
CATHAY FOREST PRODUCTS CORP.
UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS
FOR THE THREE MONTHS ENDED MARCH 31, 2010

CATHAY FOREST PRODUCTS CORP.

MARCH 31, 2010

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

	As at March 31, 2010 (Unaudited)	As at December 31, 2009 (Audited)
ASSETS		
Current assets		
Cash	\$ 12,394,154	\$ 18,072,035
Accounts receivable (net)	7,601,894	8,645,926
Deposits and prepayments	5,954,225	5,691,308
Other receivables (note 12)	3,951,307	2,648,014
Inventories (note 3)	3,364,371	961,988
Current portion of long-term loans receivable (note 4)	1,550,324	24,102
Total current assets	<u>34,816,275</u>	<u>36,043,373</u>
Long-term loans receivable (note 4)	94,087	94,538
Long-term investment (note 5)	3,424,549	3,251,974
Property and equipment (net) (note 6)	14,218,737	13,694,494
Plantation assets (note 7)	65,978,972	65,149,606
Forestry rights (net) (note 8)	17,437,112	17,686,437
Intangible assets (note 9)	5,134	8,462
Deposits (note 10)	4,609,845	4,136,007
Goodwill	988,088	988,088
TOTAL ASSETS	<u>\$ 141,572,799</u>	<u>\$ 141,052,979</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities (note 11)	\$ 66,524,836	\$ 65,798,347
Current portion of mortgage payable (note 13)	6,324	6,516
Current portion of unearned revenue	412,952	470,745
Total current liabilities	<u>66,944,112</u>	<u>66,275,608</u>
Due to related party (note 12)	4,021,784	2,303,777
Unearned revenue	212,041	321,928
Long term loan payable	55,019	56,683
Mortgage payable (note 13)	30,566	33,119
Total liabilities	<u>71,263,522</u>	<u>68,991,115</u>
Non controlling interest (note 14)	<u>581,428</u>	<u>606,166</u>
SHAREHOLDERS' EQUITY		
Capital stock (note 15)	85,526,252	85,526,252
Warrants (note 16)	648,153	648,153
Contributed surplus (note 15)	5,317,605	4,955,355
	<u>91,492,010</u>	<u>91,129,760</u>
Accumulated other comprehensive loss	(3,026,171)	(2,226,619)
Deficit	(18,737,990)	(17,447,443)
	<u>(21,764,161)</u>	<u>(19,674,062)</u>
Total shareholders' equity	<u>69,727,849</u>	<u>71,455,698</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$ 141,572,799</u>	<u>\$ 141,052,979</u>

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

	Three months ended March 31	
	2010	2009
	(Unaudited)	(Unaudited)
Revenue	\$ 6,695,383	\$ 6,277,519
Cost of sales	<u>5,773,458</u>	<u>5,741,471</u>
Gross profit	<u>921,925</u>	<u>536,048</u>
Expenses		
General and administrative	1,240,756	1,254,832
Selling and marketing	440,095	345,704
Stock based compensation	362,250	-
Foreign exchange loss (gain)	144,110	(28,210)
	<u>2,187,211</u>	<u>1,572,326</u>
Loss before undernoted	<u>(1,265,286)</u>	<u>(1,036,278)</u>
Amortization (note 17)	217,094	108,083
Interest income	(8,862)	(11,195)
Interest expense	396	512
Dilution gain on long-term investment (note 5)	(266,689)	-
Proportionate share of investee loss (note 5)	<u>90,444</u>	<u>-</u>
Loss before income taxes and non controlling interest	(1,297,669)	(1,133,678)
Non controlling interest	<u>7,122</u>	<u>15,770</u>
Net loss	(1,290,547)	(1,117,908)
Deficit - beginning of period	<u>(17,447,443)</u>	<u>(14,337,808)</u>
Deficit - end of period	<u>\$ (18,737,990)</u>	<u>\$ (15,455,716)</u>
Net loss per share (note 18)		
Basic and diluted	<u>\$ (0.009)</u>	<u>\$ (0.010)</u>
Weighted Average- Common Shares Outstanding		
Basic and diluted	<u>138,086,814</u>	<u>112,524,714</u>

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

	Three months ended March 31	
	2010	2009
	(Unaudited)	(Unaudited)
Net Loss	\$ (1,290,547)	\$ (1,117,908)
Other comprehensive loss, net of tax:		
Unrealized losses on translating financial statements of self-sustaining foreign operations	(799,552)	(655,029)
Total comprehensive loss	<u>\$ (2,090,099)</u>	<u>\$ (1,772,937)</u>

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

	Three months ended March 31	
	2010	2009
	(Unaudited)	(Unaudited)
Balance - beginning of period	\$ (2,226,619)	\$ 4,527,752
Other comprehensive loss	(799,552)	(655,029)
Balance - end of the period	<u>\$ (3,026,171)</u>	<u>\$ 3,872,723</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, 2008	112,524,714	72,151,841	1,061,635	3,018,748	4,527,752	(14,337,808)	66,422,168
Issuance of Shares	25,562,100	14,022,564					14,022,564
Stock based compensation				874,972			874,972
Warrants expired			(1,061,635)	1,061,635			-
Underwriters warrants issued		(648,153)	648,153				-
Net unrealized loss on translation of self-sustaining foreign subsidiaries	-	-	-	-	(6,754,371)	-	(6,754,371)
Net loss	-	-	-	-	-	(3,109,635)	(3,109,635)
Balance, December 31, 2009	138,086,814	85,526,252	648,153	4,955,355	(2,226,619)	(17,447,443)	71,455,698
Stock based compensation	-	-	-	362,250	-	-	362,250
Net unrealized loss on translation of self-sustaining foreign subsidiaries	-	-	-	-	(799,552)	-	(799,552)
Net loss	-	-	-	-	-	(1,290,547)	(1,290,547)
Balance, March 31, 2010	138,086,814	85,526,252	648,153	5,317,605	(3,026,171)	(18,737,990)	69,727,849

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

2010

2009

	2010	2009
Cash flows from operating activities		
Net Loss	\$ (1,290,547)	\$ (1,117,908)
Items not affecting cash:		
Amortization	843,183	848,083
Stock based compensation	362,250	-
Proportionate share of investee loss	90,444	-
Dilution gain on long term investment	(266,689)	-
Non controlling interest	(7,122)	(15,770)
Net change in non-cash items from operations		
Accounts receivable	845,498	104,206
Deposits and prepayments	(379,205)	1,390,918
Other receivables	(2,936,688)	125,375
Inventories	(2,461,575)	(1,813,312)
Accounts payable and accrued liabilities	99,496	814,989
Unearned revenue	(147,985)	(70,485)
Cash provided by (used in) operating activities	(5,248,940)	266,096
Cash flows from investing activities		
Decrease (increase) in long-term loans receivable	(2,278)	463
Purchase of property and equipment	(1,266,951)	(764,024)
Investment in plantation assets	(324,262)	(560,960)
Deposits	(609,896)	-
Cash provided by (used in) investing activities	(2,203,387)	(1,324,521)
Cash flows from financing activities		
Due to related party	1,829,687	-
Mortgage payable	(1,621)	(1,936)
Cash flow provided by (used in) financing activities	1,828,066	(1,936)
Effect of exchange rate changes on cash	(53,620)	91,543
Net change in cash	(5,677,881)	(968,818)
Cash - beginning of period	18,072,035	9,944,726
Cash - end of period	\$ 12,394,154	\$ 8,975,908
Supplemental information		
Interest paid	\$ 396	\$ 512
Non-cash transaction		
Accrued liabilities related to plantation assets	\$ 2,472,549	\$ 3,380,329

See accompanying notes to consolidated financial statements.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(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, 2009.

The unaudited interim consolidated financial statements follow the same accounting policies and methods of their application as the December 31, 2009 consolidated annual financial statements.

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. 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

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(All amounts are in Canadian dollars)

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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 with early adoption permitted. The Company is in the process of evaluating the impact of these standards.

The Company must adopt sections 1582, 1601 and 1602 concurrently.

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”).

Accounting Changes – Section 1506

In June 2009, the CICA amended Handbook Section 1506 Accounting Changes. The amendment excludes from the scope of Section 1506 changes in accounting policies upon the complete replacement of an entity’s primary basis of accounting, as will occur when an entity adopts IFRSs for the first time.

EIC 175 - Multiple Deliverable Revenue Arrangements

In December 2009, the CICA issued *EIC 175, Multiple Deliverable Revenue Arrangements*, replacing *EIC 142, Revenue Arrangements with Multiple Deliverables*. This abstract was amended to: (1) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated and the consideration allocated; (2) require, in situations where a vendor does not have vendor-specific objective evidence (“VSOE”) or third-party evidence of selling price, that the entity allocate revenue in an arrangement using estimated selling prices of deliverables; (3) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and (4) require expanded qualitative and quantitative disclosures regarding significant judgments made in applying this guidance. The accounting changes summarized in EIC 175 are effective for fiscal years beginning on or after January 1, 2011, with early adoption permitted. Adoption may either be on a prospective basis or by retrospective application. If the Abstract is adopted early, in a reporting period that is not the first reporting period in the entity’s fiscal year, it must be applied retroactively from the beginning of the Company’s fiscal period of adoption. The Company is currently assessing the future impact of these amendments on

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(All amounts are in Canadian dollars)

(Unaudited)

its financial statements and has not determined the timing and method of its adoption.

3. Inventories

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

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
	(Unaudited)	(Audited)
Wood Products	\$3,204,729	\$805,107
Spare parts for forestry machines	<u>159,642</u>	<u>156,881</u>
Total	<u>\$3,364,371</u>	<u>\$961,988</u>

Wood products inventory represents the value of logs and sawn timber 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.

The amount of inventory recognized as an expense and included in cost of sales in was \$5,773,458 (2009 – \$5,741,471). None of the inventories have been pledged as security for liabilities.

4. Long Term Loans Receivable

Long-term loans receivable are as follows:

	<u>March 31, 2010</u>	<u>December 31, 2009</u>
	(Unaudited)	(Audited)
Employee loans receivable (note i)	\$121,011	\$118,640
Convertible debenture (note ii)	1,523,400	-
	1,644,411	118,640
Current portion	(1,550,324)	(24,102)
Long term	<u>\$94,087</u>	<u>\$ 94,538</u>

Note i) Employee loans receivable totalling \$121,011 (December 31, 2009- \$118,640) 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.

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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(All amounts are in Canadian dollars)

(Unaudited)

4. Long Term Loans Receivable - continued

Note ii) In October, 2009, the Company advanced amounts to its investee company Eco-Energy China Group Inc. (refer to note 12). In January, 2010, US\$1,500,000 of the advanced amounts was converted into a 1% convertible debenture with a two year maturity term. The debenture is convertible into common shares at US\$2.80 per common shares. The Company has agreed not to demand repayment of this note for at least 12 months beginning January 1, 2010.

5. Long Term Investment

On May 7, 2009, the Board of Directors approved an investment of \$2,600,400 (US \$2,400,000) for 2,400,000 common shares in cash to acquire a 40% interest in a China based Company, Eco-Energy China Group Inc., 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 July 27, 2009, Eco-Energy China Group Inc. issued 1,085,500 shares at US\$2.00 per share and 946,072 shares at US\$2.80 per share, resulting in the Company's interest in Eco-Energy China Group Incorporated being diluted from 40% to 29.88%.

In the three month period ending March 31, 2010, Eco-Energy China Group Inc. issued an additional 635,523 shares at US\$2.80 resulting in the Company's interest in Eco-Energy China Group Inc. being diluted from 29.88% to 27.69%. (see note 24)

	March 31,2010	December 31,2009
	(Unaudited)	(Audited)
Balance at the beginning of the period	\$3,251,974	-
Initial Investment at cost	-	\$ 2,600,400
Proportionate share of investee loss	(90,444)	(220,496)
Dilution gain	266,689	872,070
Proportion share of comprehensive loss	(3,670)	-
Balance at the end of the period	<u>\$3,424,549</u>	<u>\$3,251,974</u>

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(All amounts are in Canadian dollars)

(Unaudited)

6. Property and Equipment

March 31, 2010	Cost	Accumulated Amortization (Unaudited)	Net Book Value
Automobiles	\$737,358	\$580,116	\$157,242
Buildings	550,829	109,413	441,416
Leasehold Improvements	154,928	148,518	6,410
Machinery and Equipment	9,106,689	3,992,480	5,114,209
Office Furniture	226,088	154,237	71,851
Infrastructure-Roads/Rails	6,416,997	286,363	6,130,634
Land	3,969	-	3,969
Construction in Progress	2,293,006	-	2,293,006
Total	\$19,489,864	\$5,271,127	\$14,218,737

December 31, 2009	Cost	Accumulated Amortization (Audited)	Net Book Value
Automobiles	\$ 801,453	\$568,188	\$233,265
Buildings	567,218	105,745	461,473
Leasehold Improvements	159,612	141,041	18,571
Machinery and Equipment	8,949,053	3,387,311	5,561,742
Office Furniture	228,021	142,680	85,341
Infrastructure-Roads/Rails	6,420,719	220,673	6,200,046
Land	3,971	-	3,971
Construction in Progress	1,130,085	-	1,130,085
Total	\$18,260,132	\$4,565,638	\$13,694,494

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, 2010

(All amounts are in Canadian dollars)

(Unaudited)

7. 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, 2010, the subsidiaries, collectively, had approximately 14,610 hectares ("ha") (December 31, 2009 – 14,444 ha) planted under management. To date, the Forest Bureau has not yet issued a Forestry Certificate to the various Chinese subsidiaries except for 658 hectares. 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.

8. 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, 2010, 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, 2010.

	March 31, 2010	December 31, 2009
	(unaudited)	(audited)
Cost	\$18,565,413	\$18,733,547
Accumulated Amortization	1,128,301	1,047,110
Net Book Value	<u>\$17,437,112</u>	<u>\$17,686,437</u>

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(All amounts are in Canadian dollars)

(Unaudited)

9. 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, 2010</u>	<u>December 31, 2009</u>
	(Unaudited)	(Audited)
Cost	\$61,604	\$ 63,466
Accumulated Amortization	<u>(56,470)</u>	<u>(55,004)</u>
Balance	<u>\$5,134</u>	<u>\$ 8,462</u>

10. 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 \$3,422,415 (Rmb 23,000,000) of which \$151,777 (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, 2010, the outstanding deposits totalled \$3,270,639 (Rmb 21,980,000) (2009 - \$3,369,512 Rmb 21,980,000).

In July 2008, the Company entered into an acquisition agreement for the acquisition of a standing timber property in Jiangxi Province in China. Under the terms of the agreement the Company would acquire subject to the completion of due diligence a 6,667 hectare property. To date the Company has made deposits of \$1,339,206 (Rmb 9,000,000) (2009- \$766,495-Rmb 5,000,000) with the final payments to be made pending final due diligence.

11. Accounts payable and accrued liabilities

Included in Accounts payable and accrued liabilities is \$59,503,763 (December 31, 2009 - \$58,755,300) 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.

CATHAY FOREST PRODUCTS CORP.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(All amounts are in Canadian dollars)

(Unaudited)

12. 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, 2010, included in other receivables is a loan to a related company controlled by the same management team totalling \$38,391 (Rmb 258,000) (2009- \$30,353 - Rmb 198,000). The balance relates to short term advances from the Company and are unsecured, non-interest bearing and repayable on demand.

Also included in other receivables is an advance to Eco-Energy China Group Inc. (investee company) totalling \$2,056,921 (US \$2,000,000) (2009 - \$1,836,522 - Rmb 11,980,000 – part of the amount has become the convertible debenture receivable as mentioned in note 4). These amounts are unsecured, non-interest bearing and repayable on demand.

The Company may borrow funds from time to time from related parties. As at March 31, 2010, outstanding advances made by the minority shareholder of the export trading company totalled \$4,021,784 (December 31, 2009- \$2,303,777), which is non-interest bearing. The related party has agreed not to demand payment of the outstanding amount during 2010.

13. Mortgage Payable

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

At March 31, 2010, the principal outstanding is \$36,890 (Rmb 247,918). For December 31, 2009 principal outstanding was \$39,635 (Rmb 258,543). Interest is set at 5.8% and the principal is repayable at \$525 (Rmb 3,542) per month plus interest. The mortgage matures in January 2016.

The annual minimum required principal repayments are as follows:

2011	\$ 6,324
2012	6,324
2013	6,324
2014	6,324
2015	6,324
Thereafter	<u>5,270</u>
Total	36,890
Short term obligation	<u>(6,324)</u>
Long term obligation	<u>\$30,566</u>

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2010

(All amounts are in Canadian dollars)

(Unaudited)

14. 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:

	March 31, 2010	December 31, 2009
	(unaudited)	(audited)
Shanghai Shengtai Forest Company Limited	\$74,356	\$ 78,216
Henan Xinya Cathay Forest Products Company Limited	364,902	379,235
Jiangsu Cathay Forest Company Ltd.	45,857	47,801
Guizhou Hanfang Cathay Forestry Company Limited	96,313	100,914
Total	\$581,428	\$ 606,166

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 three month period March 31, 2010, the Company had no capital transactions.

During the fiscal year ending December 31, 2009, the Company had the following capital transactions:

- in December 2009, the Company closed a bought deal equity financing for a total of 25,000,000 shares issued from treasury at a price of \$0.61 per share for gross proceeds of \$15.25 million. Share issue costs of \$2,218,470 were incurred including issuance of underwriter warrants of \$648,153. Subsequent to the offering 562,100 shares relating to an over-allotment to the underwriters were exercised for proceeds of \$342,881.

	Number of Shares	Capital Stock	Contributed Surplus
Balance as at December 31, 2008	112,524,714	\$72,151,841	\$3,018,748
Issuance of shares	25,562,100	14,022,564	-
Expiring of warrants	-	-	1,061,635
Issuance of Underwriter warrants	-	(648,153)	-
Stock based compensation	-	-	874,972
Balance as at December 31, 2009	138,086,814	\$85,526,252	\$4,955,355
Stock based compensation	-	-	362,250
Balance as at March 31, 2010	138,086,814	\$85,526,252	\$5,317,605

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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.

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

	<u>To March 31, 2010</u>		<u>To December 31, 2009</u>	
	<u>Number</u>	<u>Weighted Average Exercise Price</u>	<u>Number</u>	<u>Weighted Average Exercise Price</u>
Balance outstanding at beginning of the period	9,190,000	\$ 0.93	4,190,000	\$ 0.93
Granted	Nil	Nil	5,000,000	0.50
Exercised	Nil	Nil	Nil	Nil
Balance outstanding at end of the period	9,190,000	\$0.70	9,190,000	\$0.70
Balance exercisable at end of the period	4,190,000	\$ 0.93	4,190,000	\$ 0.93

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16. Options and Warrants - continued

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
Risk free interest rate	1.50%	3.75%	4.50%	3.75%
Volatility	98.0%	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 March 31, 2010.

<u>Options</u>	<u>Expiry</u>	<u>Outstanding</u> <u>Weighted</u> <u>Average</u> <u>Remaining Life</u>	<u>Outstanding</u> <u>Weighted</u> <u>Average</u> <u>Price</u>	<u>Exercisable</u> <u>Quantity</u>	<u>Exercisable</u> <u>Weighted</u> <u>Average</u> <u>Price</u>
1,420,000	May 2010	0.1 year	\$ 0.60	1,420,000	\$ 0.60
940,000	Dec 2010	0.7 year	\$ 0.80	940,000	\$ 0.80
1,830,000	May 2012	2.1 years	\$ 1.25	1,830,000	\$ 1.25
5,000,000	May 2014	4.1years	\$0.50	-	-

(b) Warrants

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

	Number of Warrants	Stated Value
Balance December 31, 2008	1,500,000	1,061,635
Expired	(1,500,000)	(1,061,635)
Private Placement (i)	<u>1,533,726</u>	<u>648,153</u>
Balance December 31, 2009 and March 31, 2010	<u>1,533,726</u>	<u>\$648,153</u>

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16. Options and Warrants - continued

There was no transaction involving warrants in the three month period ending March 31, 2010.

(i) Underwriters' warrants issued to the underwriters for services provided in conjunction with the bought deal in December 2009 are exercisable into one common share at a price of \$0.61 at any time up to 24 months following the closing of the deal which is not to exceed December 2011.

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	December 15, 2009
Number	1,533,726
Exercise Price	\$0.61
Expected Option Life	2 years
Risk free interest rate	1.25%
Volatility	114.9%
Dividend yield	0.0%
Fair Value at date of Grant	\$0.423

17. Amortization

Amortization expense includes the following:

	March 31, 2010	March 31, 2009
	(Unaudited)	(Unaudited)
Property and equipment	\$161,095	\$ 70,056
Intangibles	3,156	3,770
Forestry rights	52,843	34,257
	<u>\$217,094</u>	<u>\$108,083</u>

Amortization of property and equipment for \$626,089 (2009 - \$740,000) is included in cost of sales.

18. 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.

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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, 2010	December 31, 2009
	(Unaudited)	(Audited)
Weighted average common shares issued and outstanding (note 15)	138,086,814	113,632,924
Warrants outstanding (note 16)	1,533,726	1,533,726
Stock options outstanding (note 16)	9,190,000	9,190,000
	<u>148,810,540</u>	<u>124,356,650</u>

19. 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:

2011	\$11,536
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(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:

2011	\$179,360
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(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, 2010 the portion of the lease payments that could be payable contingent upon harvesting the plantation assets is as follows:

2011	\$ 7,132,453
2012	8,265,603
2013	8,270,086

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2014	8,274,569
2015	8,279,053
Thereafter	<u>75,537,095</u>
Total	<u>\$115,758,858</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, 2010 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 March 31, 2010, approximately 14,610 hectares (ha) (December 31, 2009 – 14,444 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.

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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.

20. Segmented Information

The Company's segmented information is presented by operating business segments. Each of the reporting segments represents segments that offer products and services that are different from those of other segments. The segments are identified as follows:

- 1) Plantation segment represents the fast growth poplar plantations in China
- 2) Harvesting segment represents the log harvesting operations based in Russia
- 3) Importing segment represents the operation involved in the importing and exporting of logs to China and Japan
- 4) Corporate segment represents all operations not directly related to revenue generating operations

In determining the Company's geographical segments revenue are attributed to the segments based on the location of the customers, and assets are attributed based on the location of the assets.

Three months ended March 31, 2010

	Plantation	Harvesting	Importing	Corporate	Total
Revenue from external customers	\$177,745	\$725,441	\$5,792,197	-	\$6,695,383
Inter-segment revenue (see note i)	-	1,692,637	-	-	1,692,637
Net income (loss)	(102,209)	581,526	235,341	(2,005,205)	(1,290,547)
Interest income	231	-	630	8,002	8,862
Interest expense	372	-	-	24	396
Amortization	59,066	729,781	23,155	31,181	843,183
Identifiable assets	76,507,621	18,656,923	11,882,410	34,525,914	141,572,868
Additions to property and equipment	-	1,266,951	-	-	1,266,951
Equity on investment income (net) (note ii)	-	-	-	176,245	176,245
Stock based compensation	-	-	-	362,250	362,250

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Three months ended March 31, 2009

	Plantation	Harvesting	Importing	Corporate	Total
Revenue from external customers	\$210,822	\$366,850	\$5,699,847	-	\$6,277,519
Inter-segment revenue (see note i)	-	648,488	-	-	648,488
Net income (loss)	(108,302)	(317,296)	109,037	(801,346)	(1,117,908)
Interest income	347	-	801	10,047	11,195
Interest expense	512	-	-	-	512
Amortization	50,391	733,561	27,136	36,995	848,083
Identifiable assets	83,208,186	21,212,166	13,815,949	26,968,821	145,205,122
Additions (disposals) to property and equipment	49,105	718,947	(92,543)	88,515	764,024

Note i

Consolidated revenue is reconciled as follows:

	March 31, 2010	March 31, 2009
Total revenue of reportable segments	\$8,388,020	\$6,926,007
Elimination of inter-segment revenue	(1,692,637)	(648,488)
Consolidated revenue	\$6,695,383	\$ 6,277,519

Note ii

The amount includes the gain on dilution of the long-term investment of \$266,689 and the Company's proportionate share of the investee's loss for the quarter of \$90,444.

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

	March 31, 2010	March 31, 2009
China	\$5,451,403	\$5,358,722
Russia	725,441	366,850
Japan	518,539	551,947
Total	\$6,695,383	\$ 6,277,519

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

	March 31, 2010	December 31, 2009
Canada	\$ -	\$ 1,852
China	5,482,674	5,761,186
Russia	26,178,309	25,626,355
	\$31,660,983	\$ 31,389,393

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

21. 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, 2010	December 31, 2009
Held for trading (a)	\$12,394,154	\$18,072,035
Loans and receivables (b)	13,197,612	11,412,580
Other financial liabilities (c)	70,638,529	68,198,442

(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 (current and non-current), 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, long term loans receivable and accounts payable (current and non-current) 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 loan payable approximates its 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.

Section 3862, Financial Instruments – Disclosures requires additional disclosure requirements about fair market

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value measurements for financial instruments and liquidity risk disclosures. The Company has assessed its financial instruments that are reported at market value, cash and cash equivalents, and determined that they are based on Level 1 inputs.

There is no change in all of the risks from the prior year.

Credit Risk

Credit risk is the risk of the 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 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, with the largest significant portion held in a major Canadian bank.

The carrying amount of these financial assets represents the maximum credit exposure.

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.

The Company reviews aging of accounts receivable on an on-going basis for impairment and the need for discounting. For accounts receivable which are expected to be outstanding for 180 days or more, discounting of the receivable to net present value is considered as appropriate on a customer by customer basis. If any accounts receivable value were impaired, appropriate reserves would be established.

Included in the accounts receivable balance are two (2009 - two) major customers that comprise 52% (2009 - 50%) of the total outstanding balance.

As at March 31, 2010, accounts receivable from customers located outside Canada represented 100% of the accounts receivable balance. The aging of accounts receivable was as follows:

Current	\$ 2,873,639
31-60 days	355,588
61-90 days	173,581
91+ days	4,199,086
Total	<u>7,601,894</u>

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

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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 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 19) and the ability to raise funds in order to meet commitments and sustain operations.

Contractual Obligations

The following table lists the Company's contractual obligations as at March 31, 2010:

	2011	2012	2013	2014	2015	Thereafter	Total
Land leases obligations	\$ 7,132,453	\$ 8,265,603	\$ 8,270,086	\$ 8,274,569	\$ 8,279,053	\$ 75,537,095	\$ 115,758,858
Plantation asset obligations *	59,503,763	-	-	-	-	-	59,503,763
Operating lease obligations	11,536	-	-	-	-	-	11,536
Management fees and Consulting Services	179,360	-	-	-	-	-	179,360
Mortgage Payable	6,324	6,324	6,324	6,324	6,324	5,270	36,890
Long term loan payable	-	-	-	-	-	55,019	55,019
	<u>\$ 66,833,436</u>	<u>\$ 8,271,927</u>	<u>\$ 8,276,410</u>	<u>\$ 8,280,893</u>	<u>\$ 8,285,377</u>	<u>\$ 75,597,384</u>	<u>\$ 175,545,426</u>

* Although the amounts are shown as pending obligations for the purpose of these financial statements, management has reached an understanding with the lessors to defer the actual payment of the liabilities until the plantations are harvested. (see Note 11)

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

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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, 2010, the Company had foreign currency denominated amounts of approximately:

	China		Russia	
	Rmb	Cdn\$	Rub	Cdn\$
Cash	10,582,951	\$ 1,574,750	321,852	\$ 11,107
Accounts Receivable and				
Other Receivables	55,729,699	8,292,616	76,678,606	2,646,179
Liabilities	442,464,213	65,838,970	133,499,064	4,607,054

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

	China		Russia	
	Rmb	Cdn\$	Rub	Cdn\$
Cash	17,945,919	\$ 2,751,091	158,088	\$ 5,456
Accounts Receivable and				
Other Receivables	59,493,105	9,120,233	59,626,331	2,058,899
Liabilities	415,681,148	63,723,502	110,021,470	3,799,045

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 \$554,000 (2009 - \$513,000) in the case of Rmb denominated financial instruments and approximately \$19,000 (2009 - \$17,000) 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

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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.

A fluctuation of +/- 1% provided as an indicative range in commodity price movement, with all other things being equal, have an effect on the results from operations and other comprehensive income of approximately \$9,000 (2009 - \$6,000).

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 contracts 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 year end.

22. 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) which is \$72,754,020 at March 31, 2010 (2009 - \$73,682,317).

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.

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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.

23. Economic dependence

The Company purchased 69% (2009 – 48%) of its log trading supplies from its largest supplier during the period. The balance of the logs acquired for sale was supplied by two (2009-three) other suppliers.

24. Subsequent Events

Subsequent to the period-end, Eco-Energy China Group Inc. completed additional private placement financing issuing 409,546 shares at US\$2.80 per share which resulted in the Company's interest being decreased from 27.69% to 26.44% resulting in an additional gain on dilution of its investment totaling \$148,064.

In April 2010, the Company advanced US\$2,000,000 to its investee company Eco-Energy China Group Inc. by way of an unsecured demand note, bearing interest at 3% per annum.