13 Notes was calculated as 10% of par value. To date, the Company received an interest payment of \$95,302 on the notes and a payment of \$4,619 as partial redemption of the MAV II Class A-1 tracking notes. The interest received was accounted for as a reduction of the Company’s investment.

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6. INVESTMENT AND BANK LOAN (continued)

There is significant amount of uncertainty in estimating the amount and timing of cash flows associated with these notes. Until an active market develops for the MAV II notes, the fair value will be determined using a discounted cash flow approach based on the maximum use of inputs observed from market conditions on subsequent reporting dates. Therefore, the fair values may change materially in subsequent periods. The fair value of the Company's investment in the ABCP is classified as Level 3 within the fair value hierarchy established by CICA section 3862.

The Company secured a \$1,376,126 demand non-revolving bridge loan from its bank pending any possible long-term solution to the current liquidity issues affecting the Company's investment in ABCP. The bridge loan is secured by the Company's investment in ABCP, cash, and credit balances. Interest on direct advances is paid at the Bank's prime rate plus a stamping fee for banker's acceptances of 2.5% per annum. The outside date for the repayment of the loan is September 30, 2011. The Company paid \$29,059 in interest and stamping fees on the loan during the nine-month period ended January 31, 2011.

7. RELATED PARTY TRANSACTIONS

- a) Director of the Company provides management and advisory services pursuant to a consulting agreement, for consideration of \$12,000 plus HST per month. In addition, pursuant to the agreement, a private company controlled by the Director provides administrative, accounting and the services of a chief financial officer to the Company in consideration of a monthly fee of \$12,075. Included in administrative and management services is \$199,375 and in audit and accounting is \$17,100 of fees incurred by the Company according to the agreement.
- b) As at January 31, 2011, accounts receivable, prepaids and deposits included \$18,848 of advances made to a private company controlled by a Director of the Company. The advances were made for the payroll tax remittances and working capital for the Company's Baton Rouge office.

The related party transactions incurred during the period were in the normal course of operations and were measured at the exchange value, which represented the amount of consideration established and agreed by the related parties.

8. SUPPLEMENTAL DISCLOSURE WITH RESPECT TO CASH FLOWS

During the nine months ended January 31, 2011, the Company had the following significant non-cash transactions:

- a) allocated \$118,844 to contributed surplus for the shares repurchased for cancellation under the normal course issuer bid;
- b) included in investing activities \$59,052 (April 30, 2010 - \$73,192) of accounts payable related to the oil and gas interest expenditures.

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9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company designated its financial instruments as follows:

- a) Cash and cash equivalents are classified as “*Held-for-trading*”. The fair value of the Company’s cash and cash equivalents are classified as Level 1 within the fair value hierarchy established by CICA section 3862.
- b) Accounts receivable are classified as “*Loans and Receivables*”. The recorded values of receivables approximate their current fair value because of their nature and respective maturity dates or durations.
- c) Investments in Master Asset Vehicle II notes are discussed in Note 6.
- d) Accounts payable and accrued liabilities are classified as “*Other Financial Liabilities*”. The Company believes that the recorded values of accounts payable and accrued liabilities approximate their current fair value because of their nature and respective maturity dates or durations.
- e) The Company’s non-revolving bridge loan is classified as “*Other Financial Liabilities*”. The fair value of the loan equal to the principal amount drawn and is classified as Level 2 within the fair value hierarchy established by CICA section 3862.

The Company may be exposed to risks of varying degrees of significance which could affect its ability to achieve its strategic objectives. The Company manages risks to minimize potential losses. The main objective of the Company’s risk management process is to ensure that the risks are properly identified and that the capital base is adequate in relation to those risks. The principal risks to which the Company is exposed are described below.

Credit risk

Credit risk is the risk of an unexpected loss if a customer or third party to a financial instrument fails to meet its contractual obligations. Financial instruments that potentially subject the Company to a concentration of credit risk consist primarily of cash, cash equivalents and accounts receivable. Management’s assessment of the Company’s risk for cash is low as it is attributable to cash held in major banks. The Company limits its exposure to credit loss by placing its cash with major financial institutions and invests only in short-term obligations.

A portion of the Company’s accounts receivable and prepaids consists of harmonized sales tax (HST) due from the Federal Government of Canada. The remaining part of Company’s accounts receivable and prepaids consists of receivables from customers in the energy industry, receivables from purchasers of the Corporation’s natural gas, and other miscellaneous receivables and prepaids and are subject to normal industry credit risk. To date the Company has not experienced any collection issues with its oil and natural gas partner.

Credit risk with respect to investments in Canadian Asset-Backed Commercial Paper (“ABCP”) is discussed in Note 6.

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9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

Liquidity risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is to evaluate current and expected liquidity requirements under both normal and stressed conditions to ensure that it maintain sufficient reserves of cash and cash equivalents or have an available credit facility to meet its liquidity requirements in the short and long term. As the industry in which the Company operates is very capital intensive, the majority of the Company's spending is related to its capital programs. The Company prepares annual budgets, which are regularly monitored and updated as considered necessary.

The Company's short-term financial liabilities are comprised of accounts payable and accrued liabilities which have expected maturities of less than one year and the bank loan which is secured by the Company's investment in ABCP, resulting in their current classification on the balance sheet.

As at January 31, 2011, the Company had cash and cash equivalents balance of \$2,759,712 (April 30, 2010 - \$6,386,141) to settle current liabilities of \$1,553,530 (April 30, 2010 – \$1,517,381). The Company intends to settle these with funds from its positive working capital position.

Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risks: interest rate risk, foreign exchange risk and price risk.

a) Interest rate risk

Interest rate risk is the risk that the fair value of future cash flows from a financial instrument will fluctuate as a result of changes in market interest rates. The Company is exposed to interest rate risk to the extent that the cash maintained at the financial institutions and investments included in the Company's cash and cash equivalents are subjects to a floating rate of interest. If the interest rate on the Company's cash and cash equivalents held at the financial institutions decreased by 1%, the Company's net income would have decreased by approximately \$27,597.

The interest rate risks on cash and on the Company's obligations are not considered significant.

The Company is exposed to interest rate risk to the extent that the Company's loan is subject to a floating rate of interest. If the interest rate on the Company's floating rate bank loan increased by 1%, the Company's net income would have decreased by approximately \$13,761.

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9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

b) Price risk

The Company is exposed to price risk with respect to commodity and equity prices. Equity price risk is defined as the potential adverse impact on the Company's earnings due to movements in individual equity prices or general movement in the level of the stock market.

Commodity price risk is defined as the potential adverse impact on earnings and economic value due to commodity price movements and volatility. The supply and demand for natural gas, the level of interest rates, the rate of inflation, investment decisions by large holders of commodities can all cause significant fluctuations in commodity prices. The Company closely monitors commodity prices or resources, individual equity movements, and the stock market to determine the appropriate course of actions to be taken by the Company.

c) Foreign exchange risk

The Company incurs operating expenses and capital expenditures mostly in Canadian dollars. The Company's exposure to assets and liabilities denominated in foreign currencies is nominal. Accordingly, the Company does not have a significant exposure to losses arising from fluctuations in exchange rates.

10. CAPITAL DISCLOSURE

The Company's objectives when managing capital are to safeguard the Company's ability to continue as a going concern in order to pursue the exploration and development of its properties and to maintain a flexible capital structure. The Capital structure of the Company consists of shareholders' equity and working capital, including bank debt. The Company manages the capital structure and makes adjustments to it in light of changes in economic conditions and the risk characteristics of the underlying assets.

In order to carry out the planned exploration and pay for administrative costs, the Company will spend its existing working capital and raise additional amounts as needed and if available. Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. There were no changes in the Company's approach to capital management during the period ended January 31, 2011.

11. COMMITMENTS

- a) The Company has committed to rent office space in the amount of \$16,361 during the remainder of fiscal 2011, \$51,852 during fiscal 2012, and \$17,284 during fiscal 2013;
- b) Oil and gas properties (Note 3);
- c) Asset retirement obligations (Note 4).