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**CATHAY FOREST PRODUCTS CORP.  
UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS  
FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2009**

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**CATHAY FOREST PRODUCTS CORP.**

**September 30, 2009**

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**CATHAY FOREST PRODUCTS CORP.**  
**CONSOLIDATED BALANCE SHEETS**  
(All amounts are in Canadian dollars)

	As at September 30, 2009 (Unaudited)	As at December 31, 2008 (Audited)
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents (note 4)	\$ 4,665,617	\$ 9,944,726
Accounts receivable (net)	8,232,464	1,971,238
Deposits and prepayments	6,006,506	5,016,876
Other receivables (note 14)	1,580,492	3,093,097
Inventories (note 5)	3,682,652	9,284,876
Current portion of long-term loans receivable (note 6)	19,135	2,005
<b>Total current assets</b>	<u>24,186,866</u>	<u>29,312,818</u>
<b>Long-term loans receivable (note 6)</b>	103,971	137,783
<b>Long-term investment (note 10)</b>	2,594,616	-
<b>Property and equipment (net) (note 7)</b>	15,087,575	17,828,633
<b>Plantation assets (note 8)</b>	63,675,470	69,964,502
<b>Forestry rights (net) (note 9)</b>	17,828,134	18,824,663
<b>Intangible assets (note 11)</b>	11,916	24,771
<b>Deposits (note 12)</b>	3,450,874	3,945,432
<b>Goodwill</b>	988,088	988,088
<b>TOTAL ASSETS</b>	<u>\$ 127,927,510</u>	<u>\$ 141,026,690</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Accounts payable and accrued liabilities (note 13)	\$ 62,701,409	\$ 67,014,830
Current portion of mortgage payable (note 15)	6,673	7,629
Current portion of unearned revenue	471,224	484,653
<b>Total current liabilities</b>	<u>63,179,306</u>	<u>67,507,112</u>
<b>Due to related party (note 14)</b>	2,899,193	5,390,055
<b>Unearned revenue</b>	435,677	901,747
<b>Long term loan payable</b>	58,598	34,185
<b>Mortgage payable (note 15)</b>	35,587	46,409
<b>Total liabilities</b>	<u>66,608,361</u>	<u>73,879,508</u>
<b>Non controlling interest (note 18)</b>	<u>653,846</u>	<u>725,014</u>
<b>SHAREHOLDERS' EQUITY</b>		
Capital stock (note 16)	72,151,841	72,151,841
Warrants (note 17)	1,061,635	1,061,635
Contributed surplus (note 16)	3,531,470	3,018,748
Accumulated other comprehensive income (loss)	(1,146,678)	4,527,752
Deficit	(14,932,965)	(14,337,808)
<b>Total shareholders' equity</b>	<u>60,665,303</u>	<u>66,422,168</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<u>\$ 127,927,510</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 September 30		Nine months ended September 30	
	2009	2008	2009	2008
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Revenue</b>	\$ 23,304,614	\$ 5,560,299	\$ 44,515,820	\$ 16,196,572
Cost of sales	<u>17,753,915</u>	<u>4,701,152</u>	<u>37,039,936</u>	<u>14,064,351</u>
<b>Gross profit</b>	<u>5,550,699</u>	<u>859,147</u>	<u>7,475,884</u>	<u>2,132,221</u>
<b>Expenses</b>				
General and administrative	1,227,143	360,474	3,719,720	2,092,232
Selling and marketing	451,210	370,918	1,224,832	1,078,828
Foreign exchange loss	81,711	199,274	109,583	127,748
Stock based compensation	362,250	-	512,722	-
	<u>2,122,314</u>	<u>930,666</u>	<u>5,566,857</u>	<u>3,298,808</u>
<b>Income (Loss) before undernoted</b>	<u>3,428,385</u>	<u>(71,519)</u>	<u>1,909,027</u>	<u>(1,166,587)</u>
Amortization (note 19)	788,340	503,908	2,505,508	1,074,638
Interest income	(1,852)	(147,176)	(26,126)	(746,696)
Interest expense	<u>503</u>	<u>673</u>	<u>1,753</u>	<u>2,090</u>
<b>Income (Loss) before income taxes and non controlling interest</b>	2,641,394	(428,924)	(572,108)	(1,496,619)
<b>Non controlling interest</b>	(49,996)	(109,795)	(17,265)	(262,594)
<b>Proportionate share of investee loss (note 10)</b>	<u>(5,784)</u>	<u>-</u>	<u>(5,784)</u>	<u>-</u>
<b>Net income (Loss)</b>	2,585,614	(538,719)	(595,157)	(1,759,213)
<b>Deficit - beginning of period</b>	<u>(17,518,579)</u>	<u>(11,026,072)</u>	<u>(14,337,808)</u>	<u>(9,805,578)</u>
<b>Deficit - end of period</b>	<u>\$ (14,932,965)</u>	<u>\$ (11,564,791)</u>	<u>\$ (14,932,965)</u>	<u>\$ (11,564,791)</u>
<b>Net income (loss) per share (note 20)</b>				
Basic	<u>\$ 0.023</u>	<u>\$ (0.005)</u>	<u>\$ (0.005)</u>	<u>\$ (0.016)</u>
Diluted	<u>\$ 0.021</u>	<u>\$ (0.005)</u>	<u>\$ (0.005)</u>	<u>\$ (0.016)</u>
<b>Weighted Average- Common Shares Outstanding</b>				
Basic	<u>112,524,714</u>	<u>112,524,714</u>	<u>112,524,714</u>	<u>112,219,158</u>
Diluted	<u>123,214,714</u>	<u>118,214,714</u>	<u>120,640,640</u>	<u>117,909,158</u>

See accompanying notes to consolidated financial statements.

**CATHAY FOREST PRODUCTS CORP.**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

(All amounts are in Canadian dollars)

	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Net Income (Loss)	\$ 2,585,614	\$ (538,719)	\$ (595,157)	\$ (1,759,213)
Other comprehensive income (loss), net of tax:				
Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations	(2,923,983)	1,330,372	(5,674,430)	2,683,019
Total comprehensive income (loss)	<u>\$ (338,369)</u>	<u>\$ 791,653</u>	<u>\$ (6,269,587)</u>	<u>\$ 923,806</u>

**CONSOLIDATED STATEMENTS OF ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

(All amounts are in Canadian dollars)

	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
Balance - beginning of period	\$ 1,777,305	\$ 963,457	\$ 4,527,752	\$ (389,190)
Other comprehensive income (loss)	(2,923,983)	1,330,372	(5,674,430)	2,683,019
Balance - end of the period	<u>\$ (1,146,678)</u>	<u>\$ 2,293,829</u>	<u>\$ (1,146,678)</u>	<u>\$ 2,293,829</u>

See accompanying notes to consolidated financial statements.

**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	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					(5,674,430)		(5,674,430)
Stock based compensation				512,722			512,722
Net Income (loss)						(595,157)	(595,157)
Balance, September 30, 2009	112,524,714	72,151,841	1,061,635	3,531,470	(1,146,678)	(14,932,965)	60,665,303

See accompanying notes to consolidated financial statements.

**CATHAY FOREST PRODUCTS CORP.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(All amounts are in Canadian dollars)

	<b>Three months ended September 30</b>		<b>Nine months ended September 30</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	(Unaudited)	(Unaudited)	(Unaudited)	(Unaudited)
<b>Cash flows from operating activities</b>				
Net Income (Loss)	\$ 2,585,614	\$ (538,719)	\$ (595,157)	\$ (1,759,213)
Items not affecting cash:				
Amortization	788,340	503,908	2,505,508	1,074,638
Non controlling interest	49,996	109,795	17,265	262,594
Proportionate share of investee loss (note 10)	5,784	-	5,784	-
Stock based compensation	362,250	-	512,722	-
	<u>3,791,984</u>	<u>74,984</u>	<u>2,446,122</u>	<u>(421,981)</u>
Net change in non-cash items from operations				
Accounts receivable	(4,131,718)	456,843	(6,858,895)	(598,280)
Deposits and prepayments	(1,233,798)	(41,404)	(1,013,150)	(5,524,124)
Other receivables	262,505	(1,393,473)	1,129,351	(1,461,879)
Inventories	633,202	(2,313,751)	4,978,938	(6,929,017)
Accounts payable and accrued liabilities	(177,311)	1,546,935	638,671	2,625,336
Unearned revenue	(82,786)	(145,729)	(335,093)	470,288
<b>Cash provided by (used in) operating activities</b>	<u>(937,922)</u>	<u>(1,815,595)</u>	<u>985,944</u>	<u>(11,839,657)</u>
<b>Cash flows from investing activities</b>				
Reduction to short-term investment	-	2,000,000	-	6,900,000
Deposit for investment	(599,854)	25,958	(2,659,288)	(902,566)
Decrease (increase) in long-term accounts receivable	437	5,901	1,353	(68,034)
Purchase of property and equipment	(496,680)	(8,646,435)	(1,495,387)	(12,289,958)
Investment in plantation assets	1,350,975	(142,830)	335,040	(395,447)
<b>Cash provided by (used in) investing activities</b>	<u>254,878</u>	<u>(6,757,406)</u>	<u>(3,818,282)</u>	<u>(6,756,005)</u>
<b>Cash flows from financing activities</b>				
Short term loan financing (repayment)	-	1,343	-	(207,051)
Advance from (repayment to) related party	-	2,383,814	(2,037,443)	3,395,522
Mortgage repayment	(1,706)	(4,556)	(3,044)	(4,667)
Advance of long-term loan	12,396	-	23,455	-
Issuance of capital stock	-	-	-	182,000
<b>Cash provided by (used in) financing activities</b>	<u>10,690</u>	<u>2,380,601</u>	<u>(2,017,032)</u>	<u>3,365,804</u>
<b>Effect of exchange rate changes on cash</b>	<u>(248,559)</u>	<u>690,869</u>	<u>(429,739)</u>	<u>569,163</u>
<b>Net change in cash and cash equivalents</b>	<u>(920,913)</u>	<u>(5,501,531)</u>	<u>(5,279,109)</u>	<u>(14,660,695)</u>
<b>Cash and cash equivalents - beginning of period</b>	<u>5,586,530</u>	<u>27,731,227</u>	<u>9,944,726</u>	<u>36,890,391</u>
<b>Cash and cash equivalents - end of period (note 4)</b>	<u>\$ 4,665,617</u>	<u>\$ 22,229,696</u>	<u>\$ 4,665,617</u>	<u>\$ 22,229,696</u>
<b>Supplemental information</b>				
Interest paid	503	673	1,753	2,090
<b>Non Cash Transactions</b>				
Accrued liabilities related to plantation assets	(\$1,454,846)	\$ 4,253,044	\$ 3,219,930	\$ 7,740,564
Share issuance as settlement of transaction	-	-	-	1,296,000

See accompanying notes to consolidated financial statements.

## CATHAY FOREST PRODUCTS CORP.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2009

(All amounts are in Canadian dollars)

(Unaudited)

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#### **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 accounting method for the Company’s interest in a Long Term Investment follows the equity method of accounting.

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 accounting policy described above with regards to the Long Term Investment and those 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

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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(All amounts are in Canadian dollars)

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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 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 for the period ended September 30, 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

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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(All amounts are in Canadian dollars)

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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”).

**4. Cash and Cash Equivalents**

Cash and cash equivalents are comprised of the following:

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Cash held in banks	\$4,665,617	\$7,294,726
Cash held as term deposits	<u>-</u>	<u>2,650,000</u>
Cash and cash equivalents	<u>\$4,665,617</u>	<u>\$9,944,726</u>

Cash held as term deposits at December 31, 2008 represented short term guaranteed investment certificates with a Canadian chartered bank bearing interest at 1.6%. These investment certificates matured in January 2009.

**5. Inventories**

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

	<u>September 30, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Wood Products	\$3,433,395	\$8,861,501
Spare parts for forestry machines	<u>249,257</u>	<u>423,375</u>
Total	<u>\$3,682,652</u>	<u>\$9,284,876</u>

At September 30, 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 \$123,106 (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 \$149 in one

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

SEPTEMBER 30, 2009

(All amounts are in Canadian dollars)

(Unaudited)

instance and in the second case repayment is to start in January 2010 in equal instalments of \$1,928. 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.

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Loans receivable	\$123,106	\$139,788
Current portion of loans receivable	(19,135)	(2,005)
Long term loans receivable	\$103,971	\$ 137,783

**7. Property and Equipment**

<b>September 30, 2009</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
		(Unaudited)	
Automobiles	\$766,050	\$533,739	\$232,311
Buildings	571,808	101,147	470,661
Leasehold Improvements	163,466	132,183	31,283
Machinery and Equipment	8,888,597	2,878,960	6,009,637
Office Furniture	229,465	126,162	103,303
Roads	5,371,380	-	5,371,380
Railway Siding	1,077,202	-	1,077,202
Construction in Progress	1,791,798	-	1,791,798
<b>Total</b>	<b>\$18,859,766</b>	<b>\$3,772,191</b>	<b>\$15,087,575</b>

<b>December 31, 2008</b>	<b>Cost</b>	<b>Accumulated Amortization</b>	<b>Net Book Value</b>
		(Audited)	
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
<b>Total</b>	<b>\$19,583,172</b>	<b>\$1,754,539</b>	<b>\$17,828,633</b>

Construction in Progress represents the amount expended to date for the construction of infrastructure in Russia. This infrastructure under construction at December 31, 2008 consisted of the main logging road, railway spur line, shipping and sorting site 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. In the three month period ending June 30, 2009 the costs established from the construction of the main road and railway siding were transferred to an appropriate asset category and amortization will be calculated in subsequent periods. At September 30, 2009, the assets under construction consist of the sorting yard and the base camp facilities.

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

SEPTEMBER 30, 2009

(All amounts are in Canadian dollars)

(Unaudited)

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**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 September 30, 2009, the subsidiaries, collectively, had approximately 13,581 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**

Beginning in September 2006, the company began acquiring land use and harvesting rights through its PRC company Jiangxi Cathay Forest Co. Ltd. The cost of the investments are being amortized on a straight line basis over the terms of the contract lives.

At September 30, 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 September 30, 2009.

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Cost	\$18,809,778	\$19,641,862
Accumulated Amortization	981,644	817,199
Net Book Value	<u>\$17,828,134</u>	<u>\$18,824,663</u>

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

SEPTEMBER 30, 2009

(All amounts are in Canadian dollars)

(Unaudited)

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**10. Long Term Investment**

On May 7, 2009, the Board of Directors approved an investment of \$2,600,400 (US \$2,400,000) to acquire a 40% interest in a China based company, Eco-Energy China Group Incorporated, a vertically integrated biodiesel fuel producer in China. The transaction was completed on July 27, 2009. As a result of an additional equity infusion which took place subsequent to September 30, 2009, the Company's interest in Eco-Energy China Group Incorporated was diluted to 33.8%. The long term investment in Eco-Energy China Group Incorporated is being accounted for using the equity accounting method.

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Opening balance	\$ -	\$ -
Long term investment	2,600,400	-
Proportionate share of investee loss	(5,784)	-
Ending balance	<u>\$2,594,616</u>	<u>\$ -</u>

**11. 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.

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Cost	\$64,998	\$ 74,313
Accumulated Amortization	(53,082)	(49,542)
Balance	<u>\$11,916</u>	<u>\$ 24,771</u>

**12. 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 \$3,611,015 (Rmb 23,000,000) of which \$160,141 (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 September 30, 2009, the outstanding deposits totalled \$3,450,874 (Rmb 21,980,000) (December 31, 2008 - \$3,945,432 – Rmb 21,980,000).

**CATHAY FOREST PRODUCTS CORP.**

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**13. Accounts payable and accrued liabilities**

Included in Accounts payable and accrued liabilities is \$57,481,927 (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.

**14. 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 September 30, 2009, included in other receivables are loans to a related company controlled by the same management team totalling \$31,086 (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.

Also included in other receivable at September 30, 2009 is an advance of \$671,963 (Rmb 4,280,000) to Eco-Energy China Group Inc. This balance is a short term advance from the Company and is 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 September 30, 2009, there were advances by the minority shareholder of the export trading company totalling \$2,899,193 (December 31, 2008- \$5,390,055). The related party has agreed not to demand payment of the outstanding amount within the next year.

**15. Mortgage Payable**

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

At September 30, 2009, the principal outstanding is \$42,260 (Rmb 269,168). For December 31, 2008 principal outstanding was \$54,038 (Rmb 301,042). Interest is set at 5.8% and the principal is repayable at \$556 (Rmb 3,542) per month plus interest. The mortgage matures in January 2016.

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The annual minimum required principal repayments are as follows:

2010	\$6,673
2011	6,673
2012	6,673
2013	6,673
2014	6,673
Thereafter	<u>15,569</u>
Total	42,260
Short term obligation	<u>(6,673)</u>
Long term obligation	<u>\$35,587</u>

**16. 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.

	<b>No. of Shares</b>	<b>Share Capital</b>	<b>Contributed Surplus</b>
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
Stock based compensation			512,722
Balance as at September 30, 2009	112,524,714	\$72,151,841	\$3,531,470

During the nine month period ending September 30, 2009, the only transaction was the issuance of stock options in May 2009.

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**17. 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.

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

	<b>To September 30, 2009</b>		<b>To December 31, 2008</b>	
	(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	5,000,000	0.50	Nil	Nil
Exercised	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>	<u>Nil</u>
Balance at end of the period	<u>9,190,000</u>	<u>\$ 0.70</u>	<u>4,190,000</u>	<u>\$ 0.93</u>

During the three month period ended September 30, 2009, the Company recorded \$362,250 (2008- \$nil) as a stock based compensation expense. For the nine month period ending September 30, 2009 the Company recorded \$512,722 (2008-\$nil) as 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 2009</u>	<u>May 2007</u>	<u>December 2005</u>	<u>May 2005</u>
Number of Options .....	5,000,000	1,830,000	1,475,000	2,490,000
Exercise price .....	\$0.50	\$1.25	\$ 0.80	\$ 0.60
Expected option life .....	5 years	5 years	5 years	5 years

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Risk free interest rate .....	1.25%	3.75%	4.50%	3.75%
Volatility .....	106.3%	98.6%	50%	35%
Dividend yield .....	0.00%	0.00%	0.00%	0.00%
Weighted average fair value of options granted .....	\$0.39	\$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 September 30, 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	0.6 years	\$ 0.60	1,420,000	\$ 0.60
940,000	Dec 2010	1.2 years	\$ 0.80	940,000	\$ 0.80
1,830,000	May 2012	2.6 years	\$ 1.25	1,830,000	\$ 1.25
5,000,000	May 2014	4.6 years	\$ 0.50	-	-

**(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	(350,000)	(122,214)
Balance December 31, 2008	1,500,000	1,061,635
Exercised	-	-
Balance September 30, 2009	<u>1,500,000</u>	<u>\$1,061,635</u>

The Company has 1,500,000 warrants issued and outstanding as at September 30, 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:

	<b>Broker Warrants</b>
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

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**18. 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:

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Shanghai Shengtai Forest Company Limited	\$91,171	\$ 28,223
Henan Xinya Cathay Forest Products Company Limited	404,094	490,138
Jiangsu Cathay Forest Company Ltd.	49,427	58,421
Guizhou Hanfang Cathay Forestry Company Limited	109,154	148,232
<b>Total</b>	<b>\$653,846</b>	<b>\$ 725,014</b>

**19. Amortization**

Amortization expense includes the following:

	<b>9 months ended</b>	<b>9 months ended</b>
	<b>September 30, 2009</b>	<b>September 30, 2008</b>
	(Unaudited)	(Unaudited)
Property and equipment	\$2,189,358	\$ 766,810
Intangibles	6,500	13,927
Forestry rights	309,650	293,901
	<b>\$2,505,508</b>	<b>\$1,074,638</b>

**20. Net Income (Loss) Per Common Share**

The calculation of diluted loss per common share excludes all options and warrants for all periods (except for the quarter ended September 30, 2009) 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:

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Weighted average common shares issued and outstanding (note 16)	112,524,714	112,106,818
Warrants outstanding (note 17)	1,500,000	1,500,000
Stock options outstanding (note 17)	9,190,000	4,190,000
	<b>123,214,714</b>	<b>117,796,818</b>

**CATHAY FOREST PRODUCTS CORP.**

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(All amounts are in Canadian dollars)

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**21. 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 September 30 are approximately as follows:

2010	\$ 116,919
2011	<u>30,615</u>
Total	<u>\$147,534</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	\$ 366,595
2011	211,396
2012	163,909
2013	163,909
2014	163,909
Thereafter	<u>54,636</u>
Total	<u>\$ 1,124,354</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 September 30, 2009 the portion of the lease payments that could be payable contingent upon harvesting the plantation assets is as follows:

2010	\$11,161,077
2011	11,161,077
2012	11,161,077
2013	11,161,077
2014	1,700,844
Thereafter	<u>898,125</u>
Total	<u>\$ 47,243,276</u>

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(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 September 30, 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 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 September 30, 2009, approximately 14,929 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,

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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.

**22. 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:

	<b>9 months ended September 30, 2009</b>	<b>9 months ended September 30, 2008</b>
	(Unaudited)	(Unaudited)
Canada	\$ 2,354,313	\$ -
China	37,479,364	16,196,572
Russia	4,682,143	-
Total	<u>\$44,515,820</u>	<u>\$ 16,196,572</u>

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

	<b>September 30, 2009</b>	<b>December 31, 2008</b>
	(Unaudited)	(Audited)
Canada	\$ 1,381	\$ 3,781
China	5,939,725	7,066,084
Russia	26,986,519	29,608,202
	<u>\$32,927,625</u>	<u>\$ 36,678,067</u>

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

**23. 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:

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	<u>September 30, 2009</u>	<u>December 31, 2008</u>
	(Unaudited)	(Audited)
Held for trading (a)	\$4,665,617	\$ 9,944,726
Loans and receivables (b)	9,936,062	5,204,123
Other financial liabilities (c)	65,701,460	72,493,108

(a) Cash and cash equivalents, 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.

### 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, 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.

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As at September 30, 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. The Company's largest trade receivables from three customers comprises 65% of the total accounts receivable as at September 30, 2009. (December 31, 2008- Nil)

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 2010 and the commitments as disclosed in Note 21 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 September 30, 2009, the Company had foreign currency denominated amounts of approximately:

	<b>China</b>		<b>Russia</b>	
	Rmb	Cdn\$	Rub	Cdn\$
Cash	12,417,493	\$ 1,949,555	290,778	\$ 10,381
Accounts Receivable and Other Receivables	55,245,062	8,673,511	31,630,209	1,129,199
Liabilities	399,059,323	62,652,577	102,124,477	3,645,844

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

	<b>China</b>		<b>Russia</b>	
	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 the results from operations and other comprehensive income of approximately \$515,000 in the case of Rmb denominated financial instruments and approximately \$25,000 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 has 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.

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**24. 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 property and equipment 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.

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.

**25. Economic dependence**

The Company acquires logs for its log importing business from its Russian subsidiary and from two other suppliers. During the nine month period ending September 30, 2009, 56% (2008-Nil) of the logs acquired from Russia were sourced through the Company's Russian subsidiary, DalEuroLes L.L.C.

**26. Comparative Figures**

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