
CATHAY FOREST PRODUCTS CORP.
UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2009

CATHAY FOREST PRODUCTS CORP.

MARCH 31, 2009

CONTENTS

	Page
Interim Unaudited Consolidated Financial Statements:	
Consolidated Balance Sheets	1
Consolidated Statements of Operations and Deficit	2
Consolidated Statements of Comprehensive Income (Loss)	2
Consolidated Statements of Accumulated Other Comprehensive Income (Loss)	2
Consolidated Statements of Shareholders' Equity	3
Consolidated Statements of Cash Flows	4
Notes to the Consolidated Financial Statements	5-22

CATHAY FOREST PRODUCTS CORP.

CONSOLIDATED BALANCE SHEETS

(All amounts are in Canadian dollars)

	As at March 31, 2009	As at December 31, 2008
	(Unaudited)	(Audited)
ASSETS		
Current assets		
Cash and cash equivalents (note 4)	\$ 8,975,908	\$ 9,944,726
Accounts receivable (net)	1,885,761	1,971,238
Deposits and prepayments	3,707,976	5,016,876
Other receivables (note 13)	2,769,984	3,093,097
Inventories (note 5)	11,320,502	9,284,876
Current portion of long-term loans receivable (note 6)	7,874	2,005
Total current assets	<u>28,668,005</u>	<u>29,312,818</u>
Long-term loans receivable (note 6)	121,126	137,783
Property and equipment (net) (note 7)	16,595,260	17,828,633
Plantation assets (note 8)	75,851,601	69,964,502
Forestry rights (net) (note 9)	18,906,305	18,824,663
Intangible assets (note 10)	21,630	24,771
Deposits (note 11)	4,053,107	3,945,432
Goodwill	988,088	988,088
TOTAL ASSETS	<u>\$ 145,205,122</u>	<u>\$ 141,026,690</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 12)	\$ 72,848,350	\$ 67,014,830
Current portion of mortgage payable (note 14)	7,837	7,629
Current portion of unearned revenue	497,879	484,653
Total current liabilities	<u>73,354,066</u>	<u>67,507,112</u>
Due to related party (note 13)	5,537,157	5,390,055
Unearned revenue	854,998	901,747
Long term loan payable	35,119	34,185
Mortgage payable (note 14)	45,716	46,409
Total liabilities	<u>79,827,056</u>	<u>73,879,508</u>
Non controlling interest (note 17)	728,835	725,014
SHAREHOLDERS' EQUITY		
Capital stock (note 15)	72,151,841	72,151,841
Warrants (note 16)	1,061,635	1,061,635
Contributed surplus (note 15)	3,018,748	3,018,748
Accumulated other comprehensive income	3,872,723	4,527,752
Deficit	(15,455,716)	(14,337,808)
Total shareholders' equity	<u>64,649,231</u>	<u>66,422,168</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 145,205,122</u>	<u>\$ 141,026,690</u>

CATHAY FOREST PRODUCTS CORP.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
(All amounts are in Canadian dollars)

	Three months ended March 31	
	2009	2008
	(Unaudited)	(Unaudited)
Revenue	\$ 6,277,519	\$ 6,130,201
Cost of sales	5,001,471	5,320,174
Gross profit	<u>1,276,048</u>	<u>810,027</u>
Other receivables		
General and administrative	1,254,832	663,498
Selling and marketing	345,704	237,633
Foreign exchange gain	(28,210)	(82,981)
	<u>1,572,326</u>	<u>818,150</u>
Loss before undernoted	<u>(296,278)</u>	<u>(8,123)</u>
Amortization (note 18)	848,083	335,636
Interest income	(11,195)	(329,946)
Interest expense	512	669
Loss before income taxes and non controlling interest	(1,133,678)	(14,482)
Non controlling interest	<u>15,770</u>	<u>(44,535)</u>
Net loss	(1,117,908)	(59,017)
Deficit - beginning of period	<u>(14,337,808)</u>	<u>(9,805,578)</u>
Deficit - end of period	<u>\$ (15,455,716)</u>	<u>\$ (9,864,595)</u>
Net loss per share (note 19)		
Basic and diluted	<u>\$ (0.010)</u>	<u>\$ (0.001)</u>
Weighted Average- Common Shares Outstanding		
Basic and diluted	<u>112,524,714</u>	<u>111,608,047</u>

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(All amounts are in Canadian dollars)

	Three months ended March 31	
	2009	2008
	(Unaudited)	(Unaudited)
Net Loss	\$ (1,117,908)	\$ (59,017)
Other comprehensive income (loss), net of tax:		
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	(655,029)	1,190,970
Total comprehensive income (loss)	<u>\$ (1,772,937)</u>	<u>\$ 1,131,953</u>

CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)
(All amounts are in Canadian dollars)

	Three months ended March 31	
	2009	2008
	(Unaudited)	(Unaudited)
Balance - beginning of period	\$ 4,527,752	\$ (389,190)
Other comprehensive income (loss)	(655,029)	1,190,970
Balance - end of the period	<u>\$ 3,872,723</u>	<u>\$ 801,780</u>

CATHAY FOREST PRODUCTS CORP.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(All amounts are in Canadian dollars)
(Unaudited)

	Common shares		Warrants	Contributed Surplus	Accumulated Other Comprehensive Income (loss)	Deficit	Total Shareholders' Equity
	#	\$					
Balance, December 31, 2007	111,374,714	70,551,627	1,183,849	3,018,748	(389,190)	(9,805,578)	64,559,456
Issuance of shares as settlement of liability	800,000	1,296,000	-	-	-	-	1,296,000
Warrants exercised	350,000	304,214	(122,214)	-	-	-	182,000
Net unrealized (loss) gain on translation of self-sustaining foreign subsidiaries	-	-	-	-	4,916,942	-	4,916,942
Net loss	-	-	-	-	-	(4,532,230)	(4,532,230)
Balance, December 31, 2008	112,524,714	72,151,841	1,061,635	3,018,748	4,527,752	(14,337,808)	66,422,168
Net unrealized (loss) gain on translation of self-sustaining foreign subsidiaries	-	-	-	-	(655,029)	-	(655,029)
Net loss	-	-	-	-	-	(1,117,908)	(1,117,908)
Balance, March 31, 2009	112,524,714	72,151,841	1,061,635	3,018,748	3,872,723	(15,455,716)	64,649,231

See accompanying notes to consolidated financial statements.

CATHAY FOREST PRODUCTS CORP.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(All amounts are in Canadian dollars)

(Unaudited)

Three months ended March 31

2009 **2008**

Cash flows from operating activities		
Net Loss	\$ (1,117,908)	\$ (59,017)
Items not affecting cash:		
Amortization	848,083	335,736
Non controlling interest	(15,770)	44,535
Net change in non-cash items from operations		
Accounts receivable	104,206	(1,849,307)
Deposits and prepayments	1,390,918	(2,980,937)
Other receivables	125,375	366,928
Inventories	(1,813,312)	510,446
Accounts payable and accrued liabilities	814,989	451,731
Unearned revenue	(70,485)	802,482
Cash provided by (used in) operating activities	266,096	(2,377,403)
Cash flows from investing activities		
Reduction to short-term investment	-	4,251,539
Decrease (increase) in long-term loans receivable	463	(66,996)
Purchase of property and equipment	(764,024)	(1,870,797)
Investment in plantation assets	(560,960)	(173,376)
Deposits	-	(1,057,465)
Cash provided by (used in) investing activities	(1,324,521)	1,082,905
Cash flows from financing activities		
Short term loan financing	-	(175,698)
Advance from related party	-	25,758
Mortgage payable	(1,936)	2,789
Issuance of capital stock	-	182,000
Cash flow provided by (used in) financing activities	(1,936)	34,849
Effect of exchange rate changes on cash	91,543	(494,209)
Net change in cash and cash equivalents	(968,818)	(1,753,858)
Cash and cash equivalents - beginning of period	9,944,726	36,890,391
Cash and cash equivalents - end of period (note 4)	\$ 8,975,908	\$ 35,136,533
Supplemental information		
Interest paid	\$ 512	\$ 669
Non-cash transaction		
Accrued liabilities related to plantation assets	\$ 3,380,329	\$ 13,445,697

See accompanying notes to consolidated financial statements.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

1. Organization and Basis of Presentation

Nature of Business

Cathay Forest Products Corp. (the “Company”) is incorporated under the Canada Business Corporations Act and is engaged in the development of tree plantations, sub-concession of harvesting rights and log trading in the People’s Republic of China (“PRC”) and a forest harvesting operations in the Russian Federation (“Russia”).

Basis of Consolidation

The unaudited interim consolidated financial statements include the accounts of the Company and all of its subsidiaries. All significant intercompany balances and transactions have been eliminated on consolidation.

These unaudited interim consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles for interim financial statements and do not contain all of the information that is required for annual financial statements. Accordingly, they should be read in conjunction with the consolidated annual financial statements for the year ended December 31, 2008.

The unaudited interim consolidated financial statements follow the same accounting policies and methods of their application as the December 31, 2008 consolidated annual financial statements, except for changes described in Note 2 below.

Currency Presentation

All amounts in these financial statements are in Canadian dollars unless indicated with a “Rmb” to represent the Chinese Renminbi, “Rub” to represent the Russian Rouble or “US” to represent a United States dollar denominated amount.

2. Changes in Accounting Policies

On January 1, 2009, the Company adopted the following new Canadian Institute of Chartered Accountants (the “CICA”) accounting standards.

Section 3064 – Goodwill and Intangible Assets and Section 1000 – Financial Statement Concepts

In February 2008, the CICA released new Handbook Section 3064 “Goodwill and intangible assets”, replacing Handbook Section 3062 “Goodwill and Intangible Assets” and Handbook Section 3450 “Research and development costs”. The CICA also amended Handbook Section 1000 “Financial Statements Concepts” to provide consistency with this new standard. Section 3064 establishes standards for the recognition, measurement, presentation and disclosure of goodwill subsequent to its initial recognition and of intangible assets by profit-oriented enterprises. This section clarifies that costs can be deferred only when they relate to an item that meets the definition of an asset and as a result start-up costs must be expensed as incurred. The provisions relating to the definition and initial

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

recognition of intangible assets, including internally generated intangible assets, are equivalent to the corresponding provisions of International Financial Reporting Standards IAS 38 “Intangible Assets”. Upon adoption, there was no impact on the Company’s consolidated financial statements.

Abstract EIC-173- Credit Risk and Fair Value of Financial Assets and Financial Liabilities

In January 2009, the CICA issued the Emerging Issues Committee (EIC) Abstract EIC-173, “Credit Risk and the Fair Value of Financial Assets and Financial Liabilities”, effective for interim and annual financial statements ending on or after January 20, 2009. The adoption of this new standard had no impact on the Company’s presentation of its financial position or results of operations as at March 31, 2009.

3. New Accounting Pronouncements

Section 1582 – Business Combinations

This section replaces CICA Section 1581 “Business Combinations” and improves the relevance, reliability and comparability of the information that the entity provides in its financial statements about a business combination and its effects. This section is applicable to the annual and interim financial statements of the Company beginning on or after January 1, 2011, with early adoption permitted. The Company is in the process of evaluating the impact of this standard.

Section 1601 – Consolidations and Section 1602- Non-controlling Interests

The CICA Section 1601 establishes standards for the preparation of consolidated financial statements. CICA Section 1602 establishes standards for accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are applicable to interim and annual financial statements of the Company beginning on January 1, 2011. The Company is in the process of evaluating the impact of these standards.

Harmonizing of Canadian and International Financial Reporting Standards

In February, 2008, the Accounting Standards Board (“AcSB”) of the CICA confirmed that Canadian GAAP for publicly accountable enterprises will be converged with International Financial Reporting Standards (“IFRS”) effective in the calendar year 2011. The conversion to IFRS will be required, for the Company, for interim and annual financial statements beginning on January 1, 2011. IFRS uses a conceptual framework similar to Canadian GAAP, but there are significant differences on recognition, measurement and disclosures. In the period leading up to the conversion, the AcSB will continue to issue accounting standards that are converged with IFRS such as IAS 2 “Inventories” and IAS 38 “Intangible Assets”, thus mitigating the impact of adopting IFRS at the mandatory transition date. The Company continues to monitor changes arising from this convergence and, as required by CSA Staff Notice 52-320, the Company has included a discussion of the key elements and timing of its IFRS changeover plan in its annual Management’s Discussion and Analysis (“MD&A”).

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

4. Cash and Cash Equivalents

Cash and cash equivalents are comprised of the following:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Cash held in banks	\$ 8,975,908	\$7,294,726
Cash held as term deposits	_____ -	<u>2,650,000</u>
Cash and cash equivalents	<u>\$ 8,975,908</u>	<u>\$9,944,726</u>

Cash held as term deposits represented short term guaranteed investment certificates with a Canadian chartered bank bearing interest at 1.6% which matured in January 2009.

5. Inventories

Inventory components consist of wood products in transit for sale and spare parts inventory for forestry machines.

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Wood Products	\$10,844,326	\$8,861,501
Spare parts for forestry machines	<u>476,176</u>	<u>423,375</u>
Total	<u>\$11,320,502</u>	<u>\$9,284,876</u>

At March 31, 2009 wood products inventory represents the value of logs held for resale in China and Russia. The spare parts for forestry machines value represents inventory supplies of goods located at the Company's Russian operations.

6. Long Term Loans Receivable

Long-term loans receivable totalling \$129,000 (December 31, 2008- \$139,788) represents interest free loans given to two senior employees of the Russian subsidiary. The loans are unsecured, subject to agreements with the employees and are repayable over a 60 month period beginning December 2008 in equal instalments of \$155 in one instance and in the second case repayment is to start in January 2010 in equal instalments of \$1,985. Should the employment of the employees with the Company cease, the loans will become payable in full 10 days following the last day of employment.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

	March 31, 2009	December 31, 2008
	(Unaudited)	(Audited)
Loans receivable	\$129,000	\$139,788
Current portion of loans receivable	(7,874)	(2,005)
Long term loans receivable	\$121,126	\$ 137,783

7. Property and Equipment

March 31, 2009	Cost	Accumulated Amortization (Unaudited)	Net Book Value
Automobiles	\$830,486	\$422,847	\$407,639
Buildings	671,597	180,818	490,779
Leasehold Improvements	191,993	69,225	122,768
Machinery and Equipment	10,953,049	1,648,629	9,304,420
Office Furniture	232,927	136,954	95,973
Construction in Progress	6,173,681	-	6,173,681
Total	\$19,053,733	\$2,458,473	\$16,595,260

December 31, 2008	Cost	Accumulated Amortization (Audited)	Net Book Value
Automobiles	\$ 834,851	\$257,189	\$577,662
Buildings	653,756	161,236	492,520
Leasehold Improvements	186,893	58,976	127,917
Machinery and Equipment	10,891,997	1,165,741	9,726,256
Office Furniture	228,308	111,397	116,911
Construction in Progress	6,787,367	-	6,787,367
Total	\$19,583,172	\$1,754,539	\$17,828,633

Construction in Progress represents the amount expended to date for the construction of infrastructure in Russia. This infrastructure currently under construction consists of the main logging road, railway spur line, shipping and sorting site and base camp facilities. As each of these projects is completed and receives government certification, the project cost is transferred to the appropriate capital asset category and amortization is calculated from that point forward.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

8. Plantation Assets

All of the Company's plantation assets are located in the PRC and are owned by subsidiaries which take the PRC legal form of joint ventures and wholly foreign owned enterprises. As at March 31, 2009, the subsidiaries, collectively, had approximately 14,101 hectares ("ha") (December 31, 2008 - 13,786 ha) planted under management. To date, the Forest Bureau has not yet issued a Forestry Certificate to the various Chinese subsidiaries. Such certificate shall be issued once the individual subsidiaries are satisfied with the growth and quality of the saplings. The Company is not responsible for the liabilities associated with the planting of these saplings should the management of the specific subsidiaries not be satisfied with the growth and quality of the saplings.

9. Forestry Rights

In September 2006, the company acquired land use and harvesting rights through its PRC company Jiangxi Cathay Forest Co. Ltd. The cost of the investment is being amortized on a straight line basis over a 30 year period.

At March 31, 2009, in addition to its plantation assets, the Company via its PRC companies has approximately 5,173 ha of standing timber assets in Jiangxi Province and is currently managing 6,996 ha in Guizhou Province.

Through its investment made in 2007 in the Russian company DalEuroLes L.L.C., the Company obtained controlling interest in 271,000 ha of standing timber in Far East Russia. The cost of the investment is being amortized over the term of the land lease concession beginning January, 2008.

In July 2008, the Company entered into a 49 year land lease agreement for forestry rights to an additional 721,198 ha concession in Russia for cash consideration totalling \$8,142,620. The cost of the investment in the second concession is currently not being amortized as operations on this property have not started as at March 31, 2009.

	March 31, 2009	December 31, 2008
Cost	\$19,557,894	\$19,641,862
Accumulated Amortization	651,589	817,199
Net Book Value	\$18,906,305	\$18,824,663

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

10. Intangible Assets

Intangible assets represent acquired intellectual property that relates to the technology involved with the fast growth plantations. These assets are being amortized on a straight-line basis over a 5 year period.

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Cost	\$ 76,342	\$ 74,313
Accumulated Amortization	<u>(54,711)</u>	<u>(49,542)</u>
Balance	<u>\$ 21,630</u>	<u>\$ 24,771</u>

11. Deposits

In July 2007, the Company entered into a strategic cooperation agreement for the development of standing timber properties in the Guizhou Province in China. Under terms of the agreement, the Company will acquire a 51% ownership interest, at a cost of approximately \$7,500,000, of a plantation currently wholly owned by the strategic partner pending the completion of certain approvals and transfer agreements. In conjunction with entering into the agreement, the Company has made initial contributions to this project totalling \$4,128,523 (Rmb 23,000,000) of which \$183,091 (Rmb 1,020,000) has been applied to the initial share capital (which has been eliminated on consolidation) for setting up a new company for the purpose of this project. At March 31, 2009, the outstanding deposits totalled \$4,053,107 (Rmb 21,980,000) (December 31, 2008 - \$3,945,432 – Rmb 21,980,000)

12. Accounts payable and accrued liabilities

Included in Accounts payable and accrued liabilities is \$67,692,781 (December 31, 2008 - \$62,688,949) which relates to the accrued land leases for plantations. This amount is calculated based on the contractual terms of the land lease agreements plus maintenance and planting costs associated with the plantation assets. Although the amounts are shown as current liabilities for the purpose of these financial statements, management has reached an understanding with the lessor and suppliers to defer the actual payment of the liabilities until the plantations are harvested. Accruals made by management in this regard may be different from those determined by the Company's vendors. The effect on the financial statements resulting from such adjustments, if any, could be significant.

13. Related Party Transactions

Amounts due from/to related parties are receivable and payable to entities controlled by shareholders, officers or directors of the Company. Related party transactions are with these related parties.

At March 31, 2009, included in other receivables are loans to a related company controlled by the same management

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

team totalling \$36,511 (Rmb 198,000) (December 31, 2008 - \$63,005 - Rmb 351,000). This balance relates to short term advances from the Company and are unsecured, non-interest bearing and repayable on demand.

The Company may borrow funds from time to time from related parties. To date these cash advances have been unsecured, non-interest bearing and payable on demand. As at March 31, 2009, there were advances by the minority shareholder of the export trading company totalling \$5,537,157 (December 31, 2008- \$5,390,055). The related party has agreed not to demand payment of the outstanding amount during 2009.

14. Mortgage Payable

The Company has entered into a mortgage agreement for a residential property in the Jiangxi Province of China.

At March 31, 2009, the principal outstanding is \$53,553 (Rmb 290,417). For December 31, 2008 principal outstanding was \$54,037 (Rmb 301,042). Interest is set at 5.8% and the principal is repayable at \$653 (Rmb 3,542) per month plus interest. The mortgage matures in January 2016.

The annual minimum required principal repayments are as follows:

2010	\$7,837
2011	7,837
2012	7,837
2013	7,837
2014	7,837
Thereafter	<u>14,368</u>
Total	53,553
Short term obligation	<u>(7,837)</u>
Long term obligation	<u>\$45,716</u>

15. Capital Stock

The Company is authorized to issue an unlimited number of common shares without par value. Each common share entitles the holder to one vote.

During the fiscal year ending December 31 2008, the Company had the following capital transactions:

1. issued 350,000 common shares upon the exercise of warrants at \$0.52 per unit;
2. issued 800,000 common shares from treasury in settlement of the DalEuroLes L.L.C. transaction at an agreed value of \$1,296,000.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

	No. of Shares	Share Capital	Contributed Surplus
Balance as at December 31, 2007	111,374,714	\$70,551,627	3,018,748
Exercise of warrants	350,000	182,000	-
Allocation from warrants	-	122,214	-
Issuance of shares as settlement of DalEuroLes payable	800,000	1,296,000	-
Balance as at December 31, 2008	112,524,714	\$72,151,841	\$3,018,748
Balance as at March 31, 2009	112,524,714	\$72,151,841	\$3,018,748

During the three month period ending March 31, 2009, there were no transactions involving share capital.

16. Options and Warrants

(a) Stock Options

The Company is authorized under a stock option plan approved by the shareholders to issue stock options to its directors, officers, employees and consultants up to an amount not exceeding 10% of the issued and outstanding common shares.

The option period for options granted under the Plan is for a maximum period of 5 years. Options granted may be vested over certain time periods within the option period, which will limit the number of options that may be exercised. Each option is exercisable into one common share of the Company at the price specified in the terms of the option.

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, the option valuation model requires the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing model does not necessarily provide a reliable single measure of the fair value of its employee stock options.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

The following table is a summary of stock option plan activity:

	To March 31, 2009		To December 31, 2008	
	(Unaudited)		(Audited)	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Balance at beginning of the period	4,190,000	\$ 0.93	4,190,000	\$ 0.93
Granted	Nil	Nil	Nil	Nil
Exercised	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>
Balance at end of the period	<u>4,190,000</u>	<u>\$ 0.93</u>	<u>4,190,000</u>	<u>\$ 0.93</u>

During the three months ended March 31, 2009, the Company recorded \$nil (2008- \$nil) stock based compensation expense.

The fair value for these options was estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	<u>May 2007</u>	<u>December 2005</u>	<u>May 2005</u>
Number of Options	1,830,000	1,475,000	2,490,000
Exercise price	\$1.25	\$ 0.80	\$ 0.60
Expected option life	5 years	5 years	5 years
Risk free interest rate	3.75%	4.50%	3.75%
Volatility	98.6%	50%	35%
Dividend yield	0.00%	0.00%	0.00%
Weighted average fair value of options granted	\$1.12	\$ 0.16	\$ 0.16

The following table summarizes the weighted average exercise price and the weighted average remaining contractual life of the options outstanding and exercisable as at March 31, 2009.

<u>Options Outstanding</u>	<u>Expiry Date</u>	<u>Outstanding Weighted Average Remaining Life</u>	<u>Outstanding Weighted Average Price</u>	<u>Exercisable Quantity</u>	<u>Exercisable Weighted Average Price</u>
1,420,000	May 2010	1.2 years	\$ 0.60	1,420,000	\$ 0.60
940,000	Dec 2010	1.8 years	\$ 0.80	940,000	\$ 0.80
1,830,000	May 2012	3.2 years	\$ 1.25	1,830,000	\$ 1.25

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

(b) Warrants

The following table summarizes information about the Company's warrants:

	<u>Number of Warrants</u>	<u>Stated Value</u>
Balance December 31, 2007	1,850,000	\$ 1,183,849
Exercised	<u>(350,000)</u>	<u>(122,214)</u>
Balance December 31, 2008	1,500,000	1,061,635
Exercised	<u>-</u>	<u>-</u>
Balance March 31, 2009	<u>1,500,000</u>	<u>\$1,061,635</u>

The Company has 1,500,000 warrants issued and outstanding as at March 31, 2009, with an exercise price of \$1.50 and expected option life not to exceed November 2009.

The fair values for the above warrants were estimated at the date of grant using a Black-Scholes option-pricing model with the following weighted-average assumptions:

	Broker Warrants
Issue Date	November 21, 2007
Number	1,500,000
Exercise Price	\$1.50
Expected Option Life	2 years
Risk free interest rate	4.0%
Volatility	96%
Dividend yield	0.0%
Fair Value at date of Grant	\$1,061,635

17. Non-Controlling Interest

The non controlling interest is comprised of the minority interest in the Company's subsidiaries which are consolidated in accordance with Canadian Generally Accepted Accounting Principles. The balances are as follows:

	<u>March 31, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Shanghai Shengtai Forest Company Limited	\$27,913	\$ 28,223
Henan Xinya Cathay Forest Products Company Limited	498,111	490,138
Jiangsu Cathay Forest Company Ltd.	58,933	58,421
Guizhou Hanfang Cathay Forestry Company Limited	143,878	148,232
Total	<u>\$728,835</u>	<u>\$ 725,014</u>

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

18. Amortization

Amortization expense includes the following:

	March 31, 2009	March 31, 2008
	(Unaudited)	(Unaudited)
Property and equipment	\$760,056	\$ 232,103
Intangibles	3,770	7,257
Forestry rights	84,257	96,276
	<u>\$848,083</u>	<u>\$335,636</u>

Capitalized within Construction in Progress is amortization of \$645,893 (March 31, 2008 –\$nil) representing amortization calculated for equipment used in the construction of roads and lower landing.

19. Net Loss Per Common Share

The calculation of diluted loss per common share excludes all options and warrants for all periods as they were anti-dilutive.

The following table presents the maximum number of shares that would be outstanding if all dilutive instruments were exercised or converted as at:

	March 31, 2009	December 31, 2008
	(Unaudited)	(Audited)
Weighted average common shares issued and outstanding (note 15)	112,524,714	112,106,818
Warrants outstanding (note 16)	1,500,000	1,500,000
Stock options outstanding (note 16)	4,190,000	4,190,000
	<u>118,214,714</u>	<u>117,796,818</u>

20. Commitments and Contingencies

(a) Operating Lease Commitments

The Company has entered into various operating leases for automobiles, equipment and office premises and is responsible for minimum lease payments. Under terms of the various leases, the Company's annual minimum future payments to March 31 are approximately as follows:

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

2010	\$250,612
2011	<u>96,878</u>
Total	<u>\$347,490</u>

(b) Management Fees and Consulting Fees Commitments

The Company has entered into various agreements relating to management and consulting services relating to plantation management and is responsible for minimum fee payments. Under terms of the various agreements, the Company's annual minimum future payments are approximately as follows:

2010	\$ 572,752
2011	417,112
2012	251,152
2013	251,152
2014	251,152
Thereafter	<u>209,294</u>
Total	<u>\$ 1,465,056</u>

(c) Land lease commitments

The Company has entered into various land rental agreements in several locations for its plantations. The lease payments for these properties are calculated on an annual basis and the amount is accrued, however the actual payment of the lease cost is contingent upon the timing of the harvest of the plantations. At March 31, 2009 the portion of the lease payments that could be payable contingent upon harvesting the plantation assets is as follows:

2010	\$13,108,863
2011	13,108,863
2012	13,108,863
2013	13,108,863
2014	8,319,147
Thereafter	<u>1,231,938</u>
Total	<u>\$ 61,986,537</u>

(d) Contingencies

From time to time, the Company may be exposed to claims and legal actions in the normal course of business, some of which may be initiated by the Company. As at March 31, 2009 no material claims were outstanding.

The enforcement of environmental regulation in Russia is evolving and the enforcement posture of government authorities is continually being reconsidered. The Company periodically evaluates its obligations under environmental regulations. As obligations are determined, they are recognized immediately. Potential

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

liabilities, which might arise as a result of changes in existing regulations, civil litigation or legislation, can not be estimated but could be material. In the current enforcement climate under existing legislation, management believes that the Company is in compliance with the Russian government's federal and regional requirements concerning environmental matters; therefore there are no significant liabilities for environmental damage and remediation recorded in the accounts.

(e) Plantation Assets

The Company's plantation assets are located in the PRC and owned by subsidiaries which take the PRC legal form of joint ventures and wholly foreign owned enterprises. As at March 31, 2009, approximately 14,101 hectares (ha) (December 31, 2008 – 13,786 ha) were planted. To date, the Company has received forestry certificates from the local government forest bureau for approximately 4,337 ha. The balance of the certificates shall be issued once the Chinese forestry authorities are satisfied with the growth and quality of the saplings. The subsidiaries are not required to pay for the liabilities associated with the planting of these saplings until such time as the management of the Sino Joint Ventures or Wholly Owned Foreign Entities have received the forestry certificates.

(f) Tax provision

The calculations of the provision for income taxes and other tax related liabilities are subject to various factors and estimates made by management in the course of preparing financial information. A change in factors and estimates used in the calculations could have a material impact on the Company's reported tax position.

The Company presently operates in countries, such as PRC and Russia, where civil laws apply. Similar to the situation of the new Land Appreciation Tax (LAT) towards the rental of property, the implementation of this tax varies among various PRC cities which make the application of the local tax authority to the national policy, not conclusive and uncertain.

One of the Company's subsidiaries adopted local practice in respect of the compilation of the value-added-tax submission. Such policy has certain inherent discrepancy compared to the national value-added tax policy. The Directors and the management of the subsidiary considered that satisfactory documentation had been submitted to the PRC authority in connection with those returns, and up to and inclusive until the date of the report, neither the Company, nor its subsidiary have received any notification from the tax authority regarding the subject matter. Accordingly, no additional provision for taxation has been made in respect of this subsidiary. In the event as stated above that a difference of opinion exists toward the interpretation of the tax policy by the respective authorities, the Company might be required to make further submissions and clarifications due to the uncertainty as highlighted, consequential additional tax liability might result.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

21. Segmented Information

The Company operates in one industry segment, forestry products.

The geographic source of the Company's revenue from external customers is as follows:

	March 31, 2009 (Unaudited)	March 31, 2008 (Unaudited)
Canada	\$ 551,947	\$ -
China	5,358,722	6,130,201
Russia	366,850	-
Total	\$ 6,277,519	\$ 6,130,201

The geographic location of the Company's property and equipment, forestry rights and intangible assets are as follows as at:

	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)
Canada	\$ 1,381	\$ 3,781
China	7,149,390	7,066,084
Russia	28,372,424	29,608,202
	\$35,523,195	\$ 36,678,067

The plantation assets, long-term deposits, and goodwill balances were derived from transactions based in China.

22. Financial Instruments

Under Canadian generally accepted accounting principles, all financial instruments must be classified into a defined category, namely, held-to-maturity investments, available for sale investments, loans and receivables, held-for-trading financial assets or financial liabilities and other financial liabilities.

The carrying values of the Company's financial instruments are classified into the following categories:

	March 31, 2009 (Unaudited)	December 31, 2008 (Audited)
Held for trading (a)	\$ 8,975,908	\$ 9,944,726
Loans and receivables (b)	4,784,745	5,204,123
Other financial liabilities (c)	78,474,179	72,493,104

(a) Cash and cash equivalents and short-term investments, measured at fair value.

(b) Accounts receivable, other receivables, and long-term loans receivable measured at amortized cost using the effective interest rate method.

(c) Accounts payable and accrued liabilities, due to related party, long term loan payable and mortgage payable measured at amortized cost.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

Fair Value

Fair value estimates of financial instruments are made at a specific point in time, based on relevant information about financial markets and specific financial instruments. As these estimates are subjective in nature, involving uncertainties and matters of significant judgement, they cannot be determined with precision. Changes in assumptions can significantly affect estimated fair values.

The carrying values of cash and cash equivalents, short term investments, other receivables, accounts receivable and accounts payable and accrued liabilities approximate their fair value because of the short-term nature of these instruments.

The carrying value of the mortgage payable approximates its fair value due to the fact that there have been minimal changes in the prevailing interest rates and the long-term profile of the Company has not significantly changed. The carrying value of long-term loans receivable and long-term loan payable approximate their fair value as the prevailing interest rate is not significantly different from the existing rates on the loans.

The fair value of the amount due to related party is not determinable as there is no comparable market data.

Credit Risk

Credit risk is the risk of financial loss to the Company if a customer fails to meet its contractual obligations, and arises principally from the Company's accounts receivable, long-term loans receivable and other receivables. The carrying amount of financial assets represents the maximum credit exposure.

The Company's cash and cash equivalents subject the Company to a significant concentration of credit risk. The cash and cash equivalents balances are held in bank accounts in various geographic regions.

The Company's credit procedure is to review each new customer for credit worthiness before the standard terms and conditions are offered. The Company's exposure to credit risk with its customers is influenced mainly by the individual characteristic of each customer. Substantially all of the Company's customers are located in China.

As at March 31, 2009, accounts receivables from customers located outside Canada represented 100% of the accounts receivable balance and all accounts were outstanding for less than 30 days.

To date the Company has not established an allowance for doubtful accounts.

Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's exposure to liquidity risk is dependent on the value of inventories, collection of accounts receivable, investment in timber holdings, property and equipment, the settlement of obligations which includes (current liabilities as they become due, due to related party which will be payable after 2009 and the commitments as

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

disclosed in Note 20 and the ability to raise funds in order to meet commitments and sustain operations.

The Company controls liquidity by managing its working capital and cash flows as well as obtaining additional equity infusion, if required.

Operating Environment of the Company

The Russian and PRC economies continue to display some characteristics of emerging markets. These characteristics include, but are not limited to the existence of currencies that are not freely convertible in most countries outside of Russia or PRC. The tax, currency and customs legislation within Russia and PRC are subject to varying interpretations, and changes, which can occur frequently.

While there have been improvements in the economic trends, the future economic direction of Russia and PRC is largely dependent upon the effectiveness of economic, financial and monetary measures undertaken by the Government together with tax, legal and political developments.

Currency risk

The Company is subject to currency risk arising from these financial instruments in the normal course of business.

As at March 31, 2009, the Company had foreign currency denominated amounts of approximately:

	China		Russia	
	Rmb	Cdn\$	Rub	Cdn\$
Cash	19,985,733	\$ 3,685,365	78,998	\$ 2,934
Accounts Receivable and Other Receivables	10,037,047	1,850,830	75,431,778	2,801,541
Liabilities	410,544,704	75,704,353	100,545,970	3,734,284

As at December 31, 2008, the Company had foreign currency denominated amounts of approximately:

	China		Russia	
	Rmb	Cdn\$	Rub	Cdn\$
Cash	20,777,074	\$ 3,729,505	2,401,000	\$ 96,280
Accounts Receivable and Other Receivables	10,893,117	1,955,325	77,458,000	4,272,987
Liabilities	392,580,381	70,468,565	55,217,000	2,214,198

A fluctuation of +/- 1% provided as an indicative range in currency movement, on financial instruments that are denominated in foreign currency other than Canadian dollars, with, all other things being equal, have an effect on

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

the results from operations and other comprehensive income of approximately \$694,734 in the case of Rmb denominated financial instruments and approximately \$10,000 for Rouble denominated financial instruments.

The Company monitors its net exposure to foreign currency fluctuations in each country and attempts to minimize the impact of the fluctuations by aligning appropriate levels of Rmb and Rub denominated liabilities with cash held in Rmb and Rub with future cash flows from the China and Russia operations.

The Company as not entered into any currency hedging contracts.

Interest Rate Risk

Fluctuations in interest rates would have no effect on the results from operations as the Company has no variable rate debt.

Commodity Price Risk

The Company is exposed to fluctuations in the prices of forestry products that it purchases and sells for the PRC market. The Company imports round wood logs purchased from suppliers outside of China, at prevailing market prices.

Any fluctuations in the prices of standing timber and other imports can have a significant effect on the Company's business, results of operations, financial condition and cash flows.

The Company's overall performance is affected by the prices of lumber set in the Russian and PRC markets that are subject to significant fluctuations. Due to the nature of the trading business, any significant fluctuation would have minimal effect on gross margins. The Company does not enter into any future contract to hedge its sales or purchases of forestry products. From time to time, the Company may use physical delivery sales agreement to manage market risks. No contracts are entered into for trading on a speculative purpose. The Company does not have any physical delivery sales contract at period end.

23. Capital Management

The Company's objective is to manage its capital to ensure that the Company will be able to continue to follow its business strategy of expanding current operations and pursue other sound opportunities that may become available from time to time. Management defines capital as the Company's shareholders' equity excluding accumulated other comprehensive income (loss).

The Company's management reviews its capital management approach on an ongoing basis to ensure that the Company's capital assets are available and deployed in an optimized fashion to meet the Company's objectives. The Board of Directors does not establish quantitative return on capital criteria for management, but promotes year over year sustainable profitable growth. There were no changes in the Company's approach to capital management during the period.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2009

(All amounts are in Canadian dollars)

(Unaudited)

At this time, the Company does not use any third party financing as all projects are internally financed. The Company will consider employing third party financing for certain future acquisitions should it be required.

The Company does not have any covenants respecting its capital ratios.

24. Economic dependence

The Company purchased 48% (2008 - 48%) of its log trading supplies from its largest supplier during the period. The balance of the logs acquired for sale was supplied by three other suppliers.

25. Comparative Figures

The comparative figures have been reclassified, where applicable, to conform to the presentation used in the current period.

26. Subsequent Events

At the Board of Directors meeting of May 7, 2009, share options totalling 4,750,000 were approved for issuance based on the Company's approved Stock Option Plan pending the necessary regulatory approvals and public disclosure of the Eco- Energy China Group transaction which was announced on May 20th, 2009. The grant date of the options was established as May 20th, 2009 at an exercise price of \$0.50 per share option.

Also on May 7, 2009, the Board of Directors approved an investment of up to \$2,400,000 US to acquire a 40% stake of a China based company involved in the production of bio diesel fuel from Jatropha plantations and by products.