
CANADA ENERGY PARTNERS INC.

INTERIM FINANCIAL STATEMENTS

FOR THE NINE MONTHS ENDED JANUARY 31, 2010

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

**MANAGEMENT'S COMMENTS ON UNAUDITED
INTERIM FINANCIAL STATEMENTS**

The accompanying unaudited interim financial statements of Canada Energy Partners Inc. for the nine months ended January 31, 2010, 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.

BALANCE SHEETS

(Unaudited – Prepared by Management)

(Expressed in Canadian Dollars)

	January 31, 2010	April 30, 2009
	<u>\$</u>	<u>\$</u>
A S S E T S		
CURRENT ASSETS		
Cash and cash equivalents	7,350,955	10,280,593
Accounts receivable, prepaids and deposits	<u>105,972</u>	<u>331,145</u>
	7,456,927	10,611,738
INVESTMENT (Note 6)	900,938	932,888
OIL and GAS INTERESTS (Note 3)	<u>83,781,263</u>	<u>82,743,778</u>
	<u>92,139,128</u>	<u>94,288,404</u>
L I A B I L I T I E S		
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	313,240	1,258,574
Bank loan (Note 6)	<u>1,376,700</u>	<u>1,376,700</u>
	1,689,940	2,635,274
ASSET RETIREMENT OBLIGATION (Note 4)	241,243	227,588
FUTURE INCOME TAX LIABILITY	<u>11,942,366</u>	<u>11,942,366</u>
	<u>13,873,549</u>	<u>14,805,228</u>
S H A R E H O L D E R S ' E Q U I T Y		
SHARE CAPITAL (Note 5)	79,543,618	79,974,557
CONTRIBUTED SURPLUS (Note 5)	5,358,565	4,932,872
DEFICIT	<u>(6,636,604)</u>	<u>(5,424,253)</u>
	<u>78,265,579</u>	<u>79,483,176</u>
	<u>92,139,128</u>	<u>94,288,404</u>
NATURE OF OPERATIONS (Note 1)		
COMMITMENTS (Note 3 and Note 12)		
CONTINGENCY (Note 11)		
SUBSEQUENT EVENTS (Note 13)		

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,	
	2010 \$	2009 \$	2010 \$	2009 \$
GENERAL AND ADMINISTRATIVE EXPENSES				
Administrative and management services (Note 7)	104,932	114,412	353,105	383,645
Accretion and depreciation	5,423	-	16,270	-
Advertising	302	8,391	11,736	26,224
Audit and accounting	20,200	23,165	58,129	62,640
Corporate development	23,541	49,948	69,509	171,391
Filing and regulatory	5,831	3,368	19,914	32,119
General exploration	12,169	4,233	74,115	7,516
Legal	4,760	12,386	47,528	50,753
Office and miscellaneous	29,643	45,527	99,525	104,582
Professional fees	29,983	22,500	55,796	69,385
Rent	19,370	37,539	82,347	79,314
Stock-based compensation	-	14,296	267,800	2,754,587
Travel	11,626	7,586	33,310	104,790
	<u>267,780</u>	<u>343,351</u>	<u>1,189,084</u>	<u>3,846,946</u>
LOSS BEFORE OTHER ITEMS	(267,780)	(343,351)	(1,189,084)	(3,846,946)
OTHER (EXPENSES)/ INCOME				
Interest	4,331	79,355	(22,012)	300,613
Foreign exchange	(6)	16,482	(1,255)	20,608
Other taxes	-	(109,004)	-	(109,004)
	<u>4,325</u>	<u>(13,167)</u>	<u>(23,267)</u>	<u>212,217</u>
NET LOSS AND COMPREHENSIVE LOSS	(263,455)	(356,518)	(1,212,351)	(3,634,729)
DEFICIT - BEGINNING OF PERIOD	<u>(6,373,149)</u>	<u>(5,650,525)</u>	<u>(5,424,253)</u>	<u>(2,372,314)</u>
DEFICIT - END OF PERIOD	<u><u>(6,636,604)</u></u>	<u><u>(6,007,043)</u></u>	<u><u>(6,636,604)</u></u>	<u><u>(6,007,043)</u></u>
LOSS PER SHARE - BASIC AND DILUTED	<u>(0.00)</u>	<u>(0.00)</u>	<u>(0.01)</u>	<u>(0.05)</u>
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING - BASIC AND DILUTED	<u>82,128,501</u>	<u>82,355,105</u>	<u>82,240,867</u>	<u>79,237,961</u>

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

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

	Three Months Ended January 31,		Nine Months Ended January 31,	
	2010 \$	2009 \$	2010 \$	2009 \$
CASH PROVIDED FROM (USED FOR)				
OPERATING ACTIVITIES				
Net loss for the period	(263,455)	(356,518)	(1,212,351)	(3,634,729)
Items not affecting cash:				
Stock-based compensation	-	14,296	267,800	2,754,587
Accretion and depreciation	5,423	-	16,270	-
Interest received from investment	7,382	-	31,077	-
Changes in non-cash working capital balances:				
Accounts receivable, prepaids and deposits	48,172	(599,286)	280,450	(515,382)
Accounts payable and accrued liabilities	37,890	(7,710)	(87,378)	(466,372)
Other tax liabilities	-	109,004	-	109,004
	<u>(164,588)</u>	<u>(840,214)</u>	<u>(704,132)</u>	<u>(1,752,892)</u>
FINANCING ACTIVITIES				
Issuance of common shares	-	10,851	-	25,057,772
Share issue costs	-	5,253	-	(1,680,129)
Issuer bid share repurchase	<u>(211,750)</u>	<u>-</u>	<u>(273,045)</u>	<u>-</u>
	<u>(211,750)</u>	<u>16,104</u>	<u>(273,045)</u>	<u>23,377,643</u>
INVESTING ACTIVITIES				
Oil and gas interests	<u>(247,795)</u>	<u>(5,246,743)</u>	<u>(1,952,461)</u>	<u>(11,235,990)</u>
(DECREASE)/INCREASE IN CASH DURING THE PERIOD				
	(624,133)	(6,070,853)	(2,929,638)	10,388,761
CASH AND CASH EQUIVALENTS - BEGINNING OF PERIOD	<u>7,975,088</u>	<u>20,276,565</u>	<u>10,280,593</u>	<u>3,816,951</u>
CASH AND CASH EQUIVALENTS - END OF PERIOD	<u><u>7,350,955</u></u>	<u><u>14,205,712</u></u>	<u><u>7,350,955</u></u>	<u><u>14,205,712</u></u>
CASH AND CASH EQUIVALENTS IS COMPRISED OF:				
Cash	7,350,955	4,145,297	7,350,955	4,145,297
Term deposits	<u>-</u>	<u>10,060,415</u>	<u>-</u>	<u>10,060,415</u>
	<u><u>7,350,955</u></u>	<u><u>14,205,712</u></u>	<u><u>7,350,955</u></u>	<u><u>14,205,712</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 FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(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) for the purpose of acquiring interests in the Peace River Coalbed Methane (“CBM”) Project in the Peace River area in northeast British Columbia. The Company possesses a large (approximately 100 square miles) concentrated land position in a high-impact, multi-zone, natural gas-bearing area in northeast 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. BASIS OF PRESENTATION

The interim period financial statements have been prepared by the Company in accordance with Canadian generally accepted accounting principles for the preparation of interim financial statements. These interim period financial statements do not include all disclosures required for annual financial statements and should be read together with the April 30, 2009, 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. Certain of the prior period comparatives have been reclassified to conform to the current period’s presentation. 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 raise financing for its activities using a variety of sources. Based on its current plans, budgeted capital expenditures, and cash requirements, the Company has sufficient cash to finance its current plans for at least 12 months from the date of approval of the financial statements. 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.

Issued but not Adopted Primary Sources of GAAP

International Financial Reporting Standards (“IFRS”)

In 2006, the Canadian Accounting Standards Board (“AcSB”) published a new strategic plan that will significantly affect financial reporting requirements for Canadian companies. The AcSB strategic plan outlines the convergence of Canadian GAAP with IFRS over an expected five year transitional period. In February 2008, the AcSB announced that 2011 is the changeover date for publicly-listed companies to use IFRS, replacing Canada’s own GAAP. The date is for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The transition date of January 1, 2011, will require the restatement for comparative purposes of amounts reported by the Company for the year ended April 30, 2011. The Company is currently engaged in the scoping phase of its conversion which involves a high level review of major differences between Canadian GAAP and IFRS, setting a timeline for resources and developing a project plan. This scoping phase is intended to provide direction to the Company’s management for the second phase of conversion project and will be disclosed in the Company’s annual financial statements and management’s discussion and analysis.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
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2. BASIS OF PRESENTATION (continued)

Business Combinations, Consolidated Financial Statements and Non-Controlling Interests

The CICA issued three new accounting standards in January 2009: Section 1582, “Business Combinations”, Section 1601, “Consolidated Financial Statements”, and Section 1602, “Non-Controlling Interests”. Section 1582 replaces Section 1581, “Business Combinations” and establishes standards for the accounting and business combinations. It provides the Canadian equivalent to *International Financial Reporting Standards IFRS 3*, “Business Combinations”. The section applies prospectively to the business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January 1, 2011. Sections 1601 and 1602 together replace Section 1600, “Consolidated Financial Statements”. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1601 applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. It is equivalent to the corresponding provisions of *International Financial Reporting Standard IAS27*, “Consolidated and Separate Financial Statements” and applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Company will consider the impact of adopting these pronouncements on its financial statements if future acquisitions are completed.

3. OIL and GAS INTERESTS

For the nine months ended January 31, 2010	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
Acquisition costs				
Leases acquisitions and rental costs	68,533	22,648	-	91,181
Balance, beginning of period	55,165,292	1,827,048	693,274	57,685,614
Balance, end of the period	55,233,825	1,849,696	693,274	57,776,795
Exploration costs				
Asset retirement costs	(2,614)	-	-	(2,614)
Drilling and completion	30,137	20,136	-	50,273
Geological and consulting	29,271	12,420	1,543	43,234
Reports and other	33,492	7,800	1,525	42,817
	90,286	40,356	3,068	133,710
Balance, beginning of period	9,499,702	4,443,638	52,281	13,995,621
Balance, end of period	9,589,988	4,483,994	55,349	14,129,331
Development costs				
Drilling and completion	629,158	-	-	629,158
Gas plant	325,155	-	-	325,155
Less: net revenue received in development stage	(141,719)	-	-	(141,719)
	812,594	-	-	812,594
Balance, beginning of period	11,062,543	-	-	11,062,543
Balance, end of period	11,875,137	-	-	11,875,137
Total deferred oil and gas interests	76,698,950	6,333,690	748,623	83,781,263

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NOTES TO FINANCIAL STATEMENTS
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FOR THE NINE MONTHS ENDED JANUARY 31, 2010
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3. OIL and GAS INTERESTS (continued)

For the year ended April 30, 2009	Peace River Project \$	Monias Prospect \$	Moberly Prospect \$	Total \$
Acquisition costs				
Leases acquisitions and rental costs	951	17,312	-	18,263
Balance, beginning of year	55,164,341	1,809,736	693,274	57,667,351
Balance, end of the year	55,165,292	1,827,048	693,274	57,685,614
Exploration costs				
Asset retirement costs	153,532	37,960	18,076	209,568
Drilling and completion	1,335,166	3,556,796	-	4,891,962
Geological and consulting	57,164	64,172	7,222	128,558
Joint interest billing – shallow rights	69,067	-	-	69,067
Reports and other	32,192	12,933	-	45,125
	1,647,121	3,671,861	25,298	5,344,280
Balance, beginning of year	7,852,581	771,777	26,983	8,651,341
Balance, end of year	9,499,702	4,443,638	52,281	13,995,621
Development costs				
Drilling and completion	7,509,005	-	-	7,509,005
Gas plant	3,598,103	-	-	3,598,103
Less: net revenue received in development stage	(44,565)	-	-	(44,565)
	11,062,543	-	-	11,062,543
Balance, beginning of year	-	-	-	-
Balance, end of year	11,062,543	-	-	11,062,543
Total deferred oil and gas interests	75,727,537	6,270,686	745,555	82,743,778

Included in the acquisition costs is \$107,000 security bond deposited in the Company's bank account in favour of the regulatory agency for the future 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.

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 CBM Project and Moosebar Shale rights.

Peace River CBM Project consists of approximately 50,788 gross (25,394 net) acres of CBM prospective acreage. 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 1.55%.

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NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

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 a total of 87.5% interest in 2 sections, subject to final completion or plug and abandonment. The Company has relinquished further drilling rights under the Farmout. The Company's interest in the Moosebar Shale is subject to Crown royalties and for certain acreage to geological overriding royalties of up to 1.55%.

Deep rights

Deep rights on the Peace River Project consist of approximately 34,391 gross and net acres of prospective acreage. The Company owns 100% working interest subject to a joint venture agreement with Crew Energy Inc. ("Crew"). According to the joint venture agreement, Crew operates the project and will earn a 50% working interest in the subject lands upon completion of the exploration program. The initial program consists of a three-dimensional seismic project over the majority of the Peace River Project lands (completed) and the drilling of four (two drilled) exploratory wells.

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 1.55% and back-in interest of 6.6% after project payout plus \$2,000,000 on approximately 3,500 acres.

Monias Prospect, British Columbia

The Company's Monias Prospect consisting of approximately 6,517 acres or 10 sections (10 square miles) and located in the Peace River Plains area near Fort St. John, British Columbia. The Company owns 100% working interest in the deep and shallow rights in 8 sections and 70% working interest in the shallow rights on 2 sections. Deep rights on the 4 sections of Monias Prospect are subject to the joint venture agreement with West Energy Ltd. ("West"). According to the joint venture agreement, West operates the project and will earn a 65% working interest in the subject lands upon completion of the exploration program. The exploration program consisted of a three-dimensional seismic project over the majority of the Monias Prospect lands and drilling and completion of one exploratory well. See Note 11.

The Company's interest in the deep rights of the Monias Prospect will be subject to Crown royalties, geological overriding royalties of 1% and back-in interest of 12.5% after project payout plus \$2,000,000.

During the year ended April 30, 2008, the Company entered into a farm-in agreement (the "Farm-in Agreement") on the lands adjacent to its Monias Prospect with a major Canadian oil and gas producer. Under the Farm-in Agreement, the Company drilled two exploratory wells and has earned a 70% interest in the Shallow Rights in two sections of the farm-in lands. One of two sections are subject to a 10% royalty on gas, a 5% - 10% royalty on oil production and both sections are subject to a back-in interest of 4.375% after project payout plus \$2,000,000.

Moberly Prospect, British Columbia

Moberly Prospect consists of approximately 2,600 gross and net acres of prospective acreage and located in the Peace River Plains area near Hudson's Hope, 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 project and will earn a 50% working interest in the subject lands upon completion of the exploration program. 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 2.43% and back-in interest of 10.5% after project payout plus \$1,000,000.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

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 \$668,139, which will be incurred from 2019 to 2035. 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	227,588
Accretion expense	13,655
Balance, end of period	241,243

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			
As at April 30, 2008	61,073,132	57,649,686	2,185,670
Exercise of agent warrants	97,152	58,292	-
Fair value of agent warrants exercised	-	13,601	(13,601)
Private placement	21,186,000	24,999,480	-
Share issuance costs	-	(1,226,494)	-
Net future income taxes on flow-through expenses renounced	-	(1,520,008)	-
Stock-based compensation	-	-	2,760,803
As at April 30, 2009	82,356,284	79,974,557	4,932,872
Stock-based compensation	-	-	267,800
Issuer bid share repurchase	(443,000)	(430,939)	157,893
As at January 31, 2010	81,913,284	79,543,618	5,358,565

During the period ended January 31, 2010, the Company received approval from TSX Venture Exchange to commence a normal course issuer bid (the "Bid") to purchase up to 4,117,814 of its common shares, representing 5% of the Company's then outstanding 82,356,284 issued and outstanding shares. The Bid commenced on May 29, 2009, and will end on the earlier of May 28, 2010, 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.

As of January 31, 2010, the Company had purchased for cancellation 443,000 common shares for \$273,045. 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 capital during the period.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

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 of January 31, 2010, and changes during the period then ended is presented below:

	Number of Options	Weighted Average Exercise Price, \$
Balance, outstanding – April 30, 2009	5,600,000	1.23
Forfeited	(912,500)	1.61
Granted	650,000	0.51
Exercised	-	-
Balance outstanding – January 31, 2010	5,337,500	1.08

Stock options outstanding and exercisable as at January 31, 2010, are as follows:

Number of Options Outstanding and Exercisable	Weighted Average Exercise Price, \$	Expiry Date
1,350,000	1.00	August 21, 2011
700,000	1.00	October 26, 2011
1,000,000	1.00	March 26, 2012
500,000	1.10	September 13, 2012
1,087,500	1.61	June 25, 2013
50,000	1.66	August 1, 2013
650,000	0.51	May 5, 2014
5,337,500	1.08	

During the period ended January 31, 2010, 912,500 stock options were forfeited and no stock options were exercised.

During the nine months ended January 31, 2010, the Company granted 650,000 stock options. The fair value of stock options granted was estimated on the date of the grant using the Black Scholes Option Pricing Model with the following assumptions: average risk-free interest rate of 2.01%, estimated volatility of 114%, expected life of 5 years, forfeiture rate of Nil, and expected dividend yield of 0%. The stock-based compensation of \$267,800 was charged to operations and credited to shareholder’s equity to reflect the fair value of stock options granted and vested during the period.

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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NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

5. SHARE CAPITAL AND CONTRIBUTED SURPLUS (continued)

Warrants

There are no warrants outstanding as at January 31, 2010. There were no warrants exercised or expired during the period ended January 31, 2010.

6. INVESTMENT AND BANK LOAN

- a) At January 31, 2010, 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. These investments were designated as held-for-trading and are accounted for at their fair value.

The market for asset-backed commercial paper not sponsored by banks froze up in early August 2007 after issuers were unable to roll over maturing notes. A Pan-Canadian Investors Committee for Third-Party Structured Asset-Backed Commercial Paper (the “Committee”) was tasked with overseeing the restructuring of the ABCP. On January 12, 2009, the Ontario Superior Court approved a complicated and controversial deal to swap essentially non-tradable, mortgage-backed debt for new securities. On January 21, 2009, the Committee announced the successful implementation of the restructuring plan. Upon the restructuring old short-term ABCP notes were exchanged for longer-term notes of various classes with maturities that generally approximate those of the assets previously contained in the underlying conduits.

As part of the Plan, the Company received new notes of various classes issued by trusts referred to as MAVII, including senior notes Class A-1, subordinated notes Class C, and ineligible tracking notes Class 13. At the time of the restructuring, DBRS assigned a rating “A” to the MAV II Class A-1 notes. The MAV II Class C and Class 13 notes have not been rated by DBRS. Upon the restructuring, the Company received the replacement notes as follows:

Notes	Maturity Date (1)	Interest Rate (2)	Face Value, \$	Fair Value Estimate, \$
MAV II Class A-1	December 2056	BA - 0.5%	1,441,880	964,830
MAV II Class C	December 2056	BA + 20%	44,594	4,459
MAV II Class 13 (Ineligible Asset Tracking Notes)			226,263	22,626
Total			1,712,737	991,915
Interest received as at April 30, 2009				(59,026)
Interest received during the nine months ended January 31, 2010				(31,077)
Interest receivable as of January 31, 2010				(874)
Fair value				900,938

(1) Maturity date reflects legal maturity date. Latest maturity date of underlying assets is December 2016.

(2) BA rate is Canadian dollar Bankers Acceptance interest rate with a maturity of 90 days.

Accounting for the exchange of the ABCP for new notes included removal of the ABCP from the Company’s balance sheet and recognition of the new notes at their fair value. The new notes are classified as held-for-trading under the Company’s Financial Instruments Policy which requires them to be fair valued at each period end with changes in fair value included in the statement of operations in the period in which they arise. The fair value is determined using a discounted cash flow approach based on the maximum use of inputs observed from the market on reporting dates.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

6. INVESTMENT AND BANK LOAN (continued)

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, average maturity of Class A -1 Notes estimated to be 7.5 years. The Class C Notes are subordinated to the Class B Notes with respect to payment of interest and principal, and no amounts will be paid with respect to the Class C Notes until the Class B Notes are repaid in full. The Class C notes are viewed as highly speculative with regard to ultimate payment of principal at maturity in 2016. 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 a payment of \$89,781 which was its share of the accumulated interest due under the ABCP Plan of Arrangements. In addition, the Company received \$321 on its MAV II Class 13 notes and is entitled to receive \$874 on the Company's MAV II Class A-1 notes. The interest received and receivable was accounted for as a reduction of the Company's investment.

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.

- b) The Company secured a \$1,376,700 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. Interest on direct advances is paid at the Bank's prime rate. The Company paid \$20,380 in interest and stamping fees on the loan during the nine-month period ended January 31, 2010.

7. RELATED PARTY TRANSACTIONS

Included in administrative and management services for the nine months ended January 31, 2010, is \$8,017 paid by the Company to a company controlled by a Director.

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, 2010, the Company had the following significant non-cash transactions:

- a) allocated \$157,893 to contributed surplus for the shares repurchased for cancellation under the normal course issued bid;
- b) included in investing activities \$231,359 (April 30, 2009 - \$1,089,316) of accounts payable related to the oil and gas interests expenditures;
- c) included in investing activities \$54,403 (April 30, 2009 - \$nil) of accounts receivable related to revenue from the sale of natural gas.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT

The Company adopted the CICA Handbook Section 3855 “Financial Instruments – Recognition and Measurement” and designated its financial instruments as follows:

- a) Cash and cash equivalents are classified as “*Held-for-trading*”. Their carrying values are equal to its fair values.
- b) Accounts receivable are classified as “*Loans and Receivables*”. These financial assets are recorded at values that approximate their amortized cost using the effective interest method.
- c) Investments in Master Asset Vehicle II notes are discussed in Note 6.
- d) Accounts payable, accrued liabilities and bank loan, are classified as “*Other Financial Liabilities*”. These financial liabilities are recorded at values that approximate their amortized cost using the effective interest method.

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.

The Company’s accounts receivable and prepaids consists of general sale tax (GST) due from the Federal Government of Canada, receivables from customers in the energy industry, and other miscellaneous receivables and prepaids and are subject to normal industry credit risk. To date the Company has not experienced any collection difficulties.

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

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.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

9. FINANCIAL INSTRUMENTS AND RISK MANAGEMENT (continued)

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 bridge loan which is secured by the Company's investment in ABCP, resulting in their current classification on the balance sheet.

As at January 31, 2010, the Company had cash balance of \$7,350,955 to settle current liabilities of \$1,689,940. Management believes that it has sufficient funds to meet its current liabilities as they become due.

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 other 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 held at the financial institutions decreased by 1%, the Company's net loss would have increased by approximately \$73,510.

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 loss would have increased by approximately \$13,767.

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.

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

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.

The Company has not paid or declared any dividends during the year. There were no changes in the Company's approach to capital management during the year.

11. CONTINGENCY

The Company has commenced legal proceedings in the Court of Queen's Bench of Alberta against West Energy Ltd. ("West") for a declaration that West has failed to earn a 65% interest and has no interest in the petroleum and natural gas rights below the Nikanassin formation (deep rights) on the four sections (2,608 acres) located within the Company's Monias Prospect pursuant to a seismic option agreement. West filed a statement of defense and counterclaim. The outcome of this legal action is not determinable and the estimate of the contingent gain/loss cannot be made as of the date of this report.

12. COMMITMENTS

a) The Company has committed to rent office space as follows:

Year end April 30, 2010	\$	12,198
Year end April 30, 2011		49,428

b) Oil and gas properties (Note 3);

c) Asset retirement obligation (Note 4).

13. SUBSEQUENT EVENTS

Subsequent to January 31, 2010 the Company:

- a) acquired an aggregate 1.5% overriding royalty interest on certain portions of the Company's land base in northeast British Columbia from two arm's-length parties in consideration for the issuance of 800,000 common shares of the Company. The shares are subject to regulatory holding period of four months. The overriding royalty covered the majority of the Company's deep and shallow rights;

CANADA ENERGY PARTNERS INC.
NOTES TO FINANCIAL STATEMENTS
(Unaudited – Prepared by Management)
FOR THE NINE MONTHS ENDED JANUARY 31, 2010
(Expressed in Canadian Dollars)

13. SUBSEQUENT EVENTS (continued)

- b) received notice from the Operator of the Peace River CBM Project that it intends to shut-in the eight producing CBM wells prior to May 1, 2010. The decision to shut the wells in was based upon continued monthly operating losses due to low gas prices and a longer than expected dewatering time to obtain gas production rates necessary to generate a positive cash flow. The Company continues to believe that the CBM Project has commercial potential and will put the Project on care and maintenance. The shut-in wells can be restarted in the future upon improvement in the gas prices;
- c) repurchased the additional 100,000 of its common shares for \$58,025 under the normal course issuer bid program.