CHINA YILI PETROLEUM CO
Form 10-Q
August 14, 2008

U. S. Securities and Exchange Commission
Washington, D. C. 20549

FORM 10-Q

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2008

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File No. 1-51554

CHINA YILI PETROLEUM COMPANY
(Name of Small Business Issuer in its Charter)

Nevada (State or Other Jurisdiction of incorporation or organization)	20-2934409 (I.R.S. Employer I.D. No.)

c/o American Union Securities, Inc., 100 Wall Street, 15th Floor, New York, NY 10005
(Address of Principal Executive Offices)

Issuer's Telephone Number: (212) 232-0120

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Sections 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No __

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check One)

Large accelerated filer __ Accelerated filer ____ Non-accelerated filer ____ Small reporting company _X_

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes __ No X

APPLICABLE ONLY TO CORPORATE ISSUERS: Indicate the number of shares outstanding of each of the Registrant's classes of common stock, as of the latest practicable date:
August 13, 2008
Common Stock: 22,139,994 shares

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

	ASS
CURRENT ASSETS:	
Cash	
Due from affiliated company	
Other sundry current assets	
TOTAL CURRENT ASSETS	
PROPERTY AND EQUIPMENT, NET OF ACCUMULATED DEPRECIATION	
TOTAL ASSETS	
LIABILITIES AND STOCKHOLDERS’ EQUITY	
CURRENT LIABILITIES:	
Accounts payable	
Note payable – stockholders	
Due to stockholders	
Accrued expenses	
Deferred revenue	
TOTAL CURRENT LIABILITIES	
STOCKHOLDERS’ EQUITY:	
Common stock, $0.001 par value	
100,000,000 shares authorized,	
22,139,994 and 300,051 shares issued and outstanding	
at June 30, 2008 and December 31, 2007, respectively	
Preferred stock, $0.001 par value,	
4,700,000 shares authorized,	
0 shares issued and outstanding	
Preferred stock, Series A, $0.001 par value,	
300,000 shares authorized,	
77,507 and 300,000 shares issued and outstanding	
at June 30, 2008 and December 31, 2007, respectively	
Additional paid-in capital	
Accumulated deficit	

Accumulated other comprehensive income	
TOTAL STOCKHOLDERS’ EQUITY	
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	

See notes to financial statements

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CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	THREE MONTHS ENDED June 30,		SIX MONTHS ENDED June 30,	
	2008	2007	2008	2007
REVENUE	$ 9,740	$ -	$ 249,901	$ -
COSTS AND EXPENSES/(INCOME):				
Cost of sales	-	-	250,231	-
General and administrative	120,031	130,249	320,250	276,892
Interest expense, net	37,662	-	72,084	-
Other Income	(17,400)		(17,400)	
TOTAL COSTS AND EXPENSES	140,293	130,249	625,165	276,892
NET LOSS	(130,553)	(130,249)	(375,264)	(276,892)
OTHER COMPREHENSIVE INCOME (LOSS):				
Foreign currency translation adjustments	148,569	100,885	427,184	182,704
TOTAL COMPREHENSIVE INCOME (LOSS)	$ 18,016	$ (29,364)	$ 51,920	$ (94,188)
Basic and diluted loss per common share	$ (0.006)	N/A	$ (0.02)	N/A
Weighted average number of shares outstanding	23,139,994	N/A	21,299,996	N/A

See notes to financial statements

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	SIX MONTHS ENDED JUNE 30, 2008	2007
OPERATING ACTIVITIES:		
Net loss	$ (375,264)	$ (276,892)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property and equipment	20,145	47,249
Changes in operating assets and liabilities:		
Sundry current assets	3,205	116
Accounts payable	(21,059)	(652,240)
Accrued expenses	25,778	7,061
Deferred revenue	(26,384)	-
NET CASH USED IN OPERATING ACTIVITIES	(373,579)	(874,706)
INVESTING ACTIVITIES:		
Acquisition of property and equipment	(22,068)	(18,639)
NET CASH USED IN INVESTING ACTIVITIES	(22,068)	(18,639)
FINANCING ACTIVITIES:		
Proceeds from notes payable – stockholders	299,281	-
Proceeds from (repayment of) stockholder loan	79,661	(467,060)
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	378,942	(467,060)
EFFECT OF EXCHANGE RATE ON CASH	1,043	33,144
DECREASE IN CASH	(15,662)	(1,327,261)
CASH – BEGINNING OF PERIOD	47,091	1,356,033
CASH – END OF PERIOD	$ 31,429	$ 28,772
Supplemental disclosures of cash flow information:		
Non-cash financing activities:		
Loan receivable from affiliated company paid by stockholder	$ 289,693	$ -

See notes to financial statements

CHINA YILI PETROLEUM COMPANY AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 2008
(Unaudited)

1 Basis of Presentation

The accompanying unaudited financial statements have been prepared in accordance with accounting principles generally accepted for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X relating to smaller reporting companies. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles (“GAAP”) for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six-month periods ended June 30, 2008 are not necessarily indicative of the results to be expected for the year ended December 31, 2008

The balance sheet at December 31, 2007 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in our Annual Report on Form 10-KSB for the year ended December 31, 2007 filed on April 15, 2008.

2 MERGER TRANSACTION AND REVERSE SPLIT

On August 13, 2007 ASAP Show, Inc. (“ASAP Show”) acquired the outstanding capital stock of Sino-American Petroleum Group, Inc., a Delaware Corporation (“Sino-American Petroleum”). Sino-American Petroleum is a holding company that owns all of the registered capital of Tongliao Yili Asphalt Co. (“Yili Asphalt”), a corporation organized under the laws of the People’s Republic of China (“PRC”). Yili Asphalt is engaged in the business of refining heavy oil into asphalt, fuel oil and lubricants. All of Yili Asphalt’s business is currently in China.

In connection with the closing of the acquisition (the “Merger”) on August 13, 2007, the following took place:

- ASAP Show issued to the stockholders of Sino-American Petroleum 200,000 shares of Series A Preferred Stock, which will be convertible into 569,348,000 shares of common stock after the distribution of the ASAP Expo Shares discussed below.

- ASAP Show issued 100,000 shares of Series A Preferred Stock for $600,000. The 100,000 shares will be convertible into 284,674,000 shares of common stock after the distribution of the ASAP Expo shares discussed below. The three purchasers assigned their interest in most of the Series A Preferred shares to other individuals, none of whom acquired sufficient shares to be a controlling stockholder of ASAP Show.

- Prior to the Merger, ASAP Show assigned all of its pre-Merger business and assets to ASAP Expo, Inc., its wholly-owned subsidiary, and ASAP Expo, Inc. assumed responsibility for all of the liabilities of ASAP Show that existed prior to the merger. At the same time, ASAP Show entered into a management agreement with Frank Yuan, its previous CEO, and ASAP Expo, Inc. The management agreement provides that Mr. Yuan will manage ASAP Expo, Inc. within his discretion, provided that his actions or inactions do not threaten material injury to ASAP

Show. The management agreement further provides that Mr. Yuan will cause ASAP Expo, Inc, to file a registration statement with the Securities and Exchange Commission that will, when declared effective, permit ASAP Show to distribute all of the outstanding shares of ASAP Expo, Inc. to the holders of its common stock. After the registration statement is declared effective, the Board of Directors of ASAP Show will fix a record date, and stockholders of record on that date will receive the shares of ASAP Expo, Inc. in proportion to their ownership of ASAP Show common stock.

• On October 22, 2007, ASAP Show, Inc. changes its corporate name to China Yili Petroleum Company ("the Company") and announced a 1-29 reverse split.

The above merger was accounted for as a reverse merger, since the former shareholders of Sino-American Petroleum and its wholly-owned subsidiary, Yili Asphalt, effectively control the Company and, accordingly, Sino-American Petroleum is considered to be the surviving entity.

On January 7, 2008, 222,493 shares of the Company's Series A Convertible Preferred Stock was converted into 21,839,943 shares of the Company's Common Stock.

3 BUSINESS DESCRIPTION

Tongliao Yili Asphalt is engaged in the business of refining heavy oil into asphalt, fuel oil and lubricants. ASAP Expo, Inc. is engaged in the business of organizing trade-shows and innovative means of financing international trade. All revenue included in the financial statements come from ASAP.

4 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of consolidation

The accompanying consolidated financial statements include the accounts of China Yili Petroleum Company and its wholly-owned subsidiaries. All significant inter-company balances and transactions have been eliminated in consolidation.

Foreign currency translation

The assets and liabilities of the Company's subsidiary, using the local currency as its functional currency, are translated to U.S. Dollars based on the current exchange rate prevailing at each balance sheet date and any resulting translation adjustments are included in Accumulated Other Comprehensive Income (Loss). The Company's revenues and expenses are translated into U.S. Dollars using the average exchange rates prevailing for each period presented.

New accounting pronouncements

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109," ("FIN 48"), which seeks to reduce the diversity in practice associated with the accounting and reporting for uncertainty in income tax positions. This interpretation prescribes a comprehensive model for the financial statement recognition, measurement, presentation and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. An uncertain tax position will be recognized if it is determined that it is more likely than not to be sustained upon examination. The tax position is measured as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

The cumulative effect of applying the provisions of this interpretation is to be reported as a separate adjustment to the opening balance of retained earnings in the year of adoption. FIN 48 is effective for fiscal years beginning after December 15, 2006.

In September 2006, the FASB issued SFAS No. 157, “Fair Value Measurements”. The objective of SFAS 157 is to increase consistency and comparability in fair value measurements and to expand disclosures about fair value measurements. SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. The provisions of SFAS No. 157 are effective for fair value measurements made in fiscal years beginning after November 15, 2007. The adoption of this statement is not expected to have a material effect on the Company's future reported financial position or results of operations.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115”. This statement permits entities to choose to measure many financial instruments and certain other items at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 “Accounting for Certain Investments in Debt and Equity Securities” applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity’s first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, “Fair Value Measurements”. The adoption of this statement did not have a material effect on the Company's financial statements.

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 160, “Non-controlling Interests in Consolidated Financial Statements – an amendment of ARB No. 51”. This statement improves the relevance, comparability, and transparency of the financial information that a reporting entity provides in its consolidated financial statements by establishing accounting and reporting standards that require the ownership interests in subsidiaries held by parties other than the parent and the amount of consolidated net income attributable to the parent and to the non-controlling interest be clearly identified and presented on the face of the consolidated statement of income, changes in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently, when a subsidiary is deconsolidated, any retained non-controlling equity investment in the former subsidiary be initially measured at fair
value, entities provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS No. 160 affects those entities that have an outstanding non-controlling interest in one or more subsidiaries or that deconsolidate a subsidiary. SFAS No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Early adoption is prohibited. The adoption of this statement is not expected to have a material effect on the Company's financial statements.

5 PROPERTY AND EQUIPMENT

Yili Asphalt acquired a 50 year land lease from the PRC. The amount is being amortized over the life of the lease.

A summary of property and equipment and the estimated lives used in the computation of depreciation and amortization are as follows:

		Amount	Life
Right to use land	$	245,857	50 years
Building and building improvements		1,800,098	39 years
Machinery and equipment		4,714,329	7 years
Office equipment and furniture		60,567	7 years
Automobiles		153,251	7 years
		6,974,102	
Accumulated depreciation and amortization		83,577	
		6,890,525	
Construction in progress		2,032,761	
	$	8,923,286	

6 BUSINESS SEGMENTS

	SIX MONTHS ENDED JUNE 30, 2008					
		Yili Asphalt		ASAP Expo		Total
Statement of income (loss):						
Revenue	$	-	$	249,901	$	249,901
Expenses		120,173		522,391		642,565
Other income		-		(17,400)		(17,400)
Net income (loss)	$	(120,173)	$	(255,091)	$	(375,264)
Balance sheet:						
Cash	$	631	$	30,798	$	31,429
Sundry current assets		336		31,342		31,678
Property and equipment		8,923,286		-		8,923,286
Total assets	$	8,924,253	$	62,140	$	8,986,393
Current liabilities	$	1,964,627	$	1,489,908	$	3,454,535
Stockholders’ equity (deficiency)		6,959,626		(1,427,768)		5,531,858

Total liabilities and stockholders' equity	$	8,924,253	$	62,140	$	8,986,393

7 EARNINGS PER SHARE

Outstanding shares prior to August 13, 2007, the date of the Merger, are indeterminable. The total shares issued are therefore used as the average shares outstanding.

8 RISK FACTORS

Vulnerability due to Operations in PRC

The Company's operations may be adversely affected by significant political, economic and social uncertainties in the PRC. Although the PRC government has been pursuing economic reform policies for more than 20 years, no assurance can be given that the PRC government will continue to pursue such policies or that such policies may not be significantly altered, especially in the event of a change in leadership, social or political disruption or unforeseen circumstances affecting the PRC's political, economic and social conditions. There is also no guarantee that the PRC government's pursuit of economic reforms will be consistent or effective.

Substantially all of the Company's businesses are transacted in RMB, which is not freely convertible. The People's Bank of China or other banks are authorized to buy and sell foreign currencies at the exchange rates quoted by the People's Bank of China. Approval of foreign currency payments by the People's Bank of China or other institutions requires submitting a payment application form together with suppliers' invoices, shipping documents and signed contracts.

Since the Company has its primary operations in the PRC, the majority of its revenues will be settled in RMB, not U.S. Dollars. Due to certain restrictions on currency exchanges that exist in the PRC, the Company's ability to use revenue generated in RMB to pay any dividend payments to its shareholders may be limited.

Environmental concerns

The refining of petroleum involves the production of pollutants. In addition, the transportation of petroleum products entails a risk of spills that may result in long-term damage to the environment. There is increasing concern in China, however, over the degradation of the environment that has accompanied its recent industrial growth. It is likely that additional government regulation will be introduced in order to protect the environment. Compliance with such new regulations could impose substantial additional costs to the Company.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

All of the revenue and 81% of the expenses reported by the Company for the six months ended June 30, 2008 were generated by ASAP Expo. There are, however, no revenue or expenses attributable to ASAP Expo reported for the six months ended June 30, 2007. Because the merger of Yili Asphalt into the Company on August 13, 2007 is accounted for as a reverse merger, the historic financial statements of Yili Asphalt have replaced the historic financial statements of the Company prior to the reverse merger. Only the results of operations of ASAP Expo occurring after August 13, 2007 are consolidated in the financial results reported in this Quarterly Report. For this reason the Company's statements of operations for the first six months of 2007 reflect only the expenses incurred by Yili Asphalt in that period, and none of the revenue or expenses previously reported by the Company for that period.

The $249,901 in revenue reported by ASAP Expo for the first six months of 2008 arose primarily from its business of selling exhibit space at trade shows, in particular the show that ASAP Expo promotes each February. Trade show business is seasonal, however, with revenue typically peaking at the time of the ASAP Global Sourcing shows held in February and August each year. In line with that trend, ASAP Expo realized $240,161 in revenue in the three months ended March 31, 2008 and only $9,740 during the three months ended June 30, 2008. By way of comparison, during the twelve months that ended on May 31, 2007, approximately 58% of annual tradeshow revenue was generated by ASAP Expo in connection with its August show and approximately 42% in connection with its February show. The revenue reported in this Quarterly Report for the three and six month periods ended June 30, 2008, therefore, is not necessarily indicative of the annual revenue that ASAP Expo will realize.

Of the $625,165 in expenses/(other income) reported by the Company for the first six months of 2008, $504,992 were attributable to the operations of ASAP Expo, including $411,784 incurred during the three months ended March 31, 2008 and $93,208 incurred during the three months ended June 30, 2008. These expenses generally involve production costs, marketing expenses, promotion costs and travel expenses relating to the show staged in February. The $120,173 in expenses attributable to the operations of Yili Asphalt during the six months ended June 30, 2008 ($47,085 in the three months ended June 30, 2008) primarily involved expenses related to its activities in completing its factory, finalizing the development of its products, and securing the government licenses necessary for it to carry out its business plan. In addition, Yili Asphalt now incurs expenses resulting from its new status as a U.S. public company and its efforts to enter into the U.S. capital market.

ASAP Expo realized a net loss of $255,091 for the six months ended June 30, 2008, and a net loss of $83,468 for the three months ended June 30, 2008. Yili Asphalt realized a net loss of $120,173 for the six month period and $47,085 for the three month period ended June 30, 2008. The consolidated net loss for the Company was $375,264 during the six months ended June 30, 2008 and $130,553 during the three months ended June 30, 2008. In each case, the net loss was not materially different than the net loss recorded by the Company for the first half and second quarter of 2007, as the reduction in loss by Yili Asphalt from 2007 to 2008 has been offset by the losses recorded by ASAP Expo. The level of operations exhibited in this Report is likely to continue in the immediate future until (a) the Company terminates its relationship with ASAP Expo and/or (b) Yili Asphalt obtains the funds needed to commence commercial-scale production.

The business of Yili Asphalt operates primarily in Chinese Renminbi, but we report our results in our SEC filings in U.S. Dollars. The conversion of our accounts from RMB to Dollars results in translation adjustments, which are reported on our Consolidated Statements of Operations as a middle step between net income and comprehensive income. The net income is added to the retained earnings on our balance sheet; while the translation adjustment is added to a line item on our balance sheet labeled "accumulated other comprehensive income," since it is more reflective of changes in the relative values of U.S. and Chinese currencies than of the success of our business. In the first six months of 2008, the effect of converting our financial results to Dollars was to add $427,184 to our comprehensive income.

Liquidity and Capital Resources

The Company's agreement with the management of ASAP Expo provides that ASAP Expo will, after it is spun-off to the Company's shareholders, indemnify the Company against any liabilities that arose prior to August 13, 2007 or that relate to the business of ASAP Expo. For this reason, the discussion of liquidity and capital resources below involves the business plan and resources of Yili Asphalt only.

Management anticipates that Yili Asphalt will commence revenue-producing operations in the coming months. In order to do so, however, Yili Asphalt will have to obtain approximately $500,000 in working capital to fund the initiation of operations. Management plans to approach a Chinese bank in order to borrow those funds from a Chinese bank on a secured basis, since Yili Asphalt has $8.9 million in capital assets on its books that are currently free of liens. To date, however, it has not obtained a commitment for the funds. If there is a delay in securing the necessary funds, the date for initiation of revenue-producing operations will be likewise delayed.

Because the Company's refining process yields three different end products (asphalt, diesel fuel, lubricants), the Company's initial operations will entail a sudden increase in working capital demands. Among the more significant funding demands will be:

- Inventory. Yili Asphalt will have to fund the carrying cost of a large inventory of products, including the investment in raw petroleum, the cost of storage, and the cost of transportation.

- Marketing. Yili Asphalt intends to engage in direct marketing of all products lines. Management expects that its direct marketing program will prove to be more efficient over the long term than a distribution network. However, the initial burden on its working capital will be considerable, as Yili Asphalt will have to carry the full cost of a sales staff, the expenses of their marketing activities, such as travel, entertainment, and promotion, and the expenses attendant to sales accounting.

- Potentially Inefficient Use of Facilities. To optimize the utilization of our refinery, we will have to generate sales of our products in the proportions in which the refinery is designed to produce them: roughly 6:3:2 for fuel, asphalt and lubricants respectively. It is unlikely that sales will occur naturally in those proportions. If sales in one or two of the categories lag the other(s), management will face the Hobson's choice of delaying production in the faster selling category, thus losing the benefit of the demand for that category, or tolerating excess inventories of the slower selling categories. This situation would result in additional demands on our working capital.

In addition to our need for working capital to initiate production, our business plan calls for substantial capital investment over the next twelve months. The primary purposes for which we anticipate a need for capital are:

- Additional Working Capital for Growth. We believe there is a high demand for our products in Inner Mongolia and the neighboring provinces. If we are correct, then demand could enable us to quickly expand our operations to full capacity. Growth at that rapid rate would require a commitment of many millions of Dollars for working capital. Our management will have to assess the value of the market opportunities that present themselves, and weight them against the cost of such capital as may be made available to us.

- Construction of Dedicated Rail Line. The government of Inner Mongolia has committed to construct a rail line that will have a siding at our refinery. Construction is scheduled in 2008. The benefit to us in terms of reduced transportation costs would be substantial. The government's proposal, however, contemplates that Yili Asphalt will make a substantial capital contribution toward the construction project. The amount of the contribution has not been determined.

- Acquisition of Refinery. Chunshi Li, our Chairman, has committed to purchase Mongolia Kailu Yili Asphalt Co., Ltd., an asphalt company with a production capacity of 100,000 tons. He intends to assign his rights in Mongolia Kailu to Yili Asphalt if we are able to fund the cost. The purchase price will be 20 million RMB (approximately $2.7 million). In addition, Mongolia Kailu is currently unproductive due to deterioration of its facilities. In order to bring it back online, we will have to fund the construction of a waterproof coiled material production line at its plant, which will entail an investment of several million more Renminbi.

At the present time, we have received no commitments for the funds required for our planned capital investments. Obtaining those funds, if we can do so, will require that we issue substantial amounts of equity securities or incur significant debts. We believe that the expected return on those investments will justify the cost. However, our plan, if accomplished, will significantly increase the risks to our liquidity.

Off-Balance Sheet Arrangements

The Company has no any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on its financial condition or results of operations.

Risk Factors That May Affect Future Results

You should carefully consider the risks described below before buying our common stock. If any of the risks described below actually occurs, that event could cause the trading price of our common stock to decline, and you could lose all or part of your investment.

Because we have not yet commenced our petroleum production operations, unexpected factors may hamper our efforts to implement our business plan.

We will not record our first sale of petroleum products until we secure working capital. Our business plan contemplates that we will engage in a three-pronged marketing operation, involving production and sales of diesel fuel, asphalt as well as lubricants. Implementation of that business plan will also entail complex production operations and an active sales force. Because these are areas in which we have limited experience, problems may occur with production or marketing that we have not anticipated, which would interfere with our business, and prevent us from achieving profitability.

Our profits will be limited unless we are able to secure a sufficient supply of heavy oil.

We manufacture our products by refining petroleum. The price of petroleum on both the Chinese market and the international market is much higher today than it was five years ago, and our expectation is that the price will remain high for the foreseeable future. Particularly in China, which has experienced unprecedented industrial growth in the past twenty years, the demand for petroleum exceeds the supply. Therefore, in order to achieve efficient operations, it will be necessary for us to develop redundant sources of heavy oil, as we cannot rely on one or two relationships to provide the steady flow of oil that we will need. If we are unable to achieve that redundancy and have interruptions in our petroleum supplies, our profitability will be limited.

Fluctuations in oil prices could impede our efforts to achieve profitability.

The market price of crude oil fluctuates dramatically, driven by economic, political and geological factors that are completely outside our control. We do not intend to engage in hedging against changes in crude oil prices. As a result, a sudden increase in the cost of our raw material – i.e. oil – could reduce or eliminate our profit margin. Although we could respond to the increase by a proportionate increase in our price list, competitive forces might prevent us from doing so – in particular competition from asphalt and diesel fuel producers that are themselves oil producers and are thus shielded from the full effect of increased oil prices.

The capital investments that we plan for the next two years may result in dilution of the equity of our present shareholders.

Our business plan contemplates that we will invest at least 30 million RMB ($3.8 million) in working capital and acquisitions during the next twelve months, and an undetermined amount in the development of a rail line to our refinery. We intend to raise a portion of the necessary funds by selling equity in our company. At present we have no commitment from any source for those funds. We cannot determine, therefore, the terms on which we will be able to raise the necessary funds. It is possible that we will be required to dilute the value of our current shareholders' equity in order to obtain the funds. If, however, we are unable to raise the necessary funds, our growth will be limited, as will our ability to compete effectively.

A recession in China could significantly hinder our growth.

The growing demand for petroleum products in China has been swelled, in large part, by the recent dramatic increases in industrial production in China. The continued growth of our market will depend on continuation of recent improvements in the Chinese economy. If the Chinese economy were to contract and investment capital became limited, construction projects would be delayed or abandoned, and the demand for our asphalt would be reduced. Many financial commentators expect a recession to occur in China in the near future. The occurrence of a recession could significantly hinder our efforts to implement our business plan.

Increased environmental regulation could diminish our profits.

The refining of petroleum involves the production of pollutants. In addition, the transportation of petroleum products entails a risk of spills that may result in long-term damage to the environment. At the present time we estimate that our compliance with applicable government regulations designed to protect the environment will cost us 1 million RMB (approximately $125,000) per year. There is increasing concern in China, however, over the degradation of the environment that has accompanied its recent industrial growth. It is likely that additional government regulation will be introduced in order to protect the environment. Compliance with such new regulations could impose on us substantial costs, which would reduce our profits.

Our business and growth will suffer if we are unable to hire and retain key personnel that are in high demand.

Our future success depends on our ability to attract and retain highly skilled petroleum engineers, production supervisors, transportation specialists and marketing personnel. In general, qualified individuals are in high demand in China, and there are insufficient experienced personnel to fill the demand. In a specialized scientific field, such as ours, the demand for qualified individuals is even greater. If we are unable to successfully attract or retain the personnel we need to succeed, we will be unable to implement our business plan.

We may have difficulty establishing adequate management and financial controls in China.

The People's Republic of China has only recently begun to adopt the management and financial reporting concepts and practices that investors in the United States are familiar with. We may have difficulty in hiring and retaining employees in China who have the experience necessary to implement the kind of management and financial controls that are expected of a United States public company. If we cannot establish such controls, we may experience difficulty in collecting financial data and preparing financial statements, books of account and corporate records and instituting business practices that meet U.S. standards.

Government regulation may hinder our ability to function efficiently.

The national, provincial and local governments in the People's Republic of China are highly bureaucratized. The day-to-day operations of our business require frequent interaction with representatives of the Chinese government institutions. The effort to obtain the registrations, licenses and permits necessary to carry out our business activities can be daunting. Significant delays can result from the need to obtain governmental approval of our activities. These delays can have an adverse effect on the profitability of our operations. In addition, compliance with regulatory requirements applicable to petroleum refining may increase the cost of our operations, which would adversely affect our profitability.

Capital outflow policies in China may hamper our ability to pay dividends to shareholders in the United States.

The People's Republic of China has adopted currency and capital transfer regulations. These regulations require that we comply with complex regulations for the movement of capital. Although Chinese governmental policies were introduced in 1996 to allow the convertibility of RMB into foreign currency for current account items, conversion of RMB into foreign exchange for capital items, such as foreign direct investment, loans or securities, requires the approval of the State Administration of Foreign Exchange. We may be unable to obtain all of the required conversion approvals for our operations, and Chinese regulatory authorities may impose greater restrictions on the convertibility of the RMB in the future. Because most of our future revenues will be in RMB, any inability to obtain the requisite approvals or any future restrictions on currency exchanges will limit our ability to pay dividends to our shareholders.

Currency fluctuations may adversely affect our operating results.

Yili Asphalt generates revenues and incurs expenses and liabilities in Renminbi, the currency of the People's Republic of China. However, as a subsidiary of the Company, it will report its financial results in the United States in U.S. Dollars. As a result, our financial results will be subject to the effects of exchange rate fluctuations between these currencies. From time to time, the government of China may take action to stimulate the Chinese economy that will have the effect of reducing the value of Renminbi. In addition, international currency markets may cause significant adjustments to occur in the value of the Renminbi. Any such events that result in a devaluation of the Renminbi versus the U.S. Dollar will have an adverse effect on our reported results. We have not entered into agreements or purchased instruments to hedge our exchange rate risks.

We have limited business insurance coverage.

The insurance industry in China is still at an early stage of development. Insurance companies in China offer limited business insurance products, and do not, to our knowledge, offer business liability insurance. As a result, we do not have any business liability insurance coverage for our operations. Moreover, while business disruption insurance is available, we have determined that the risks of disruption and cost of the insurance are such that we do not require it at this time. Any business disruption, litigation or natural disaster might result in substantial costs and diversion of resources.

The Company is not likely to hold annual shareholder meetings in the next few years.

Management does not expect to hold annual meetings of shareholders in the next few years, due to the expense involved. The current members of the Board of Directors were appointed to that position by the previous directors. If other directors are added to the Board in the future, it is likely that the current directors will appoint them. As a result, the Company's shareholders will have no effective means of exercising control over the Company's operations.

ITEMQUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK
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Not applicable.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. Our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of our disclosure controls and procedures as of June 30, 2008. Pursuant to Rule13a-15(e) promulgated by the Securities and Exchange Commission pursuant to the Securities Exchange Act of 1934, "disclosure controls and procedures" means controls and other procedures that are designed to insure that information required to be disclosed by China Yili Petroleum in the reports that it files with the Securities and Exchange Commission is recorded, processed, summarized and reported within the time limits specified in the Commission's rules. "Disclosure controls and procedures" include, without limitation, controls and procedures designed to insure that information China Yili Petroleum is required to disclose in the reports it files with the Commission is accumulated and communicated to our Chief Executive Officer and Chief Financial Officer as appropriate to allow timely decisions regarding required disclosure. Based on his evaluation, our Chief Executive Officer and Chief Financial Officer concluded that China Yili Petroleum's system of disclosure controls and procedures was effective as of June 30, 2008 for the purposes described in this paragraph.

Changes in Internal Controls. There was no change in internal controls over financial reporting (as defined in Rule 13a-15(f) promulgated under the Securities Exchange Act or 1934) identified in connection with the evaluation described in the preceding paragraph that occurred during China Yili Petroleum's second fiscal quarter that has materially affected or is reasonably likely to materially affect China Yili Petroleum's internal control over financial reporting.

PART II - OTHER INFORMATION

Item 2. Changes in Securities and Small Business Issuer Purchase of Equity Securities

(c) Unregistered sales of equity securities

None.

(e) Purchases of equity securities

The Company did not repurchase any of its equity securities that were registered under Section 12 of the Securities Exchange Act during the 2nd quarter of fiscal 2008.

Item 6. Exhibits

31	Rule 13a-14(a) Certification
32	Rule 13a-14(b) Certification

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned thereunto duly authorized.

CHINA YILI PETROLEUM COMPANY

Date: August 14, 2008

By: /s/ Chunshi Li
Chunshi Li,
Chief Executive Officer

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