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**CATHAY FOREST PRODUCTS CORP.**  
**UNAUDITED INTERIM CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE THREE MONTHS AND NINE MONTHS ENDED SEPTEMBER 30, 2010**

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**CATHAY FOREST PRODUCTS CORP.**

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**September 30, 2010**

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

|   | As at<br>September 30, 2010<br>(Unaudited) | As at<br>December 31, 2009<br>(Audited)<br>(Restated) |
|---|--|---|
| <b>ASSETS</b>   |  |   |
| <b>Current assets</b>   |  |   |
| Cash  | \$ 8,455,521                               | \$ 18,072,035   |
| Accounts receivable (net)                                     | 4,910,910                                  | 4,341,520   |
| Deposits and prepayments                                      | 6,249,038                                  | 5,691,308   |
| Other receivables (note 13)                                   | 6,094,109                                  | 2,648,014   |
| Inventories (note 3)  | 3,837,888                                  | 961,988   |
| Current portion of long-term loans receivable (note 4)        | 24,535                                     | 24,102  |
| <b>Total current assets</b>                                   | <u>29,572,001</u>                          | <u>31,738,967</u>                                     |
| <b>Long-term loans receivable (note 4)</b>                    | 1,113,725                                  | 94,538  |
| <b>Long-term investment (note 5)</b>                          | 3,309,215                                  | 3,251,974   |
| <b>Property and equipment (net) (note 6)</b>                  | 12,939,078                                 | 13,694,494  |
| <b>Plantation assets (note 7)</b>                             | 81,794,152                                 | 73,341,621  |
| <b>Forestry rights (net) (note 8)</b>                         | 17,403,136                                 | 17,686,437  |
| <b>Intangible assets (note 9)</b>                             | -  | 8,462   |
| <b>Deposits (note 10)</b>                                     | 4,767,841                                  | 4,136,007   |
| <b>Goodwill</b>   | 988,088                                    | 988,088   |
| <b>TOTAL ASSETS</b>   | <u>\$ 151,887,236</u>                      | <u>\$ 144,940,588</u>                                 |
| <b>LIABILITIES</b>  |  |   |
| <b>Current liabilities</b>                                    |  |   |
| Accounts payable and accrued liabilities (note 11)            | \$ 79,814,454                              | \$ 71,967,943   |
| Current portion of long term equipment loan payable (note 15) | 657,107                                    | -   |
| Current portion of mortgage payable (note 14)                 | 6,541                                      | 6,516   |
| Current portion of unearned revenue (note 12)                 | -  | 1,666,477   |
| <b>Total current liabilities</b>                              | <u>80,478,102</u>                          | <u>73,640,936</u>                                     |
| <b>Due to related party (note 13)</b>                         | 4,159,626                                  | 2,303,777   |
| <b>Unearned revenue (note 12)</b>                             | -  | 321,928   |
| <b>Long term equipment loan payable (note 15)</b>             | 131,422                                    | 56,683  |
| <b>Other long term loan payable</b>                           | 56,905                                     | -   |
| <b>Mortgage payable (note 14)</b>                             | 28,343                                     | 33,119  |
| <b>Total liabilities</b>                                      | <u>84,854,398</u>                          | <u>76,356,443</u>                                     |
| <b>Non controlling interest (note 16)</b>                     | <u>585,341</u>                             | <u>551,232</u>  |
| <b>SHAREHOLDERS' EQUITY</b>                                   |  |   |
| Capital stock (note 17)                                       | 85,526,252                                 | 85,526,252  |
| Warrants (note 18)  | 648,153                                    | 648,153   |
| Contributed surplus (note 17)                                 | 5,720,868                                  | 4,955,355   |
|   | <u>91,895,273</u>                          | <u>91,129,760</u>                                     |
| Accumulated other comprehensive loss                          | (2,215,689)                                | (2,037,950)   |
| Deficit   | (23,232,087)                               | (21,058,897)  |
|   | <u>(25,447,776)</u>                        | <u>(23,096,847)</u>                                   |
| <b>Total shareholders' equity</b>                             | <u>66,447,497</u>                          | <u>68,032,913</u>                                     |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>             | <u>\$ 151,887,236</u>                      | <u>\$ 144,940,588</u>                                 |

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

|   | Three months ended September 30 |                           | Nine months ended September 30 |                           |
|---|---------------------------------|---------------------------|--------------------------------|---------------------------|
|   | 2010                            | 2009                      | 2010                           | 2009                      |
|   | (Unaudited)                     | (Unaudited)<br>(Restated) | (Unaudited)                    | (Unaudited)<br>(Restated) |
| <b>Revenue (note 12)</b>  | \$ 15,238,773                   | \$ 9,553,963              | \$ 38,966,754                  | \$ 30,765,169             |
| Cost of sales   | 12,056,431                      | 9,090,379                 | 33,436,900                     | 29,856,400                |
| <b>Gross profit</b>   | <u>3,182,342</u>                | <u>463,584</u>            | <u>5,529,854</u>               | <u>908,769</u>            |
| <b>Expenses</b>   |                                 |                           |                                |                           |
| General and administrative  | 1,854,528                       | 1,227,143                 | 4,330,087                      | 3,719,720                 |
| Selling and marketing   | 390,234                         | 451,210                   | 1,337,995                      | 1,224,832                 |
| Unusual loss of plantation assets                                     | 731,893                         | -                         | 731,893                        | -                         |
| Stock based compensation  | 139,200                         | 362,250                   | 765,513                        | 512,722                   |
| Foreign exchange loss   | 307,610                         | 81,711                    | 104,187                        | 109,583                   |
|   | <u>3,423,465</u>                | <u>2,122,314</u>          | <u>7,269,675</u>               | <u>5,566,857</u>          |
| <b>Income (Loss) before undernoted</b>                                | <u>(241,123)</u>                | <u>(1,658,730)</u>        | <u>(1,739,821)</u>             | <u>(4,658,088)</u>        |
| Amortization (note 19)  | 143,744                         | 48,340                    | 519,511                        | 285,508                   |
| Interest income   | (27,181)                        | (1,852)                   | (57,853)                       | (26,126)                  |
| Interest expense  | 372                             | 503                       | 1,130                          | 1,753                     |
| Dilution gain on long-term investment (note 5)                        | -                               | -                         | (414,753)                      | -                         |
| Proportionate share of investee loss (note 5)                         | 113,398                         | 5,784                     | 353,842                        | 5,784                     |
|   | <u>(471,456)</u>                | <u>(1,711,505)</u>        | <u>(2,141,698)</u>             | <u>(4,925,007)</u>        |
| <b>Income (Loss) before income taxes and non controlling interest</b> | <u>(471,456)</u>                | <u>(1,711,505)</u>        | <u>(2,141,698)</u>             | <u>(4,925,007)</u>        |
| <b>Non controlling interest</b>                                       | <u>(17,262)</u>                 | <u>17,780</u>             | <u>(31,492)</u>                | <u>50,511</u>             |
| <b>Net income (loss)</b>  | <u>(488,718)</u>                | <u>(1,693,725)</u>        | <u>(2,173,190)</u>             | <u>(4,874,496)</u>        |
| <b>Deficit - beginning of period</b>                                  | <u>(22,743,369)</u>             | <u>(17,518,579)</u>       | <u>(21,058,897)</u>            | <u>(14,337,808)</u>       |
| <b>Deficit - end of period</b>  | <u>\$ (23,232,087)</u>          | <u>\$ (19,212,304)</u>    | <u>\$ (23,232,087)</u>         | <u>\$ (19,212,304)</u>    |
| <b>Net income (loss) per share (note 20)</b>                          |                                 |                           |                                |                           |
| Basic and diluted   | <u>\$ (0.004)</u>               | <u>\$ (0.015)</u>         | <u>\$ (0.016)</u>              | <u>\$ (0.043)</u>         |
| <b>Weighted Average- Common Shares Outstanding</b>                    |                                 |                           |                                |                           |
| Basic and diluted   | <u>138,086,814</u>              | <u>112,524,714</u>        | <u>138,086,814</u>             | <u>112,524,714</u>        |

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

(All amounts are in Canadian dollars)

|   | Three months ended September 30 |                       | Nine months ended September 30 |                        |
|---|---------------------------------|-----------------------|--------------------------------|------------------------|
|   | 2010                            | 2009                  | 2010                           | 2009                   |
|   | (Unaudited)                     | (Unaudited)           | (Unaudited)                    | (Unaudited)            |
| Net Income (Loss)   | \$ (488,718)                    | \$ (1,693,725)        | \$ (2,173,190)                 | \$ (4,874,496)         |
| Other comprehensive income (loss), net of tax:  |                                 |                       |                                |                        |
| Unrealized gains (losses) on translating financial statements of self-sustaining foreign operations | (516,658)                       | (2,923,983)           | (177,739)                      | (5,674,430)            |
| <b>Total comprehensive income (loss)</b>  | <u>\$ (1,005,376)</u>           | <u>\$ (4,617,708)</u> | <u>\$ (2,350,929)</u>          | <u>\$ (10,548,926)</u> |

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

(All amounts are in Canadian dollars)

|                                    | Three months ended September 30 |                       | Nine months ended September 30 |                       |
|------------------------------------|---------------------------------|-----------------------|--------------------------------|-----------------------|
|                                    | 2010                            | 2009                  | 2010                           | 2009                  |
|                                    | (Unaudited)                     | (Unaudited)           | (Unaudited)                    | (Unaudited)           |
| Balance - beginning of period      | \$ (1,699,031)                  | \$ 1,777,305          | \$ (2,037,950)                 | \$ 4,527,752          |
| Other comprehensive income (loss)  | (516,658)                       | (2,827,840)           | (177,739)                      | (5,578,287)           |
| <b>Balance - end of the period</b> | <u>\$ (2,215,689)</u>           | <u>\$ (1,050,535)</u> | <u>\$ (2,215,689)</u>          | <u>\$ (1,050,535)</u> |

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

|  | <b>Common shares</b> |            | <b>Warrants</b> | <b>Contributed Surplus</b> | <b>Accumulated Other Comprehensive Income (Loss)</b> | <b>Deficit</b> | <b>Total Shareholders' Equity</b> |
|--|----------------------|------------|-----------------|----------------------------|--|----------------|-----------------------------------|
|  | <b>#</b>             | <b>\$</b>  | <b>\$</b>       | <b>\$</b>                  | <b>\$</b>  | <b>\$</b>      | <b>\$</b>                         |
| 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 | -                    | -          | -               | -                          | (6,565,702)  | -              | (6,565,702)                       |
| Net loss   | -                    | -          | -               | -                          | -  | (6,721,089)    | (6,721,089)                       |
| Balance, December 31, 2009   | 138,086,814          | 85,526,252 | 648,153         | 4,955,355                  | (2,037,950)  | (21,058,897)   | 68,032,913                        |
| Stock based compensation   | -                    | -          | -               | 765,513                    | -  | -              | 765,513                           |
| Net unrealized loss on translation of self-sustaining foreign subsidiaries | -                    | -          | -               | -                          | (177,739)  | -              | (177,739)                         |
| Net loss   | -                    | -          | -               | -                          | -  | (2,173,190)    | (2,173,190)                       |
| Balance, September 30, 2010  | 138,086,814          | 85,526,252 | 648,153         | 5,720,868                  | (2,215,689)  | (23,232,087)   | 66,447,497                        |

See accompanying notes to consolidated financial statements.

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

|  | Three months ended September 30 |                           | Nine months ended September 30 |                           |
|--|---------------------------------|---------------------------|--------------------------------|---------------------------|
|  | 2010                            | 2009                      | 2010                           | 2009                      |
|  | (Unaudited)                     | (Unaudited)<br>(restated) | (Unaudited)                    | (Unaudited)<br>(restated) |
| <b>Cash flows from operating activities</b>            |                                 |                           |                                |                           |
| Net Loss   | \$ (488,718)                    | \$ (1,693,725)            | \$ (2,173,190)                 | \$ (4,874,496)            |
| Items not affecting cash:                              |                                 |                           |                                |                           |
| Amortization   | 841,527                         | 788,340                   | 2,525,432                      | 2,505,508                 |
| Stock based compensation                               | 139,200                         | 362,250                   | 765,513                        | 512,722                   |
| Write off of related party receivable (note 12)        | 30,397                          | -                         | 30,397                         | -                         |
| Proportionate share of Investee Loss                   | 113,398                         | 5,784                     | 353,842                        | 5,784                     |
| Dilution gain on long term investment                  | -                               | -                         | (414,753)                      | -                         |
| Non controlling interest                               | 17,262                          | (17,780)                  | 31,492                         | (50,511)                  |
|  | <u>653,066</u>                  | <u>(555,131)</u>          | <u>1,118,733</u>               | <u>(1,900,993)</u>        |
| Net change in non-cash items from operations           |                                 |                           |                                |                           |
| Accounts receivable                                    | 1,954,849                       | 1,309,477                 | (571,262)                      | (1,417,700)               |
| Deposits and prepayments                               | (339,599)                       | (1,233,798)               | (565,816)                      | (1,013,150)               |
| Other receivables                                      | 576,350                         | 262,505                   | (3,551,039)                    | 1,129,351                 |
| Inventories  | (1,776,315)                     | 633,202                   | (2,901,729)                    | 4,978,938                 |
| Accounts payable and accrued liabilities               | (265,883)                       | 177,354                   | (914,980)                      | 993,336                   |
| Unearned revenue                                       | (2,391,108)                     | 238,432                   | (1,997,654)                    | (13,875)                  |
| <b>Cash provided by (used in) operating activities</b> | <u>(1,588,640)</u>              | <u>832,041</u>            | <u>(9,383,747)</u>             | <u>2,755,907</u>          |
| <b>Cash flows from investing activities</b>            |                                 |                           |                                |                           |
| Deposit for investment                                 | -                               | (599,854)                 | (609,896)                      | (2,659,288)               |
| Decrease (increase) in long-term loans receivable      | (1,031,734)                     | 437                       | (1,032,730)                    | 1,353                     |
| Purchase of property and equipment                     | (134,640)                       | (496,680)                 | (1,794,321)                    | (1,495,387)               |
| Investment in plantation assets                        | 836,767                         | (418,988)                 | 589,950                        | (1,434,923)               |
| <b>Cash provided by (used in) investing activities</b> | <u>(329,607)</u>                | <u>(1,515,085)</u>        | <u>(2,846,997)</u>             | <u>(5,588,245)</u>        |
| <b>Cash flows from financing activities</b>            |                                 |                           |                                |                           |
| Advance from (repayment to) related party              | -                               | -                         | 1,829,687                      | (2,037,443)               |
| Mortgage payable (repayment)                           | (1,284)                         | (1,706)                   | (4,504)                        | (3,044)                   |
| Advance of long-term loan                              | 795,998                         | 12,396                    | 795,998                        | 23,455                    |
| <b>Cash provided by (used in) financing activities</b> | <u>794,714</u>                  | <u>10,690</u>             | <u>2,621,181</u>               | <u>(2,017,032)</u>        |
| <b>Effect of exchange rate changes on cash</b>         | <u>(23,017)</u>                 | <u>(248,559)</u>          | <u>(6,951)</u>                 | <u>(429,739)</u>          |
| <b>Net change in cash</b>                              | (1,146,550)                     | (920,913)                 | (9,616,514)                    | (5,279,109)               |
| <b>Cash - beginning of period</b>                      | <u>9,602,071</u>                | <u>5,586,530</u>          | <u>18,072,035</u>              | <u>9,944,726</u>          |
| <b>Cash - end of period</b>                            | <u>\$ 8,455,521</u>             | <u>\$ 4,665,617</u>       | <u>\$ 8,455,521</u>            | <u>\$ 4,665,617</u>       |
| <b>Supplemental information</b>                        |                                 |                           |                                |                           |
| Interest paid  | 372                             | 503                       | 1,130                          | 1,753                     |
| <b>Non-cash transaction</b>                            |                                 |                           |                                |                           |
| Accrued liabilities related to plantation assets       | \$ 2,934,579                    | \$4,654,293               | \$ 8,985,162                   | \$ 9,329,069              |

See accompanying notes to consolidated financial statements.

## CATHAY FOREST PRODUCTS CORP.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2010

(All amounts are in Canadian dollars)

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#### **1. Organization and Basis of Presentation**

##### Nature of Business

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

##### Basis of Consolidation

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

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

## CATHAY FOREST PRODUCTS CORP.

### NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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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 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

**CATHAY FOREST PRODUCTS CORP.**

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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(All amounts are in Canadian dollars)

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>September 30, 2010</u> | <u>December 31, 2009</u> |
|-----------------------------------|---------------------------|--------------------------|
|                                   | (Unaudited)               | (Audited)                |
| Wood Products                     | \$3,582,642               | \$805,107                |
| Spare parts for forestry machines | <u>255,246</u>            | <u>156,881</u>           |
| Total                             | <u>\$3,837,888</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 for the three and nine months ended September 30, 2010 was \$11,111,101 and \$32,491,570 respectively (September 30, 2009 – 3 months ended \$18,493,915, nine months ended \$39,259,936). None of the inventories have been pledged as security for liabilities.

**4. Long Term Loans Receivable**

Long-term loans receivable are as follows:

|                           | <u>September 30, 2010</u> | <u>December 31, 2009</u> |
|---------------------------|---------------------------|--------------------------|
|                           | (Unaudited)               | (Audited)                |
| Employee loans receivable | \$115,808                 | \$118,640                |
| Other loan receivable     | 1,022,452                 | -                        |
| Total loans receivable    | <u>1,138,260</u>          | <u>118,640</u>           |
| Current portion           | (24,535)                  | (24,102)                 |
| Long term                 | <u>\$1,113,725</u>        | <u>\$ 94,538</u>         |

Employee loans receivable totalling \$115,808 (December 31, 2009- \$118,640), of which \$24,535 is considered current, represents interest free loans given to three senior employees of the Russian subsidiary. The loans are unsecured, subject to agreements with the employees and are repayable over a 12 to 60 month period beginning December 2008 in equal instalments ranging from of \$139 to \$1,816 per month. Should

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**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**

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(All amounts are in Canadian dollars)

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the employment of the employees with the Company cease, the loans will become payable in full 10 days following the last day of employment.

Other loan receivable of \$1,022,452 represents a working capital loan advanced to an affiliate company of our Russian subsidiary. The loan bears interest at 4% with no set repayment terms and matures in April 2014.

**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 additional equity infusions 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 1,991,141 shares at US\$2.80 per share, resulting in the Company's interest in Eco-Energy China Group Incorporated being diluted from 40% to 26.44% resulting in a gain on dilution of investment totalling \$414,753 in the nine month period ended September 30, 2010.

There were no additional shares issued and no dilution of investment in the three month period ended September 30, 2010.

|  | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|--|---------------------------|--------------------------|
|  | (Unaudited)               | (Audited)                |
| Balance at the beginning of the period | \$3,251,974               | -                        |
| Initial Investment at cost             | -                         | \$ 2,600,400             |
| Proportionate share of investee loss   | (353,842)                 | (220,496)                |
| Dilution gain                          | 414,753                   | 872,070                  |
| Proportion share of comprehensive loss | (3,670)                   | -                        |
| Balance at the end of the period       | \$3,309,215               | \$3,251,974              |

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**6. Property and Equipment**

| <b>September 30, 2010 (unaudited)</b> | <b>Cost</b>         | <b>Accumulated<br/>Amortization</b> | <b>Net Book Value</b> |
|---------------------------------------|---------------------|-------------------------------------|-----------------------|
| Automobiles                           | \$764,599           | \$689,183                           | \$75,416              |
| Buildings                             | 569,177             | 127,176                             | 442,001               |
| Leasehold Improvements                | 160,238             | 160,238                             | -                     |
| Machinery and Equipment               | 8,935,519           | 5,087,761                           | 3,847,758             |
| Office Furniture                      | 237,900             | 183,303                             | 54,597                |
| Infrastructure-Roads/Rails            | 6,253,973           | 407,341                             | 5,846,632             |
| Land                                  | 3,867               | -                                   | 3,867                 |
| Construction in Progress              | 2,668,807           | -                                   | 2,668,807             |
| <b>Total</b>                          | <b>\$19,594,080</b> | <b>\$6,655,002</b>                  | <b>\$12,939,078</b>   |

| <b>December 31, 2009 (audited)</b> | <b>Cost</b>         | <b>Accumulated<br/>Amortization</b> | <b>Net Book Value</b> |
|------------------------------------|---------------------|-------------------------------------|-----------------------|
| 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             |
| <b>Total</b>                       | <b>\$18,260,132</b> | <b>\$4,565,638</b>                  | <b>\$13,694,494</b>   |

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.

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**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 September 30, 2010, the subsidiaries, collectively, had approximately 14,444 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.

In the summer of 2010, the Province of Jiangxi, where the Company has most recently been planting fast growth poplars, was subject to unusual weather conditions that caused what has been described as the worse flood conditions in the past 100 years. As a result of the floods experienced in the Poyang Lake region, the Company suffered losses of all of the saplings that had been planted in early 2010 and a portion of those that had been planted in 2009. The resulting loss of plantation assets was calculated at \$731,893. None of the loss plantation assets were insured.

**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 of \$8,142,620 (US\$7,100,000). The cost of the investment in the second concession is currently not being amortized as operations on this property have not started as at September 30, 2010.

|                          | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|--------------------------|---------------------------|--------------------------|
|                          | (unaudited)               | (audited)                |
| Cost                     | \$18,756,033              | \$18,733,547             |
| Accumulated Amortization | (1,352,897)               | (1,047,110)              |
| Net Book Value           | \$17,403,136              | \$17,686,437             |

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**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>September 30, 2010</u> | <u>December 31, 2009</u> |
|--------------------------|---------------------------|--------------------------|
|                          | (Unaudited)               | (Audited)                |
| Cost                     | \$63,715                  | \$ 63,466                |
| Accumulated Amortization | <u>(63,715)</u>           | <u>(55,004)</u>          |
| Balance                  | <u>\$ -</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 \$3,539,714 (Rmb 23,000,000) of which \$156,979 (Rmb 1,020,000) has been applied to the initial share capital (which has been eliminated on consolidation) for setting up a new company for the purpose of this project. At September 30, 2010, the outstanding deposits totalled \$3,382,735 (Rmb 21,980,000) (2009 - \$3,450,874 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 \$1,385,106 (Rmb 9,000,000) (2009- \$766,495-Rmb 5,000,000) with the final payments to be made pending final due diligence.

The Company has undertaken to complete a strategic review of both of these arrangement for purpose of determining the future direction the Company wishes to pursue with regards to these two properties. The Company intends to have the result of its review completed prior to the issuance of the financial statements for the year ended December 31,2010.

**11. Accounts payable and accrued liabilities**

Included in Accounts payable and accrued liabilities is \$74,283,536 (December 31, 2009 - \$65,271,191) 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

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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.

**12. Unearned Revenue**

In the course of preparing the interim consolidated financial statements for the three month period ending September 30, 2010, the Company discovered in November 2010 that customers that were party to several agreements had dissolved their incorporations during the period ending September 30, 2010. (See Note 26) As a result of the dissolution of these incorporations, the Company determined that it had no further obligation relating to the contracts as no creditors remained to complete the agreements. Consequently the Company has recognized into revenue \$2,251,493 in the current period representing the amount of deposits received from the customers that had previously been recorded as unearned revenue on the consolidated balance sheet.

**13. Related Party Transactions**

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

At December 31, 2009, included in other receivables is an advance to a related company controlled by the same management team totalling \$30,353 (Rmb 198,000). The balance related to a short term advance from the Company and was unsecured, non-interest bearing and repayable on demand. During the three month period ending September 30, 2010 this balance was written off as it was deemed uncollectible.

Also included in other receivables are advances made to Eco-Energy China Group Inc. (investee company).

|                                 | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|---------------------------------|---------------------------|--------------------------|
|                                 | (unaudited)               | (audited)                |
| Advances (note i)               | \$1,571,520               | \$1,842,772              |
| Convertible Debenture (note ii) | 1,603,245                 | -                        |
| Promissory Note (note iii)      | 2,094,091                 | -                        |
| Total                           | <u>\$5,221,375</u>        | <u>\$1,842,772</u>       |

Note i) Advances represent funds the Company advanced to its investee company Eco-Energy China Group Inc. These advances are unsecured, non -interest bearing and repayable on demand.

Note ii) In October, 2009, the Company advanced amounts to its investee company Eco-Energy China Group Inc.. In January, 2010, US\$1,500,000 of the advanced amounts was converted into a 1% convertible

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debenture with a two year maturity term. The debenture is convertible into common shares at US\$2.80 per common share. The Company has agreed not to demand repayment of this note for at least 12 months beginning January 1, 2010. The Company recognized interest income of \$3,898 for the three months period ended and \$11,606 for the nine months period ended September 30, 2010.

Note iii) In April, 2010 the Company advanced US\$2,000,000 to its investee company Eco-Energy China Group Inc. by way of a 3% unsecured promissory note payable on demand. The Company recognized interest income of \$19,491 for the three months period ended and \$34,136 for the nine months period ended September 30, 2010.

The Company may borrow funds from time to time from related parties. As at September 30, 2010, outstanding advances made by the minority shareholder of the export trading company totalled \$4,159,626 (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.

**14. Mortgage Payable**

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

At September 30, 2010, the principal outstanding is \$34,884 (Rmb 226,668). For December 31, 2009 principal outstanding was \$39,635 (Rmb 258,543). Interest is set at 5.8% and the principal is repayable at \$545 (Rmb 3,542) per month plus interest. The mortgage matures in January 2016.

The annual minimum required principal repayments are as follows:

|                       |                 |
|-----------------------|-----------------|
| 2011                  | \$ 6,541        |
| 2012                  | 6,541           |
| 2013                  | 6,541           |
| 2014                  | 6,541           |
| 2015                  | 6,541           |
| Thereafter            | <u>2,179</u>    |
| Total                 | 34,884          |
| Short term obligation | <u>(6,541)</u>  |
| Long term obligation  | <u>\$28,343</u> |

**15. Equipment Loan**

In July 2010, the Company has entered into a loan agreement for equipment located in Russia.

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At September 30, 2010 the principal outstanding is \$788,528 (23,447,720 Rubles) Interest is set at 12% and is repayable by blended monthly payments of \$48,086 (1,429,860 Rubles) with a maturity date of December 31, 2011.

|                       |                  |
|-----------------------|------------------|
| Loan Payable          | \$788,529        |
| Short term obligation | <u>(657,107)</u> |
| Long term obligation  | <u>\$131,422</u> |

**16. Non-Controlling Interest**

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

|  | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|--|---------------------------|--------------------------|
|  | (unaudited)               | (audited)                |
|  |                           | (restated)               |
| Shanghai Shengtai Forest Company Limited           | \$43,189                  | \$ 23,282                |
| Henan Xinya Cathay Forest Products Company Limited | 399,772                   | 379,235                  |
| Jiangsu Cathay Forest Company Ltd.                 | 46,772                    | 47,801                   |
| Guizhou Hanfang Cathay Forestry Company Limited    | 95,608                    | 100,914                  |
| <b>Total</b>                                       | <b>\$585,341</b>          | <b>\$ 551,232</b>        |

**17. 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 and year to date period ending September 30, 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.

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|                                  | Number of<br>Shares | Capital Stock | Contributed<br>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         | -                   | -             | 765,513                |
| Balance as at September 30, 2010 | 138,086,814         | \$85,526,252  | \$5,720,868            |

**18. 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:

| To September 30, 2010 |  | To December 31, 2009 |  |
|-----------------------|--|----------------------|--|
| <u>Number</u>         | <u>Weighted<br/>Average<br/>Exercise Price</u> | <u>Number</u>        | <u>Weighted Average<br/>Exercise Price</u> |

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|  |             |         |           |         |
|--|-------------|---------|-----------|---------|
| Balance outstanding at beginning of the period | 9,190,000   | \$ 0.70 | 4,190,000 | \$ 0.93 |
| Granted  | 400,000     | 0.50    | 5,000,000 | 0.50    |
| Expired  | (1,420,000) | (0.60)  | Nil       | Nil     |
| Exercised                                      | Nil         | Nil     | Nil       | Nil     |
|  | <hr/>       | <hr/>   | <hr/>     | <hr/>   |
| Balance outstanding at end of the period       | 8,170,000   | \$0.70  | 9,190,000 | \$0.70  |
|  | <hr/>       | <hr/>   | <hr/>     | <hr/>   |
| Balance exercisable at end of the period       | 5,270,000   | \$ 0.81 | 4,190,000 | \$ 0.93 |
|  | <hr/>       | <hr/>   | <hr/>     | <hr/>   |

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>July 2010</u> | <u>May 2009</u> | <u>May 2007</u> | <u>December 2005</u> | <u>May 2005</u> |
|--|------------------|-----------------|-----------------|----------------------|-----------------|
| Number of Options                              | 400,000          | 5,000,000       | 1,830,000       | 1,475,000            | 2,490,000       |
| Exercise price                                 | \$0.50           | \$ 0.50         | \$1.25          | \$ 0.80              | \$ 0.60         |
| Expected option life                           | 5 years          | 5 years         | 5 years         | 5 years              | 5 years         |
| Risk free interest rate                        | 1.5%             | 1.50%           | 3.75%           | 4.50%                | 3.75%           |
| Volatility                                     | 98.0%            | 98.0%           | 98.6%           | 50%                  | 35%             |
| Dividend yield                                 | 0.00%            | 0.00%           | 0.00%           | 0.00%                | 0.00%           |
| Weighted average fair value of options granted | \$0.29           | \$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 September 30, 2010.

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| <u>Options<br/>Outstanding</u> | <u>Expiry<br/>Date</u> | <u>Outstanding<br/>Weighted<br/>Average<br/>Remaining Life</u> | <u>Outstanding<br/>Weighted<br/>Average<br/>Price</u> | <u>Exercisable<br/>Quantity</u> | <u>Exercisable<br/>Weighted<br/>Average<br/>Price</u> |
|--------------------------------|------------------------|--|---|---------------------------------|---|
| 940,000                        | Dec 2010               | 0.3 year   | \$ 0.80   | 940,000                         | \$ 0.80   |
| 1,830,000                      | May 2012               | 1.7 years  | \$ 1.25   | 1,830,000                       | \$ 1.25   |
| 5,000,000                      | May 2014               | 3.7years   | \$0.50  | 2,500,000                       | \$0.50  |
| 400,000                        | July 2015              | 4.8 years  | \$0.50  | Nil                             | -   |

**(b) Warrants**

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

|  | <u>Number of<br/>Warrants</u> | <u>Stated<br/>Value</u> |
|--|-------------------------------|-------------------------|
| 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 September 30, 2010 | <u>1,533,726</u>              | <u>\$648,153</u>        |

There was no transaction involving warrants in the nine month period ending September 30, 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:

|                             | <b>Broker Warrants</b> |
|-----------------------------|------------------------|
| 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                |

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**19. Amortization**

Amortization expense includes the following:

|                        | <b>3 months ended September 30</b> |                 | <b>9 months ended September 30</b> |                  |
|------------------------|------------------------------------|-----------------|------------------------------------|------------------|
|                        | <b>2010</b>                        | <b>2009</b>     | <b>2010</b>                        | <b>2009</b>      |
|                        | (Unaudited)                        | (Unaudited)     | (Unaudited)                        | (Unaudited)      |
| Property and equipment | \$88,782                           | \$14,210        | \$316,682                          | \$138,396        |
| Intangibles            | 2,119                              | 3,325           | 8,391                              | 10,621           |
| Forestry rights        | 52,843                             | 30,805          | 194,439                            | 136,491          |
|                        | <u>\$143,744</u>                   | <u>\$48,340</u> | <u>\$519,512</u>                   | <u>\$285,508</u> |

For the three month period ending September 30, 2010, amortization of property and equipment for \$697,783 (2009 - \$740,000) is included in cost of sales. For the nine month period ending September 30, 2010, amortization of property and equipment for \$2,005,921 (2009-\$1,480,000) is included in cost of sales.

**20. Net Loss Per Common Share**

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

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

|   | <b>September 30, 2010</b> | <b>December 31, 2009</b> |
|---|---------------------------|--------------------------|
|   | (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)                             | 8,170,000                 | 9,190,000                |
|   | <u>147,790,540</u>        | <u>124,356,650</u>       |

**21. Commitments and Contingencies**

(a) Operating Lease Commitments

The Company has entered into various operating leases for automobiles, equipment and office premises and is

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responsible for minimum lease payments. Under terms of the various leases, the Company's annual minimum future payments to September 30 are approximately as follows:

|      |          |
|------|----------|
| 2011 | \$71,543 |
|------|----------|

(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 | \$60,021 |
|------|----------|

(c) Land lease commitments

The Company has entered into various land rental agreements in several locations for its plantations. The lease payments for these properties are calculated on an annual basis and the amount is accrued, however the actual payment of the lease cost is contingent upon the timing of the harvest of the plantations. At September 30, 2010 the portion of the lease payments that could be payable contingent upon harvesting the plantation assets is as follows:

|            |                      |
|------------|----------------------|
| 2011       | \$ 7,349,572         |
| 2012       | 8,521,560            |
| 2013       | 8,526,197            |
| 2014       | 8,530,834            |
| 2015       | 8,535,471            |
| Thereafter | <u>71,418,765</u>    |
| Total      | <u>\$112,882,399</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 September 30, 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.

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#### (e) Plantation Assets

The Company's plantation assets are located in the PRC and owned by subsidiaries which take the PRC legal form of joint ventures and wholly foreign owned enterprises. As at September 30 2010, approximately 14,444 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.

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.

## 22. 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:

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- 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 revenues 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 September 30, 2010**

|   | Plantation  | Harvesting  | Importing    | Corporate   | Total        |
|---|-------------|-------------|--------------|-------------|--------------|
| Revenue from external customers           | \$2,498,579 | \$1,529,623 | \$11,210,571 | -           | \$15,238,773 |
| Inter-segment revenue (see note i)        | -           | 2,338,482   | -            | -           | 2,338,482    |
| Net income (loss)                         | 1,218,884   | (285,618)   | 365,423      | (1,787,407) | (488,718)    |
| Interest income                           | 88          | -           | 536          | 26,557      | 27,181       |
| Interest expense                          | 372         | -           | -            | -           | 372          |
| Amortization                              | 67,086      | 730,271     | 14,390       | 29,480      | 841,527      |
| Identifiable assets                       | 88,379,869  | 18,648,071  | 12,739,338   | 32,119,958  | 151,887,236  |
| Additions to property and equipment       | 323         | 129,934     | 2,295        | 2,088       | 134,640      |
| Equity on investment loss (net) (note ii) | -           | -           | -            | (113,398)   | (113,398)    |
| Stock based compensation                  | -           | -           | -            | 139,200     | 139,200      |

**Three months ended September 30, 2009**

|   | Plantation | Harvesting | Importing   | Corporate   | Total       |
|---|------------|------------|-------------|-------------|-------------|
| Revenue from external customers                 | \$397,026  | \$818,083  | \$8,338,854 | -           | \$9,553,963 |
| Inter-segment revenue (see note i)              | -          | 2,491,282  | -           | -           | 2,491,282   |
| Net income (loss)                               | (301,380)  | 110,303    | 75,078      | (1,577,726) | (1,693,725) |
| Interest income                                 | 200        | 176        | 461         | 1,015       | 1,852       |
| Interest expense                                | 464        | -          | -           | 39          | 503         |
| Amortization                                    | 69,964     | 666,182    | 21,327      | 30,867      | 788,340     |
| Identifiable assets                             | 77,729,444 | 18,084,591 | 10,481,094  | 24,015,515  | 130,310,644 |
| Additions (disposals) to property and equipment | 125        | 492,454    | -           | 4,101       | 496,680     |
| Stock based compensation                        | -          | -          | -           | 362,250     | 362,258     |

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**Nine months ended September 30, 2010**

|   | Plantation  | Harvesting  | Importing    | Corporate   | Total        |
|---|-------------|-------------|--------------|-------------|--------------|
| Revenue from external customers             | \$2,950,901 | \$2,545,795 | \$33,470,058 | -           | \$38,966,754 |
| Inter-segment revenue (see note i)          | -           | 7,541,846   | -            | -           | 7,541,846    |
| Net income (loss)                           | 1,096,568   | (643,193)   | 705,139      | (3,331,705) | (2,173,191)  |
| Interest income                             | 627         | 19          | 1,744        | 55,463      | 57,853       |
| Interest expense                            | 1,106       | -           | -            | 24          | 1,130        |
| Amortization                                | 191,482     | 2,186,679   | 57,562       | 89,709      | 2,525,432    |
| Identifiable assets                         | 88,379,869  | 18,648,071  | 12,739,338   | 32,119,958  | 151,887,236  |
| Additions to property and equipment         | 11,728      | 1,774,378   | 4,893        | 3,322       | 1,794,321    |
| Equity on investment income (net) (note ii) | -           | -           | -            | 60,911      | 60,911       |
| Stock based compensation                    | -           | -           | -            | 765,513     | 765,513      |

**Nine months ended September 30, 2009**

|   | Plantation  | Harvesting  | Importing    | Corporate   | Total        |
|---|-------------|-------------|--------------|-------------|--------------|
| Revenue from external customers                 | \$1,011,743 | \$1,761,953 | \$27,991,473 | -           | \$30,765,169 |
| Inter-segment revenue (see note i)              | -           | 6,059,960   | -            | -           | 6,059,960    |
| Net income (loss)                               | (290,666)   | (1,558,007) | (76,621)     | (2,949,202) | (4,874,496)  |
| Interest income                                 | 1,044       | 7,902       | 1,434        | 15,746      | 26,126       |
| Interest expense                                | 1,714       | -           | -            | 39          | 1,753        |
| Amortization                                    | 170,169     | 2,165,089   | 70,029       | 100,221     | 2,505,508    |
| Identifiable assets                             | 77,729,444  | 18,084,591  | 10,481,094   | 24,015,515  | 130,310,644  |
| Additions (disposals) to property and equipment | 46,011      | 1,452,011   | (86,477)     | 86,814      | 1,498,358    |
| Stock based compensation                        | -           | -           | -            | 512,722     | 512,722      |

Note i

Consolidated revenue is reconciled as follows:

|                                      | 3 months ended September 30 |              | 9 months ended September 30 |              |
|--------------------------------------|-----------------------------|--------------|-----------------------------|--------------|
|                                      | 2010                        | 2009         | 2010                        | 2009         |
| Total revenue of reportable segments | \$17,577,255                | \$12,045,245 | \$46,508,600                | \$36,825,129 |
| Elimination of inter-segment revenue | (2,338,482)                 | (2,491,282)  | (7,541,846)                 | (6,059,960)  |
| Consolidated revenue                 | \$15,238,773                | \$9,553,963  | \$38,966,754                | \$30,765,169 |

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Note ii

The amount includes the Company's proportionate share of the investee's loss of \$113,398 for the three month period ended September 30, 2010. For the nine month period ended September, 30, 2010, the amount includes the gain on dilution of the long-term investment of \$414,753 and the Company's proportionate share of the investee's loss of \$353,842.

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

|        | <b>3 months ended September<br/>30</b> |             | <b>9 months ended September 30</b> |               |
|--------|--|-------------|------------------------------------|---------------|
|        | 2010                                   | 2009        | 2010                               | 2009          |
| China  | \$13,709,150                           | \$7,799,937 | \$35,361,334                       | \$26,649,235  |
| Russia | 1,529,623                              | 818,082     | 2,545,795                          | 2,100,508     |
| Japan  | -                                      | 935,944     | 1,059,625                          | 2,015,426     |
| Total  | \$15,238,773                           | \$9,553,963 | \$38,966,754                       | \$ 30,765,169 |

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

|        | September 30, 2010 | December 31, 2009 |
|--------|--------------------|-------------------|
| Canada | \$ -               | \$ 1,852          |
| China  | 5,462,995          | 5,761,186         |
| Russia | 24,879,218         | 25,626,355        |
|        | \$30,342,213       | \$ 31,389,393     |

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

**23. Financial Instruments**

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

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

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|                                 | September 30, 2010 | December 31, 2009 |
|---------------------------------|--------------------|-------------------|
|                                 |                    | (restated)        |
| Held for trading (a)            | \$8,455,521        | \$18,072,035      |
| Loans and receivables (b)       | 12,143,279         | 7,108,174         |
| Other financial liabilities (c) | 84,854,398         | 74,368,036        |

(a) Cash 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, 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 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

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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 four (2009 – two) major customers that comprise 69.27% (2009 – 64.6%) of the total outstanding balance.

As at September 30, 2010, accounts receivable from customers located outside Canada represented 100% of the accounts receivable balance. The aging of accounts receivable was as follows:

|            |                    |
|------------|--------------------|
| Current    | \$ 3,735,411       |
| 31-60 days | 317,279            |
| 61-90 days | 438,182            |
| 91+ days   | 420,039            |
| Total      | <u>\$4,910,910</u> |

To date the Company has established an allowance for doubtful accounts of \$3,751,866 to reflect the potential impairment of certain accounts receivable.

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 September 30, 2010

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|   | 2011                 | 2012                | 2013                | 2014                | 2015                | Thereafter           | Total                 |
|---|----------------------|---------------------|---------------------|---------------------|---------------------|----------------------|-----------------------|
| Land leases obligations                 | \$ 7,349,572         | \$ 8,521,560        | \$ 8,526,197        | \$ 8,530,834        | \$ 8,535,471        | \$ 71,418,765        | \$ 112,882,399        |
| Plantation asset obligations *          | 74,283,536           | -                   | -                   | -                   | -                   | -                    | 74,283,536            |
| Operating lease obligations             | 72,704               | -                   | -                   | -                   | -                   | -                    | 72,704                |
| Management fees and Consulting Services | 60,021               | -                   | -                   | -                   | -                   | -                    | 60,021                |
| Mortgage Payable                        | 6,541                | 6,541               | 6,541               | 6,541               | 6,541               | 2,179                | 34,884                |
| Long term loan payable                  | -                    | -                   | -                   | -                   | -                   | 56,905               | 56,905                |
|   | <u>\$ 81,772,374</u> | <u>\$ 8,528,101</u> | <u>\$ 8,532,738</u> | <u>\$ 8,537,375</u> | <u>\$ 8,542,012</u> | <u>\$ 71,477,849</u> | <u>\$ 187,390,449</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

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

As at September 30, 2010, the Company had foreign currency denominated amounts of approximately:

|  | China       |            | Russia      |           |
|--|-------------|------------|-------------|-----------|
|  | Rmb         | Cdn\$      | Rub         | Cdn\$     |
| Cash   | 6,011,436   | \$ 925,164 | 5,646       | \$ 190    |
| Accounts Receivable and<br>Other Receivables | 25,776,427  | 3,967,008  | 82,297,026  | 2,767,645 |
| Liabilities                                  | 516,773,451 | 79,531,750 | 132,667,352 | 4,461,596 |

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<br>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 \$739,000 (2009 - \$630,000) in the case of Rmb denominated financial instruments and approximately \$17,000 (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

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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 period end.

**24. Capital Management**

The Company's objective is to manage its capital to ensure that the Company will be able to continue to follow its business strategy of expanding current operations and pursue other sound opportunities that may become available from time to time. Management defines capital as the Company's shareholders' equity excluding accumulated other comprehensive income (loss) which is \$68,663,186 at September 30, 2010 (2009 - \$70,070,863).

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.

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

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

**25. Economic dependence**

For the nine months ending September 30, 2010, the Company purchased 71% (2009 - 97.5%) of its log trading supplies from two (2009 - two) suppliers during the period. The balance of the logs acquired for sale was supplied by four (2009 - one) other suppliers.

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**26. Comparative figures**

The company discovered in November 2010 that two parties that had entered into contractual obligations to purchase poplar and bamboo had been dissolved during the months of August and September 2010. As a result of this event, an investigative review was completed which resulted in management having to restate its prior period figures.

These consolidated financial statements have been restated to reflect the provision of CICA Handbook Section 3400 – Revenue, specifically as it relates to revenue recognition. This restatement was required in order to properly reflect the nature of the transactions which had been previously recorded on the sale of poplar and bamboo in the third quarter of 2009. At the time of recording the transaction, a portion of the plantation assets were deemed to have been sold. Upon subsequent investigation it was determined that under China law, the ownership of trees cannot be transferred until such time as the trees have been harvested. Accordingly, the revenue should not have been recognized at that time as the risks and rewards had not transferred to the purchasers. The transfer of risks and rewards will culminate when the harvesting commences. The financial statements have been restated to reflect a reversal of the sale and adjustments to the corresponding asset and liability accounts.