
CATHAY FOREST PRODUCTS CORP.
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE THREE MONTH PERIOD ENDED MARCH 31, 2010

Restated

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This discussion and analysis prepared by the management (“MD&A”) of Cathay Forest Products Corp. (“Cathay Forest” or “the Company”) provides a review of the significant developments and issues that influenced the Company during the three month period ended March 31, 2010 as compared to the three month period ended March 31, 2009. This MD&A should be read in conjunction with the restated unaudited consolidated financial statements of the Company for the three month period ended March 31, 2010 as well as the restated audited consolidated financial statements of the Company for the fiscal year ended December 31, 2009 and the accompanying Management Discussion and Analysis.

Unless otherwise indicated, in this MD&A all reference to “dollar” or the use of the symbol “\$” are to the Canadian dollar, all references to the “Rmb” are to the Renminbi, which is the legal currency in the People’s Republic of China, all references to the Rb are to the Ruble which is the legal currency in the Russian Federation and all references to “US dollars” or “US\$” are to the United States of America dollar.

Forward-Looking Statements

This MD&A contains forward-looking statements which reflect management’s expectations regarding Cathay Forest's future growth, results of operations, performance, business prospects and opportunities. Words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or similar expressions, are forward-looking statements within the meaning of securities laws. Forward-looking statements include, without limitation, the information concerning possible or assumed future results of operations of Cathay Forest. These statements are not historical facts but instead represent only Cathay Forest's expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. In addition to the factors that Cathay Forest currently believes to be material such as, but not limited to, our ability to acquire rights to additional standing timber, our ability to meet our expected plantation yields, the cyclical nature of the forest products industry and price fluctuation in the demand and supply of logs, our reliance on joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers, our ability to operate our production facilities on a profitable basis, changes in currency exchange rates and interest rates, evaluation of our provision for income and related taxes and each of the People’s Republic of China and the Russian Federation economic, political and social conditions and government policy, other factors, such as general, economic and business conditions and opportunities available to or pursued by Cathay Forest, not currently viewed as material could cause actual results to differ materially from those described in the forward-looking statements. Although Cathay Forest has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be anticipated, estimated or intended. Accordingly, readers should not place any undue reliance on forward-looking statements as such information may not be appropriate for other purposes. Except as required by securities laws, Cathay Forest does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report.

This MD&A has been prepared based on information available as at May 28, 2010 and reflect the restated financial statements presented on February 4, 2011.

Additional information relating to Cathay Forest Products Corp. can be found on the System for Electronic Document Analysis and Retrieval (SEDAR) at www.sedar.com and the Company’s website at www.cathayforest.com

Overview of Business

Cathay Forest Products Corp. (the “Company”, “Cathay” or “CFZ”) is listed on the TSX Venture Exchange for trading under the symbol CFZ. The Company is a forestry company with operations in the People’s Republic of China (“PRC” or “China”) and the Russian Federation (“Russia”). The Company holds its ownership interest by way of various Wholly Foreign Owned Enterprises (“WFOE”) as well as Joint Ventures (“JV”). As of the date of this MD&A, the Company had

five fast growth plantations (“FGP”) in the PRC: these plantations are located in Mudan (Heze), Cao Xian and Ju Ye in the Shandong province; Tongzhou in the Jiangsu province and Zhengzhou in the Henan province.

The Company also has standing timber interest in the PRC’s Jiangxi and Guizhou provinces as well as in the Khabarovsk Region of Russia.

In addition, the Company has interests in a roundwood importing operation and an investment interest in a Jatropha based biodiesel operation, based in China.

Significant Activities

Significant activities that took place during the first three months of 2010 and to the date of this MD&A were as follows:

Plantation Assets

During the first three months of 2010, Cathay expanded its poplar plantation under management by planting approximately 2,500 Mu (167 hectares) in the Poyang Lake region. The exact size of the area planted depends on the growth rate of previous season’s plantings, which is to be confirmed by forestry officials in the next few months.

Eco-Energy China Group Inc.

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 a dilution of Cathay Forest’s interest in Eco-Energy China Group Inc. from 29.88% to 27.69%.

Subsequent to the period-end, Eco-Energy China Group Inc. completed an additional private placement financing issuing 409,546 shares at US\$2.80 per share. This diluted Cathay Forest’s ownership to 26.44% and it provided 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 a demand note, unsecured, bearing interest at 3% per annum

OUTLOOK

For the balance of 2010, the Company aims to increase its volume of imported roundlogs from Russia into China and to achieve better margins from higher prices during 2010. The Company is committed to maintaining reasonable inventory levels and in doing so, optimizing margins.

For Russia, improved margins are anticipated as a result of better market prices for roundlogs harvested for export. For example sales to our Japanese customers were priced at \$124 per cu M in the spring of 2009 while the most recent sales to the same customers in the first quarter of this year were priced at \$144 per cu M. The Russian operations have now been in place for over a year and the Company anticipates that current operating costs will remain at, or near, current levels and that the improved market prices will continue to translate into better margins during 2010.

The Company plans to sell some of the Fast Growth Poplars in the Shandong area. It is anticipated that approximately 200,000 cu M of poplar will be sold in the final quarters of the current year. Management continues to monitor market conditions and will seek to establish an optimal return on these anticipated sales.

RESULTS FOR THE THREE MONTHS ENDED MARCH 31, 2010

Consolidated Financial Information

First quarter results were reflective of revenue generated primarily from trading operations and the sale of harvested timber originating from Russian operations. On a year over year basis revenue increased 6.7% to \$6.7 million from \$6.3 million in the first quarter of 2009, while gross profit margin increased to 13.8% versus 8.5% last year. Net loss for the quarter was slightly higher at \$1,290,547 versus \$1,117,908.

While demand is relatively constant throughout the year, plantation management is a seasonal business. Typically, poplar trees are not harvested during the spring and summer growing seasons. Geographical seasonal factors include Chinese New Year in February and the spring thaws experienced in Russia which disrupts roads and creates transportation havoc until the drier summer climate arrives. These factors effect operations at various levels. As a result, the third and fourth quarters will typically outperform the first and second quarters of the year.

Going forward, we anticipate that harvesting from our plantation properties in China will take place in the second half of the year with the quantity harvested largely influenced by market prices. Currently, management is forecasting a slow but steady increase in pricing for products in 2010.

The table below summarizes consolidated operating and financial data for the quarter ended March 31, 2010 and 2009:

(Cdn\$)	Three Months ended March 31,	
	2010 (restated)	2009
Revenue	\$ 6,695,383	\$ 6,277,519
Cost of Sales	5,773,458	5,741,471
Gross Profit	\$ 921,925	\$536,048
<i>Gross Margin</i>	13.8%	8.5%
Total Operating Expenses	2,260,591	1,709,131
Total Other Items	(\$48,119)	(\$55,175)
Net Income (Loss)	(\$1,290,547)	(\$1,117,908)
Loss per share	(\$0.009)	(\$0.010)

Revenue

Revenue increased by \$417,864 or 6.7% to \$6,695,383 for the three months ended March 31, 2010. This compares to revenue of \$6,277,519 for the three months ended March 31, 2009. The increase in revenue is primarily due to an increase in revenue per cubic metres for the roundwood logs being sold in conjunction with a marginal increase in the volume sold.

For the second quarter of 2010, management expects the Company's streams of revenue to continue to be primarily generated from logs exported from Russia for sale to China and Japan. The Company will continue to develop markets in more southern points in China where better prices can be realized, resulting in better gross margins.

In the final two quarters of this year it is anticipated that the Company will sell the harvest from some of its fast growth poplar plantations. This should result in higher margins for the final quarters of the year.

Cost of Sales

The cost of sales for the quarter ended March 31, 2010 increased 0.6% or \$31,987 to \$5,773,458 over the same period in 2009. The minimal increase reflects the stability of the costs of operating our business. In 2009, a significant part of the inventory being sold was inventory acquired in late 2008 at higher prices that existed prior to the global economic downturn. It also reflected the anticipated export tariff increase that had been announced for Russia which was to be in place by January 2009. After the economic downturn and the postponement of the export tariff increase, the Company was holding high priced inventory which it sold through the balance of 2009.

Gross Profit

Gross profit for the first quarter of 2010 increased to \$921,925 from a margin of \$536,048 in the first quarter of 2009. Consolidated gross profit margin increased to 13.8% in the first quarter of 2010 from 8.5 % in the comparable quarter in 2009. In 2009, gross margin was under pressure from lower wood prices and higher inventory costs as noted above. In 2010, the price of wood recovered as evidenced by pricing increases of \$24 per cubic metre from \$124 per cu M to \$144 per cu M while the cost of sales and production stabilized as Russian operations were fully established.

General and Administration Expenses

General and administrative costs for the quarter ended March 31, 2010 were \$1,240,756 versus \$1,254,832 for the same period in 2009 reflecting managements' strategy of stabilizing costs.

Selling and Marketing Expenses

Selling and marketing expenses were \$440,095 for the quarter ended March 31, 2010 versus \$345,704 a year earlier. The increase was mainly due to additional resources associated with higher volume flow in the import operations. Management does not foresee any significant changes in this type of expense in 2010 as the current resource level is deemed to be sufficient to handle the volume of transactions anticipated in coming year.

Amortization Expense

Amortization expense for the first quarter of 2010 increased by \$109,011 to \$217,094 versus \$108,083. The increase was due to the allocation of the amortization between various departments within the operations. Overall amortization costs allocated during the first quarter of 2010 remained consistent at \$843,183 versus \$848,083 for the first quarter of 2009.

Interest Income

The change in interest income was insignificant with a decrease of \$2,333 being experienced in the quarter. Interest rates continue to be low and the Company does not anticipate significant revenue being derived through interest income.

Foreign Exchange Loss

A foreign exchange loss of \$144,110 was recorded in the quarter ended March 31, 2010 versus a foreign exchange gain of \$28,210 recorded in the comparable period in 2009. The loss was primarily generated by the translation of US\$ denominated transactions made during the period.

Stock Based Compensation

The stock based compensation expense of \$362,250 recognized this quarter reflects the issuance of share options in May 2009. There was no comparable expense in the same period in 2009. The recognition of this level of stock base compensation expense for the May 2009 stock options is expected to continue to the end of the second quarter in 2010.

Following the second quarter of 2010, the level of expense being recognized should decrease to approximately \$120,750 per quarter until the second quarter of 2011. Should additional options be granted in future period it is possible that the level of expense required could be different.

LIQUIDITY AND CAPITAL RESOURCES

The following table outlines cash flows for the three month period ended March 31, 2010 and 2009:

(Cdn\$)	Three Months Ended March 31	
	2010 (restated)	2009
Opening Cash	\$ 18,072,035	\$ 9,944,726
Cash from Operations	(5,309,974)	266,096
Cash from Investing	(2,142,352)	(1,324,521)
Cash from Financing	1,828,066	(1,936)
Effect of Foreign Exchange	(53,621)	91,543
Closing Cash	\$ 12,394,154	\$ 8,975,908

Operating Activities

Cash flow from continuing operations was a negative \$5,309,974 for the first three months of 2010 compared to a positive \$266,096 in same period in 2009. In 2009, the increase in cash from operations was primarily related to the effect of a reduction of deposits and prepayments while in 2010, the decrease in cash from operations reflected an increase in other receivables and increase in the level of inventory.

Investing Activities

Negative cash flow of \$2,142,352 was used in investing activities, representing an increase of \$817,831 for the quarter ended March 31, 2010 compared to the quarter ended March 31, 2009. In 2010, the cash used for investing activities included an increase in loans receivable. The outflow for additions of property and equipment was higher than in 2009 by \$502,927. In the first quarter of 2010, the expenditures for capital assets took place in Russia and related to road building. In 2009, the expenditures related primarily to the construction of the lower landing in Russia.

For 2010, management will continue to manage its cash resources to strengthen and grow the Company. During the current year it is anticipated that cash flow from investing activities will see a conservative use of cash for capital expenditures. Once the full development of the second Russia property begins there will be additional needs for cash use to complete roadways and acquire additional forestry equipment.

Financing Activities

Cash flow from financing activities was positive \$1,828,066 for the quarter ended March 31, 2010 compared to a negative cash flow of \$1,936 in the comparable period of 2009. In 2010, the Company received a non-interest bearing advance from the minority shareholder of its trading operations totalling \$1,829,687. These funds will be used in support of working capital in the trading operations.

Management does not anticipate significant financing activities in 2010. Additional financings are possible in the long term should feasible opportunities present themselves.

Capital Resources

In order to finance the Company's future development and expansion, management may be seeking to raise additional funds until such time as cash flow from its operations, including the harvesting of plantations, are sufficient to fund growth internally. The timing and ability to fulfill this objective will depend on the liquidity of the financial markets as well as the willingness of investors to finance junior forestry companies operating in the PRC and in Russia.

Share Capital

The following financings have been completed by the Company since March 2006:

Date	Gross Proceeds	Type of Transaction
December 2009	15,592,881	Private Placement
January 2008	182,000	Exercise of Warrants
November 2007	45,000,000	Private Placement
September 2007	4,097,692 600,000	Exercise of Warrants Exercise of Options
June 2007	4,543,027	Exercise of Warrants
March 2007	37,500	Exercise of Warrants
January 2007	2,064,400	Private Placement
December 2006	3,135,000	Private Placement
September 2006	117,600	Exercise of Warrants
April 2006	122,400	Exercise of Warrants
March 2006	80,000	Exercise of Warrants

Capital Structure

The Company is authorized to issue an unlimited number of common shares, where each common share provides the holder with one vote. As of the date of this MD&A there were 138,086,814 common shares issued and outstanding. There has been no changes in the number of shares outstanding since December 2009.

In addition, the Company had the following convertible securities outstanding as at March, 2010:

<u>Type</u>	<u>Quantity</u>	<u>Exercise Price</u>	<u>Expiry Date</u>
Stock Options	1,420,000	\$ 0.60	May 31, 2010
Stock Options	940,000	0.80	December 31, 2010
Stock Options	1,830,000	1.25	May 10, 2012
Stock Options	<u>5,000,000</u>	0.50	May 20, 2014
Total Options	9,190,000		
Underwriters' Warrants	<u>1,533,726</u>	0.61	December 15, 2011
Total	<u>10,723,726</u>		

There has been no change in the number of outstanding convertible securities during the three month period ending March 31, 2010.

Off-Balance Sheet Arrangements

As of the date of this MD&A, the Company does not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future effect on the results of operations or financial condition of the Company including, without limitation, such considerations as liquidity and capital resources that have not previously been discussed.

Transactions with Related Parties

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.

Proposed Transactions

With the exception of the information provided above, the Company is not a party to any other proposed transaction that may have an effect on the financial condition, results of operations or cash flows which the management believes would require the intervention or approval of the Board of Directors of the Company.

Non-GAAP Measures

This document also includes non-GAAP financial measures that do not have any standardized meaning prescribed by GAAP and may not be comparable to similar measures presented by other companies. These measurements include EBITDA, gross profit, and sales per hectare. Management uses these statistics to assess how well the Company is performing and to make informed and strategic decisions. The inclusion of these measurements in the MD&A is intended to help investors and analysts assess the Company's current and future growth, operating results and to make informed investment decisions. The information should not be used as a substitute for the performance measures outlined by GAAP.

SUPPLEMENTAL INFORMATION

Selected Consolidated Quarterly Information

The table below outlines selected consolidated quarterly information for the eight most recently completed quarters:

(\$Cdn, 000s)	2010	2009				2008		
	Q1 (restated)	Q1	Q2	Q3 (restated)	Q4 (restated)	Q1	Q2	Q3
Revenue	\$ 6,695	\$ 6,278	\$ 14,934	\$ 9,554	\$ 11,386	\$ 6,130	\$ 4,506	\$ 5,560
Cost of Sales	5,773	5,741	15,025	9,090	10,899	5,364	4,000	4,701
Gross Profit	922	537	- 91	464	487	767	506	859
Total Expenses & Other Items	2,261	1,527	1,872	2,122	2,333	818	1,550	931
Net Income (loss)	\$ (1,291)	\$ (1,118)	\$ (2,063)	\$ (1,694)	\$ (1,847)	\$ (59)	\$ (1,161)	\$ (539)
Loss per share	(0.01)	(0.01)	(0.02)	(0.02)	(0.02)	(0.00)	(0.01)	(0.01)
<i>Gross Margin</i>	14%	9%	-1%	5%	4%	13%	11%	15%
Current Assets	30,891	28,668	21,242	18,868	31,738	48,846	48,154	40,764
Non Current Assets	114,709	116,537	113,256	111,442	113,202	68,850	74,017	89,673
Total Assets	145,600	145,205	134,498	130,310	144,940	117,696	122,171	130,437
Current Liabilities	74,670	73,354	69,356	69,812	73,641	49,463	53,499	23,229
Long Term Liabilities	4,320	6,473	3,845	3,429	2,716	1,619	1,615	39,419
Total Liabilities	78,990	79,827	73,201	73,241	76,357	51,081	55,113	62,648
Non-Controlling Interest	528	729	656	587	551	742	888	827
Shareholder's Equity	66,406	64,649	60,641	56,482	68,033	65,873	66,170	66,961

Critical Accounting Estimates

The preparation of financial statements in conformity with Canadian Generally Accepted Accounting Principles (“GAAP”) requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and accompanying notes. The Company’s significant accounting policies are noted in the annual consolidated financial statements. The application of policies involves estimates and certain assumptions that are made by management. The Company bases its estimates on historical experience and other assumptions as required that management believes are reasonable in the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. The Company reviews its estimates on an on-going basis in order to ensure the appropriateness of the estimates. Different accounting policies or changes in estimates and assumptions could potentially have a material impact, positive or negative, on the financial position and the results of operations of the Company. It is reasonably possible that circumstances may arise which cause actual results to differ from management estimates. The Company believes its most critical policies and estimates are those related to the valuation of its plantation assets and the corresponding accrued liabilities.

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)	9,272,477	7,108,174
Other financial liabilities (c)	76,950,443	74,368,037

(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 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	<u>273,951</u>
Total	<u>3,676,759</u>

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 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:

	<u>2011</u>	<u>2012</u>	<u>2013</u>	<u>2014</u>	<u>2015</u>	<u>Thereafter</u>	<u>Total</u>
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 *	66,151,806	-	-	-	-	-	66,151,806
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>\$ 73,481,479</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>\$ 182,193,469</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 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	29,351,199	4,367,478	76,678,606	2,646,179
Liabilities	494,382,781	73,564,487	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	31,414,605	4,815,827	59,626,331	2,058,899
Liabilities	463,726,668	71,088,832	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 \$670,000 (2009 - \$630,000) 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 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.

Risks related to the Forestry Industry

The forestry industry involves a degree of risk, particularly when it is conducted in other countries. The following is a brief description of some of the risks that investors should be aware of.

The cyclical nature of the forest products industry and price fluctuations could adversely affect our results of operations

Our results of operations are, and will continue to be, affected by the cyclical nature of the forest products industry. Prices and demand for logs and wood chips have been, and in the future are expected to be, subject to cyclical fluctuations. The pricing in the forestry market is affected by the prices of the ultimate wood products produced from logs in the PRC, including pulp and paper products, furniture, construction materials, and interior decoration materials. The prices of wood products are also affected by the availability of wood substitutes. The markets for wood products are sensitive to changes in industry capacity and output levels, general timber industry conditions and cyclical changes in the global and PRC economies, any of which can have a significant impact on selling prices of wood products. The demand for wood products is also substantially affected by the level of new construction activity, which is subject to fluctuations that may or may not correspond to overall economic trends. Decreases in the level of construction activity generally reduce demand for wood products. The demand for wood products is also affected by the level of interior design activity and the demand for wood chips in the pulp and paper markets. These activities are, in turn, subject to fluctuations due to, among other factors:

- changes in domestic and international economic conditions;
- governmental regulations and policies;
- interest rates;
- population growth and changing demographics; and
- seasonal weather cycles and other factors.

With PRC's entry into the World Trade Organization, the PRC is expecting to reduce or remove existing tariffs on the import of paper, paper pulp, paperboard and timber. This may lead to greater volatility of prices in paper pulp and timber in

the domestic market, potentially resulting in greater volatility of market prices of the wood fibre harvested. In the event of any material drop in the international prices of paper, pulp and/or timber, this may reduce the demand or the price at which we can sell it.

Cyclical changes in the forestry products industry, including changes in demand and pricing for our products and the other factors described above, could have a material adverse effect on our business, financial condition and results of operations.

Our ability to expand our forestry plantation resources will require substantial future capital expenditures and we may be unable to obtain adequate financing to fund our capital and other requirements

The success of our business plan is dependent, among other things, on obtaining sufficient funding to enable us to explore and develop our forestry assets. To date, we have financed our forestry asset expansion activities primarily with equity financing and may require additional capital to continue to operate our business and to continue developing our plantations. It is likely that such additional capital will be raised through the issuance of equity which will result in a dilution of ownership for our shareholders. We cannot give any assurance that we will be able to obtain adequate financing in the future or that the terms of such financing will be favourable. Failure to obtain such additional financing could result in the delay or indefinite postponement of further development of our plantations and could have a material adverse effect on our business, financial condition and results of operations.

The forestry industry is susceptible to weather conditions, timber growth cycles and natural disasters outside of our control

Our business, financial condition, and results of operations depend to a significant extent on our ability to harvest trees or engage in trading activities at adequate levels. The following factors, which are outside of our control, may affect the prices of logs and wood-based products, and our ability to harvest the trees on our forestry plantations or engage in our trading activities:

- unfavourable local and global weather conditions, such as prolonged drought, flooding, hailstorms, windstorms, typhoons, frost and winter freezing; and
- the occurrence of natural disasters, such as damage by fire, insect infestation, crop pests, and earthquakes.

In recent years, certain areas of the PRC have been adversely affected by severe flooding and severe snow storms. In addition, the coastal areas of southern China suffer a number of typhoons each season, which lasts from July to September, which occasionally results in significant damage. Dry weather conditions brought by the El Nino weather pattern in 1998 adversely affected certain areas of the world. Similar conditions may occur in the future. The occurrence of these or other natural disasters may disrupt or reduce the supply of trees available for harvesting in the areas of the PRC where our forestry plantations are located, which may adversely affect our business, financial condition and results of operations.

Reliance on a single or few suppliers for the fast growth saplings

Historically, we have relied on a single supplier of saplings for the FGP plantations, Guangzhao Plant Fast-Growing Technology Co. Ltd. In 2006, we diversified from one supplier to several across different regions in the PRC. In practice, we now formally source our supply of saplings through all local forest bureaus.

We will be materially adversely affected by any disruption in the supply of such saplings. Such disruptions may arise from natural calamities, diseases and/or pests affecting the plantations of our supplier. Moreover, there is a risk that our supplier may be unable or unwilling to fulfill its obligations, or terminate our arrangements with them. However, we intend to mitigate this risk by investigating other sources of saplings or the possibility of developing our own sapling nurseries.

Factors which may affect the growth of the saplings

The tissue cultured seedlings, rooted seedlings and grown saplings are, like other varieties of plants, vulnerable to pests, diseases and natural calamities, such as fires, droughts, floods and hurricanes. The growth and development of the saplings are affected by a number of factors, many of which are beyond our control. Factors that can affect the growth and development of the saplings include, genetic superiority, seedling quality, weather conditions, climate, soil conditions as well as damage by disease, pests and other natural disasters. The ability for the Company to maintain expected yields will depend on the impact of one or more of these factors would have on the saplings.

The Company's ability to optimize yields will depend on the factors listed above in addition to the acquisition of genetically improved materials as well as the continued development of our silviculture practices. As a result, the Company is unable to provide assurance as to future yields. If we cannot achieve the levels of expected yield, our business, financial conditions and results of operations would be materially and adversely affected.

Reliance on a few suppliers for the log trading supplies

The Company purchases its roundwood trading supplies from several suppliers. However, any disruption in the supply would have an adverse effect on Cathay's roundwood trading business.

Our insurance coverage may be insufficient to cover losses

We do not insure all of our forestry assets against losses from all natural and other disasters and we do not carry business interruption insurance. As a result, our insurance coverage may be insufficient to cover losses that we may incur on our forestry plantations. If we were to suffer an uninsured loss to our forestry plantations, our business, financial condition and results of operations could be materially adversely affected.

Our decision and ability to acquire, develop and operate future forestry assets is subject to various factors and uncertainties, and no assurance can be given that we will actually develop and operate the amount of forestry assets with respect to which we have certain contractual rights

We have entered into agreements whereby we have options to acquire plantations available for sale. All such options are subject to negotiation of a price and receipt of relevant governmental approvals, and satisfaction of registration requirements. We cannot give any assurance that we will exercise any of these options. Our decision and ability to exercise our option will depend on, among other factors, our ability to negotiate a final price, whether the area is desirable for forestry plantations and the availability of future financing.

Should we be unable to exercise the option to acquire plantations, or obtain and complete requisite government approvals for our plantations or should we be unable to acquire additional resources for expansion, our business, financial condition and results of operations could be materially and adversely affected.

Infrastructure

Industrial activities depend, to one degree or another, on adequate infrastructure. Reliable roads, bridges, power sources and water supply are important determinations which affect capital and operating costs. Unusual or infrequent weather phenomena, sabotage, government or other interference in the maintenance or provision of such infrastructure could adversely affect our financial condition and results of operations.

Loss of key personnel

We are dependent on the services of key executives and a small number of highly skilled and experienced executives and personnel. Due to a relatively small number, the loss of these persons or our inability to attract and retain additional highly skilled employees may adversely affect our business and future operations. We currently do not carry any key man life insurance on any of our executives.

We may not be able to effectively manage our forestry plantations if we do not hire additional employees and improve our management systems and internal controls

As December 31, 2009, we had 10 employees managing our forestry plantations. As we expand the area of our forestry plantations, we will have to hire additional management employees, strengthen our management processes and develop a plantation resources information system in order to effectively manage our forestry plantations. There is no assurance that we will be able to recruit qualified management employees, strengthen our management processes or develop such an information system in a timely manner, or at all. We also believe that it is necessary for us to strengthen our internal controls and corporate governance as we continue to build the business. Should we fail to take these measures, we may not be able to implement our expansion strategy or to manage our growth effectively and our business, financial condition and results of operations could be materially and adversely affected.

Difference in the Guizhou business model may pose execution risks

Guizhou is a region that we recently entered into and our intention is to execute all three phases of the Mutual Cooperation Agreement between a local forestry group and Cathay Forest. Our business model is in a development stage and has a short

operating history. Despite the strong support and collaboration we received from the local governments and forestry bureaus, there remain risks such as (i) disagreement with collective farms and (ii) execution risks of large-scale harvesting and replanting programs.

In addition, we may not have the ability to allocate proper management resources and attention to the successful implementation of the business model.

Joint venture partners and contract parties

We currently have joint venture arrangements which operate our forestry plantations and operations in the provinces of Henan, Jiangsu, Heilongjiang, Guizhou, and the region of Khabarovsk. These, and possible future joint ventures and contractual arrangements with other third parties, may involve certain risks. These risks include, among others, the possibility that the joint venture partners and contract parties may be unable or unwilling to fulfill their obligations, whether of a financial nature or otherwise, under the relevant joint venture or other agreements, or that the joint venture partners or contract parties could terminate our arrangements with them before the end of the term of the relevant contract or refuse to renew such arrangements when the term of the relevant contract expires. Although we have not experienced any significant disputes with our PRC joint venture partners or contract parties, a serious dispute over joint venture and contractual obligations, timber-sharing arrangements or otherwise, or an early termination of our arrangements with them, could adversely affect our business, financial condition and results of operations.

Following the adoption of IFRS, our results may fluctuate due to revaluation gains or losses on our forest assets

Valuation gains or losses on our forest assets can dramatically impact the results of our operations because a significant component of our profit for the year consists of changes fair value of such assets.

Our forest survey and knowledge of our forests are subject to errors of survey

Our operating results depend on our knowledge of forests. We regularly visit our forests to monitor their growth and condition. In the process, we use a random sampling method for our survey of forests. We cannot guarantee the reliability of the results of our survey. In the event that the results of our survey are not reliable, our knowledge of our forests and our ability to manage our forests could be greatly hampered, which may have a material adverse effect on our business, financial condition and results of operations.

We may face increased operating costs and staff costs

Our business may face increased operating costs as the forestry industry continues to develop in the PRC and the Russian Federation. We expect labour costs to rise as villagers who harvest our logs become more experienced and increase their wage demands. Our staff costs are also impacted by the new PRC Labour Contract Law which took effect as of January 1, 2008. The law establishes minimum wage, safety and educational requirements, all of which are expected to increase our staff costs as well as our regulatory compliance costs.

The forestry industry faces competition from wood substitutes

In addition to competition within the forestry industry, the forest industry faces competition from wood substitutes. We face competition from companies that manufacture wood substitutes, such as imitation wood and other materials that are used as alternative materials mainly in construction and in furniture production. The demand for wood products is also affected by changes in consumer trends and tastes. Preference for wood substitutes among manufacturers, construction companies and consumers could decrease demand for our products and have a material adverse effect on our revenue, financial condition and results of operations.

The Forest Valuation Reports are subject to significant assumptions and limitations and actual values realized by the Company may differ

The Company engaged Pöyry Beijing to prepare reports and provide its opinion on the value of the Company's plantation forest crop assets in China and Russia as at September 30, 2009, and Pöyry Beijing's reports are incorporated by reference herein. The Forest Valuation Reports contain a discussion of the principal assumptions, limitations and other considerations utilized in their preparation, which prospective investors should review carefully.

As a result of the foregoing and other limitations to the Forest Valuation Reports, actual conditions of the Company's forestry plantations may be substantially different than those set forth in the Forest Valuation Reports, and, as a result, you

should not place undue reliance on the reports. Accordingly, the valuations set forth in the Forest Valuation Reports are not necessarily indicative of the actual values that can be realized by the Company. If actual values realized by the Company are less favourable than those shown in the Forest Valuation Reports or the assumptions used in deriving the valuations included in the Forest Valuation Reports prove to be incorrect, the Company's business, financial condition or results of operations could be adversely affected.

Conflicts of interest

Certain of our directors and officers also serve as directors and/or officers of other companies and consequently there exists the possibility for such directors and officers to be in a position of conflict. Any decision made by any of such directors and officers involving Cathay Forest will be made in accordance with their duties and obligations to deal fairly and in good faith to the best interests of the Company and its shareholders.

Risks related to the PRC

Environmental risks and hazards

The grown saplings originally used by us have been sold for cultivation on a commercial basis since 2003. While our supplier of saplings has advised that there have not been any adverse biological or environmental issues that have arisen in the cultivation of the saplings, there is no assurance that such issues will not arise in the future. If these issues arise and we are unable to resolve them, we may have to cease the cultivation and sale of the plantations utilizing that sapling. Consequently, such issues could adversely affect our business, financial condition and results of operations.

PRC economic, political and social conditions as well as government policies could adversely affect our business

Until recently, all of our forestry plantations were located in China. The PRC economy differs from the economies of most developed countries in many respects, including structure, government involvement, level of development, economic growth rate, government control of foreign exchange, allocation of resources and balance of payment position.

The PRC economy has been transitioning from a planned economy to a more market-oriented economy. For the past two decades the PRC government has implemented economic reform measures emphasizing utilization of market forces in the development of the PRC economy. Some of these measures will benefit the overall PRC economy, but may have a negative effect on us.

Our business, financial condition and results of operations may be adversely affected by:

- changes in PRC political, economic and social conditions;
- changes in policies of the PRC government, including changes in policies affecting the forestry industry;
- changes in laws and regulations or the interpretation of laws and regulations;
- measures which may be introduced to control inflation or deflation;
- changes in the rate or method of taxation;
- imposition of additional restrictions on currency conversion and remittances abroad; and/or
- reduction in tariff protection and other import restrictions.

In addition, the growth of demand in China for forestry products depends heavily on economic growth. Between 1994 and 2007, China's GDP increased from approximately RMB482 billion to approximately RMB25 trillion. The annual per capita GDP had also risen during this period, from RMB4,044 to RMB18,934. The central government has been prompt to take corrective measures and actions to stabilize the country's economy and any possible social unrest. After the country's soft landing from an overheating economy, the central government implemented various measures to strengthen and improve macroeconomic regulation and is slowly pushing forward reform programs to create stable momentum growth. There is no assurance that such growth will be sustained in the future.

In addition, there have been concerns about a rising demand for labour, a shrinking supply of traditional unskilled labour and increase in workforce wages. While the rise in wages may increase consumption power, it may increase inflationary pressures in the economy. The reform programmes and shortage of supply of labour may have an adverse impact on our business, financial condition and results of operations could be adversely affected.

Uncertainty of the PRC legal system

The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, the PRC government has been developing a comprehensive system of commercial laws, and

considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, as these laws and regulations are relatively new, and due to the limited volume of published cases and judicial interpretation and their lack of precedential force, interpretation and enforcement of these laws and regulations involve significant uncertainties.

At present, the legal framework for the forestry plantation industry in the PRC is at an early stage of development. For example, the laws and regulations relating to the ownership, licensing and rights over forestry areas are not well developed. Because these laws and regulations may not be comprehensive, and because of the limited volume of published cases and judicial interpretations and the non-binding nature of prior court decisions, the interpretation and enforcement of these laws, regulations and legal requirements involve some uncertainty. Such uncertainty may make it difficult for us to enforce our plantation land use rights and other rights. As the PRC legal system develops together with the PRC forestry industry, we cannot provide any assurance that changes in such laws and regulations, or in their interpretation or enforcement, will not have a material adverse effect on our business, financial condition and results of operations.

Extensive PRC laws and regulations

We are subject to regulation under a variety of PRC national and local laws and regulations, including, among others, the PRC Forestry Law and its Implementation Regulations, the Forest Tree and Forestry Land Ownership and Use Rights Registration Administrative Measures. Violations of a variety of PRC laws and regulations, including PRC environmental policies and programs that apply to our forestry plantations, could result in civil and criminal penalties, including the revocation of licenses required for our business. We engage in the following activities that are subject to regulation:

1. forestry plantation activities, including planting, plantation use and maintenance, logging and transportation of logs; and
2. marketing, sale and trading of standing timber, logs and wood-based products.

Restrictions on foreign currency exchange

We receive most of our revenues in Renminbi. As a result, any restrictions on currency exchange may limit our ability to use revenue generated in Renminbi to:

- purchase timber imported from other countries;
- fund other business activities outside the PRC;
- service and repay our indebtedness; and/or
- pay out dividends to our shareholders.

Current account transactions refer to those international revenue and expenditure dealings that occur on a current basis, including revenues and expenditures in trade and labour services, and the declaration of and payment of dividends out of retained earnings. Foreign exchange for current account transactions may be obtained by producing commercial documents evidencing such transactions, provided that the transactions are processed through banks in China licensed to engage in foreign exchange.

Foreign exchange transactions under capital account, however, are subject to the registration requirements of the State Administration of Foreign Exchange. Capital account transactions refer to international revenues and expenditures that, being inflows and outflows of capital, produce increases or reductions in debt and equity, including direct investment, various types of borrowings and investment in securities. In addition, for either current or capital account transactions, our joint ventures must purchase foreign currency from one of the PRC banks licensed to conduct foreign exchange.

We cannot provide assurance that the PRC government will not impose further restrictions on the convertibility of the Renminbi.

Operational licenses and permits

Currently, PRC laws and regulations require forestry plantation companies to obtain licenses and permits to operate forestry plantations, harvest logs on the forestry plantations and transport the logs out of the forest areas. Forestry plantation companies must apply to the relevant Administration for Industry and Commerce of the PRC for the business license, and must apply to the local forest bureaus for the logging permits and transportation permits for plantations that are to be harvested. We currently have the relevant business licenses for our subsidiary companies in the PRC to engage in forestry activities and have received the requisite logging and transportation permits for our completed logging and transportation activities. In this regard, the PRC government allocates logging quotas and transportation quotas annually for plantations

that are to be harvested, rather than granting permits at the time the forest is established. There is no assurance that we will continue to maintain the business licenses and obtain the relevant permits for our future logging and transportation activities or that the PRC government will not enact laws and regulations that would add requirements for forestry plantation companies to conduct these activities in the PRC.

Environmental regulations

Laws and regulations protecting the environment have generally become strict in the PRC in recent years and could become more stringent in the future. On December 26, 1989, the Standing Committee of the National People's Congress of the PRC adopted the Environmental Protection Law of the PRC. This law and future legislation with respect to protection of the environment, whether it relates to forests, protected animal species, or water conservation, could contain restrictions on tree planting, timber harvesting, and other forest practices. Currently, it is a general policy of the PRC that a person who harvests trees is required to replant the harvested lands. Our forestry plantations could also be subject to future environmental laws and regulations. Any failure by us to comply with applicable environmental laws and regulations could result in civil or criminal fines or penalties or enforcement actions, including a requirement to install pollution control equipment or other mandated actions. Compliance with environmental laws and regulations may adversely affect our business, financial condition and results of operations.

Plantation land use rights

Our PRC joint venture partners generally obtain the plantation land use rights from third parties, who are generally rural collective organizations, and then contribute plantation land use rights to the joint ventures. Under the Rural Land Contracting Law in the PRC, which took effect on March 1, 2003, our PRC joint venture partners must fulfill all relevant legal formalities for the transfer of plantation lands and the rights to operate and manage the plantations. These include obtaining consents from all members of the farming households who have contracted to transfer the plantation lands, from all members of the collective organizations where such farms are located to waive their pre-emptive rights and from the contracting parties who have rights to operate and manage the plantations. Because of the additional requirements of the Rural Land Contracting Law, our PRC joint venture partners may not be able to obtain sufficient plantation land use rights from the rural collective organizations or the farming households, which would adversely affect their ability to make their required contributions to the joint ventures. As a result, our PRC joint venture partners may not be able to provide us with the plantation land use rights to all the forestry plantations that we have the right to obtain.

Implementation of new form of plantation rights certificate

Since 2000, the PRC has been improving its system of registering plantation land ownership, plantation land use rights and plantation ownership rights and of issuing certificates to the persons having land use rights, to owners owning the plantation trees and to owners of the plantation land. In April 2000, the State Forest Bureau issued a notice, which provided that a new form of plantation rights certificate was to be used from the date of the notice. The PRC government is now issuing the new form of certificates on a nationwide scale. In addition, for the purchased tree plantations, we have obtained confirmations from the relevant forest bureaus that the Company has the legal right to own the purchased tree plantations for which we have not received certificates. Until official new-form plantation rights certificates are issued, there can be no assurance that our rights to our forestry plantations will not be subject to dispute or challenge. If such certificates are not issued, or are not issued in a timely manner, or if our right to any of our forestry plantation lands is subject to dispute or challenge, our business, financial condition and results of operations could be materially adversely affected.

Deferred Rent

In our 2008 Audited Financials, included under "Accounts payable and accrued liabilities" is an amount for deferred rent which relates to 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 on the financial statements, management has reached an understanding with the lessors and suppliers to defer the actual payment of the liabilities until the plantations are harvested. Although the Company and the lessors have this understanding with regards to the settlement of deferred rent, there is no assurance that the lessors will not demand repayment of such deferred rent prior to harvesting of the plantations.

Risks related to the Russian Federation

Our operations are subject to the uncertainty of the Russian legal system

The Russian Federation is continuing to develop an adequate legal framework required for the proper functioning of a market economy. Several fundamental Russian laws have only recently become effective. Russian laws and regulations regarding leasing of forest land, as well as regulations regarding construction, are often poorly drafted, containing vague and unclear provisions, inaccuracies and contradictions. This is the result of frequent changes in legislation over time (with new and old regulations often overlapping), a lack of coordination between various federal, regional, and local state bodies charged with enacting and enforcing such legislation, the repeated restructuring of relevant government bodies authorized to legislate in given areas, and often simply bad editing. Given the unclear nature of the legislation, its implementation in practice is often inconsistent. In addition, many Russian laws are structured in a way that provides for significant administrative discretion in application and enforcement. Reliable texts of laws and regulations at the regional and local levels may not be available and are subject to different and changing interpretations and administrative applications.

The difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us from obtaining effective redress in court proceedings

Enforcement of court judgments can in practice be very difficult in Russia. Court claims are often used in furtherance of political and commercial aims and court judgments are not always enforced or followed by law enforcement agencies. Russia is not a party to multilateral or bilateral treaties for the mutual enforcement of court judgments with most Western countries. Consequently, if a judgment is obtained from a court in any such jurisdiction, it is highly unlikely to be given direct effect in Russian courts. Though Russia is a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (the “**New York Convention**”) and an award obtained in a state which is a party to the New York Convention should be recognised and enforced in Russia, in practice, reliance upon international treaties may meet with resistance on the part of Russian courts. All of these factors make judicial decisions in Russia difficult to predict and make effective redress uncertain.

Selective or arbitrary government action could adversely affect our business

Governmental authorities in Russia have a high degree of discretion and at times exercise their discretion arbitrarily, including unscheduled inspections by regulators, suspension or withdrawal of permissions, unexpected tax audits, criminal prosecutions and civil actions. In this environment our competitors may receive preferential treatment from the Russian governmental authorities, potentially giving them a competitive advantage. Unlawful, selective or arbitrary government action could have a material adverse effect on our business, results of operations and prospects.

Russian tax law and practice are not fully developed and are subject to frequent changes, which could have an adverse effect on our business

DalEuroLes is subject to a broad range of taxes and other compulsory payments imposed at federal, regional and local levels, including, but not limited to, profits tax, export duties, VAT, property tax and social taxes. Russian tax laws have been in force for a relatively short period and the implementation of these tax laws is often unclear or inconsistent. The ambiguities in the application and interpretation of Russian tax law and regulations create tax risks in Russia that are more significant than typically found in countries with more developed tax systems. There can be no assurance that the Russian tax regulations will not be changed in the future in a manner adverse to the stability and predictability of the tax system. There can be no assurance that our current taxes will not be increased, that additional tax charges will not be imposed or that additional sources of revenue or income, or other activities, will not be subject to new taxes, charges or similar fees in the future. In addition to creating a substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties, and could have a material adverse effect on our business.

Russian economic, political and social conditions as well as government policies could adversely affect our business

There can be no assurance that industries deemed of national or strategic importance to Russia, like forestry, will not be nationalized. In addition, the Khabarovsk regional government current policy of encouragement of foreign investment may change, nationalization of the forestry industry may occur, or other government limitations, restrictions or requirements not at present foreseen, may be implemented. Changes in policy that alter Russian laws regulating forestry or export tariffs could have a material adverse effect on our financial position. There can be no assurance that our assets will not be subject to nationalization, requisition or confiscation, whether legitimate or not, by any authority or body. While there are

provisions for compensation and reimbursement of losses to investors under such circumstances, there can be no assurance that such provisions would be effective to restore the market value or value of the original investment taxes and other fiscal measures. Customs and other import regulations are particularly susceptible to revision in reaction to political changes and the pressure on the Russian Government to generate revenue or to conserve hard currency.

Crime and corruption could disrupt our ability to conduct our business and could adversely affect our financial condition and results of operations

The weakened economic conditions in Russia, caused by the current international financial crisis, have resulted in higher unemployment and increased levels of social unrest. In addition, both the Russian and international press continue to report high levels of official corruption in Russia, including the bribery of officials. Press reports have also described instances in which state officials have engaged in selective investigations and prosecutions to further interests of the government officials and certain individuals. The effects of organised or other crime, demands or claims of corrupt officials could result in negative publicity, disrupt our ability to conduct business effectively and, thus, have a material adverse effect on our business.

High levels of inflation in Russia

The Russian economy has been characterised by high rates of inflation. Although inflation in Russia subsided to 9.0% in 2006, it increased to 11.9% in 2007 and 13.3% in 2008 and is forecast by the International Monetary Fund to reach 12.3% by the end of 2009. Certain of our costs are sensitive to increases in the general price level in Russia and the effects of inflation could cause some of our costs to rise. To the extent inflation causes these costs to increase, such inflation may materially adversely affect our business and results of operations.

Russia's physical infrastructure is in poor condition, which could disrupt our normal business activity

Russia's physical infrastructure largely dates back to the Soviet period and in certain respects has not been adequately funded and maintained. Particularly affected are the rail and road networks, power generation and transmission, communication systems and building stock. In addition, road conditions throughout Russia are poor and power disruptions also occur. Breakdowns and failures of any part of Russia's physical infrastructure may disrupt the transportation of goods and supplies, add costs to doing business in Russia and interrupt our normal business operations.

Changes in the foreign policy of the Russian Government and changes in its key global relationships could adversely affect the Russian political and economic environment in general

Russia's exports are commodity driven and are heavily oriented toward developed nations and nations with fast-growing economies. Nevertheless, Russia's foreign policy interests have often diverged from the interests and goals of its main trading partners. There can be no assurance that Russia's political relationships with key trading partners, including China, will remain at the level where they currently stand. Any deterioration in relations with any one or more nations could result in a lower volume of exports and a lower volume of inbound investment and other transfers. Changes in the Russian Government's policy or deterioration in key global relationships with Russia could have a material adverse effect on our business.

Russian export taxation

In 2007, the Russian Government announced plans to significantly increase the export duty on logs from then existing level of 6.5%. The tariffs were increased to 20% as of July 1, 2007 and then to 25% as of April 1, 2008. Initially, it has been planned to further increase the export duty to 80% as of January 1, 2009. However, the Russian Government froze the 25% export duty rate for the year 2009; postponing the export duty increase to 80% until January 1, 2010. On October 25, 2009, the Russian Government stated its intention to delay the implementation of the tariff until January 2011.

As the Russian Government is implementing their plans to consolidate their forestry industry and stimulate investment in the wood processing industry, there is resistance from importers of Russian wood such as Finland. The proposed increase in export tariffs are being challenged by various importers in the World Trade Organization. The outcome and implementation of increases in the export taxes will have material effect on the operations of our Russian subsidiary and our Chinese importing unit.

Environmental regulations

Existing and possible future environmental legislation, regulations and actions could cause significant expense, capital expenditures, restrictions and delays in our activities, the extent of which cannot be predicted and which may well be

beyond our capacity to fund. Our rights to exploit the forestry concession area are subject to various reporting requirements being mandatory under Russian environmental legislation. Environmental impact studies may be required for some operations, and significant fines and clean-up responsibilities may be assessed for companies causing damage to the environment in the course of their activities.

Priority Investment Program

The Priority Investment Program was initiated by the regional government of Khabarovsk and is subject to Russian Federal Government approval. There is no assurance that the Russian Federal Government will approve the Priority Investment Program. The final approved version of the Priority Investment Program could entail changes including the terms of membership and preferential policies provided to the members under the program. In addition, the Priority Investment Program approves its participating members based on a commitment to investment in the processing industry in Russia. Our Russian joint venture's membership in the program has significant reliance on our joint venture partner's commitment. The execution of our joint venture partner's commitment is dependent, among other things, on obtaining sufficient future funding. We can give no assurance that our joint venture partner will be able to obtain adequate financing in the future for these commitments. Our risks include, among others, the possibility that the joint venture partners and contract parties may be unable or unwilling to fulfill their obligations, whether of a financial nature or otherwise. Failure to execute such commitment could have a material adverse effect on our qualification for the Priority Investment Program. Our participation in the Priority Investment Program will have a material effect on the business, financial condition and operations of our Russian subsidiary and our Chinese importing unit.

Restrictions on foreign currency exchange may limit our ability to utilize our revenue effectively

The introduction of the Russian currency control law in 2004 and the numerous amendments to the currency control legislation made since then have been generally intended to liberalize the control over currency transactions in Russia. However, there can still be practical difficulties and delays involved in seeking to remit funds from Russia. The Russian rouble is not widely convertible outside Russia and is not traded internationally.

Participant liability under Russian legislation could cause us to become liable for the obligations of our subsidiary

The Russian Civil Code and the Law on Limited Liability Companies generally provide that participants in a Russian limited liability company are not liable for the obligations of the company and bear only the risk of loss of their investment. This may not be the case, however, when one person ("parent company") is capable of determining decisions made by another ("subsidiary"). The parent company bears joint and several liability for transactions concluded by the subsidiary in carrying out the parent's instructions if the right to issue binding instructions to the subsidiary is provided for in the charter of the subsidiary or in a contract between the companies.

In addition, a parent is secondarily liable for a subsidiary's debts if a subsidiary becomes insolvent or bankrupt due to the fault of a parent, irrespective of how the parent's ability to determine decisions of the subsidiary arises. In these instances, other participants of the subsidiary may claim compensation by the parent for a loss caused to the subsidiary due to the fault of the parent. Accordingly, in our position as a parent, we could be liable in some cases for the debts of our Russian subsidiary. This liability could have a material adverse effect on our business, financial condition and results of operations.

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 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.

Summarized below is a description of our progress towards completion of selected key activities of our IFRS changeover plan as at March 31, 2010. At this time we cannot quantify the impact that the future adoption of IFRS will have on our financial statements and operating performance measures, however, such impact may be material. We also expect the changeover to IFRS to impact internal controls over financial reporting and disclosure controls and procedures. Additional information will be provided as we move towards the changeover date.

	SELECTED KEY ACTIVITIES	MILESTONES/DEADLINES	PROGRESS TO DATE
Financial statement preparation	<p>Identify relevant differences between IFRS and our accounting policies and practices and design and implement solutions</p> <p>Evaluate and select one-time and ongoing accounting policy alternatives</p> <p>Benchmark findings with peer companies</p> <p>Prepare financial statements and related note disclosures to comply with IFRS</p> <p>Quantify the effects of changeover to IFRS</p>	<p>Assessment and quantification of the significant effects of the changeover completed by the second quarter of 2010.</p> <p>Final selection of accounting policy alternatives by the changeover date</p>	<p>Currently in the process of identifying IFRS differences</p> <p>Design solutions to resolve IFRS differences progressing and it is anticipated that it will be completed during the second quarter of 2010</p> <p>Evaluation and selection of accounting policy alternatives is ongoing</p>
Training and communication	<p>Provide training to affected employees of operating units, management and board of directors and relevant</p>	<p>Timely training provided to align with work under changeover –training completed by mid 2010</p>	<p>Training for resources directly engaged in the changeover and general awareness for board of directors and affected</p>

	<p>committees thereof, including the Audit Committee</p> <p>Engage subject matter experts to assist in the transition</p> <p>Communicate progress of changeover plan to internal and external stakeholders</p>	<p>Communicate effects of changeover in time for the 2011 financial planning process, by the third quarter of 2010</p>	<p>employees is on-going</p> <p>Periodic internal and external communications about our progress are ongoing,</p>
<p>Contractual arrangements and compensation</p>	<p>Identify impact of changeover on contractual arrangements.</p> <p>Make any required changes to arrangements and plans.</p>	<p>Changes completed by the third quarter of 2010</p>	<p>IFRS differences with potential impacts on contractual arrangements are being evaluated</p>
<p>Internal Control over financial reporting (ICFR)</p>	<p>Revise existing internal control and procedures to address significant changes to existing accounting policies and practices, including the need for dual record keeping during 2010</p> <p>Design and implement internal control with respect to one-time changeover adjustments and related communications</p>	<p>Changes completed by the first quarter of 2010</p> <p>Conduct management evaluation of new and revised controls throughout 2010</p> <p>Update Chief Executive Officer and Chief Financial Officer certification process as required by fourth quarter of 2010</p>	<p>In the process of reviewing IFRS differences to permit design, revision and testing of controls, if required, and implementation of necessary internal controls changes</p>
<p>Disclosure controls and procedures (DC&P)</p>	<p>For changes to accounting policies and practices identified, assess the DC&P design and effectiveness implications</p>	<p>See ICFR deadlines above</p>	<p>Expanded MD&A disclosure have begun</p>