ANNUAL REPORT 2009

ChangFeng Energy Inc

长丰能源有限公司

DIRECTORS EXECUTIVE MANAGEMENT

MR. HUAJUN LIN
Director, Chairman & CEO

MR. GRAHAM WARREN
Chief Financial Officer

MR. WENCHENG ZHANG
Director

MR. DAN LIU
Director

MR. HUI CAI
Director

MR. PETER CHEUNG
Director

MR. ROBERT C. KAY
Director

MS. ANN SIYIN LIN
Corporate Secretary

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ChangFeng Energy Inc
长丰能源有限公司

CHAIRMANS MESSAGE

Dear Changfeng Shareholders

Your Company entered into 2009, during a period of significant worldwide economic unrest, strong and poised for continued growth. Despite the economic downturn the Company generated record revenues for the year, expanded its infrastructure in the Greater Sanya region, completed construction of its first CNG vehicle filling station in Changsha and continued to generate significant future opportunities in Mainland China.

The Company generated revenues of $17,876,478 for the year ended December 31, 2009 compared to $13,014,236 in the year ended December 31, 2008. This 37% increase can be attributed to the growth in piped gas sales and connection fees as more customers are connected. The gross margin for the year was 60% which is unchanged from the comparable period in 2008.

During the year, the Company connected 12,654 new residential customers and 65 new commercial customers. While these numbers are lower in actual number of customers signed in 2008, the revenue generated from these connections was 34% higher than last year an indication in particular of larger scale commercial projects. As at December 31, 2009 the Company had 50,455 residential and 440 commercial customers. Its order backlog as indicated by deposits received increased 13% over 2008.

Gas sales volumes increased 29% over 2008 to 25 MM M3 and this trend is continuing through the first part of 2010.

On the supply side in 2009 Changfeng utilized all its 24 MM M3 yearly allowance under its contract with Hainan petrol. As an interim measure and in order to ensure a long term economical supply the Company recently announced a five year contract with an LNG supplier on Hainan Island. Currently a natural gas pipeline is being constructed around the perimeter of Hainan Island by CNOOC which is projected to feed natural gas into Changfengs' pipeline network by 2015.

Changfeng continued to invest in its pipeline network construction in the new Haitang Bay district. At year end, the Company had completed over 28 km of a mid-pressure pipeline network and more recently announced the commencement of construction of a LNG gasification and storage facility in the district which will not only supply the Haitang Bay district but also the Greater Sanya region.

The central government is actively promoting the development of Hainan Island into an international tourism destination, which is stimulating the hotel and tourism industry in the Sanya region. As the flagship project of the island, the Haitang Bay district when fully developed is expected to have a total of 72 hotels. By 2020 it is projected that gas consumption for the area will exceed 60 MM M3 per anum. The first hotels are expected to be completed in October of 2010.

We were pleased to announce on January 25, 2010 receipt of a RMB 100 million (Cdn$ 15.3 million) which were used to repay the Sanya State Assets Management Corporation's and Bank of China's existing term loan facility and fund the capital expenditures in the Greater Sanya region and in particular Haitang Bay.

The Company's joint venture with CNPC and other parties to construct CNG filling stations in Hunan continues to progress. The first has commenced operations and a further two have been approved and are expected to start construction shortly. This partnership will establish a solid foundation for Company developing natural gas distribution markets in Mainland China cities and also support securing natural gas supply for future projects.

We believe our continued focus on the smaller cities, combined with our strong relationships and experience will lead to significant opportunities in the near future.

In closing I would like to thank, the continued support of our various levels of government, our shareholders, our loyal customers and the ongoing dedication, loyalty and hard work of our employees.

Sincerely

Huajin Lin
Chairman and CEO

MANAGEMENT'S DISCUSSION & ANALYSIS

FOR THE YEAR ENDING DECEMBER 31, 2009

INTRODUCTION

This management discussion and analysis ("MD&A") provides an analysis of the financial condition and results of operations of Changfeng Energy Inc. (the "Company") and compares the financial results for the year ended December 31, 2009 with those of the same period the previous year. The MD&A should be read in conjunction with the Company's audited consolidated financial statements and related notes for the year ended December 31, 2009 and the audited consolidated financial statements and related notes and the MD&A for the year ended December 31, 2008 which have been prepared in accordance with generally accepted accounting principles in Canada. Additional information about the Company is available at www.sedar.com.

CAUTION REGARDING FORWARD LOOKING STATEMENTS

Certain statements in this MD&A may constitute "forward looking" statements which involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company and its subsidiary, or the industry in which they operate, to be materially different from any future results, performance or achievements expressed or implied by such forward looking statements. When used in this report, the words "estimate", "believe", "anticipate", "intend", "expect", "plan", "may", "should", "will", the negative thereof or other variations thereon or comparable terminology are intended to identify forward looking statements. Such forward looking statements reflect the current expectations of the management of the Company with respect to future events based on currently available information and are subject to risks and uncertainties that could cause actual results, performance or achievements to differ materially from those expressed or implied by those forward looking statements, such as significant changes in market conditions, the inability of the Company to close sales and the inability of the Company to attract sufficient financing and including the risk factors summarized below under the heading "Risk Factors". New risk factors may arise from time to time and it is not possible for management of the Company to predict all of those risk factors or the extent to which any factor or combination of factors may cause actual results, performance or achievements of the Company to be materially different from those expressed or implied in such forward looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward looking statements as a prediction of actual results. Although the forward looking statements contained in this MD&A are based upon what management believes to be reasonable assumptions, the Company cannot assure investors that actual results will be consistent with these forward looking statements. The forward looking statements contained in this MD&A speak only as of the date hereof. The Company does not undertake or assume any obligation to release publicly any revisions to these forward looking statements to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events, except as required by law.

DESCRIPTION OF BUSINESS

Changfeng Energy Inc. is a Canadian public company currently trading on the TSX Venture Exchange, as a Tier 1 company, under the stock symbol "CFY". The Company was formed via a reverse takeover of McBroom Resources and the merger was completed on January 29, 2008. The Company through its wholly owned subsidiary Hainan Energy Limited and its wholly owned subsidiary Sanya Changfeng Offshore Natural Gas Supply Co. Ltd. is engaged in the design and construction of natural gas distribution networks and the distribution of natural gas to residential and commercial customers in the greater Sanya region, Hainan Province, People's Republic of China ("PRC").

The primary business objective is to become one of the predominant natural gas distributors in the southern PRC. Changfeng has acquired a Hainan Natural Gas Operating Permit which provides it with the rights to distribute natural gas throughout the greater Sanya region. Changfeng has developed a natural gas pipeline network in Sanya City and is in the process of expanding the distribution network in various other communities throughout the greater Sanya region. Changfeng has been formally recognized as Sanya City's exclusive natural gas distributor through the signing of a concession agreement.

DESCRIPTION OF OPERATIONS

Changfeng conducts its business through three primary operating segments: Distribution Network Design and Construction, Natural Gas Supply and Distribution and CNG Filling Stations, each of which is described in further detail below.

DISTRIBUTION NETWORK DESIGN AND CONSTRUCTION AND NATURAL GAS SUPPLY AND DISTRIBUTION

Changfeng has built and owns Sanya City's main pipeline network and branch pipeline networks to effect gas connections to residential, industrial and commercial users. Each of Changfeng's pipeline customers is physically connected to its pipeline network through connection equipment and natural gas usage monitoring systems which are installed and maintained by Changfeng.

Changfeng's network includes 38 km of high pressure gas pipelines, over 100 km of medium to low pressure gas pipelines and over 120 km of branch/customer pipelines. The network includes one primary station, 2 gate processing stations and 3 gas pressure regulating stations. The primary station is connected to the state owned natural gas processing plant located nearby. This processing plant is directly connected via high pressure sub sea pipeline to the CNOOC Ya13-1 gas field located approximately 100 km offshore in the South China Sea.

Changfeng is continuing to expand its customer base in Sanya City and is also in the process of expanding its operations to newly developed business, tourist and residential areas, including the districts of Haitang Bay and Green Scientific Park. Changfeng has been granted the right to construct facilities and distribute natural gas to Haitang Bay, a tourist destination located in Hainan Province currently under development. Changfeng is not dependent upon any single customer or group of customers for a material portion of its natural gas sales or revenues. Changfeng has been formally recognized as the City of Sanya's exclusive natural gas distributor through the signing of a concession agreement. This concession agreement gives Changfeng the exclusive right to piped gas distribution in the City of Sanya for 30 years commencing December 31, 2007 and includes any future geographical boundary increases of the City of Sanya.

Following the completion of its natural gas distribution networks, Changfeng retains ownership in such networks and manages its operation to transport natural gas to residential and commercial end users. Changfeng charges its customers a one time connection fee to the network.

CNG FILLING STATIONS

On December 18, 2008, the Company established a new company, Hunan Changfeng CNPC Energy Co. Ltd. ("Hunan CF CNPC"), with a subsidiary of China National Petroleum Corporation ("CNPC") and its associates to pursue compressed natural gas ("CNG") distribution opportunities in Changsha, a major city in China and capital of Hunan Province. The Company has 58% of the equity interests of Hunan CF CNPC through its newly incorporated, 99.92% owned subsidiary, Sanya Changfeng New Energy Investment Co. Ltd. ("Sanya CF NEI") and its 60% owned subsidiary Hunan CNPC New Energy Investment Ltd. (see below). As of December 31, 2009, the Company has made its capital contribution in Hunan CF CNPC and the other parties are required to make their capital contribution by December 2010.

In January 2009, the Company acquired 60% of the equity interest in Hunan CNPC New Energy Investment Ltd. ("Hunan CNPC NEI"), which has a contract with Hunan CNPC Pipeline Gas Co. Ltd., an arm's length corporation, to purchase 11 million M3 of CNG a year until September 12, 2027. The CNG purchased pursuant to this contract will be used to supply the Company's CNG commercial vehicle filling stations in Changsha City, upon completion of construction.

The first CNG station has been completed, tested and operations commenced in 2010. Two more stations are expected to commence construction shortly. Changfeng's share of the capital expenditures will be funded from existing working capital.

FOREIGN EXCHANGE RATES

The Company undertakes substantially of its transactions in Chinese RMB. All revenues are earned in Chinese RMB.

CANADIAN DOLLAR TO RMB	2009	2008
Annual average rate	5.98	6.51
Year end rate	6.52	5.57

As the Company's subsidiaries in China are considered self sustaining, any impact on financial instruments due to foreign exchange fluctuations arising from the translation of the foreign subsidiary balances into Canadian dollars have been recognized as other comprehensive income, not as net income.

SUMMARY FINANCIAL INFORMATION

KEY FINANCIAL DATA AND COMPARATIVE FIGURES			
($ 000's) except per share amounts	31-Dec-09	31-Dec-08	31-Dec-07
Foreign exchange rate RMB (Average rate)	5.98	6.51	7.08
Revenue	17,876	13,014	9,240
Net Income	1,123	918	918
Earnings (loss) per share	0.017	0.014	0.031
Foreign exchange rate RMB (Year end rate)	7	6	7
BALANCE SHEET			
Cash and cash equivalents	3,782	5,477	2,598
Working capital (deficit)	**(4,383)**	**(9,401)**	**(9,053)**
Plant and equipment	29,214	31,664	21,548
Total assets	36,069	40,091	25,925
Long term liabilities	9,535	5,852	5,980
Shareholders' equity	9,595	9,859	1,668
WEIGHTED AVERAGE NUMBER OF SHARES			
outstanding - basic (000's)	66,025	63,479	29,234

ChangFeng Energy Inc
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QUARTERLY DATA ($000'S)	2009				2008			
except per share amounts	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Foreign exchange rate RMB	6.46	6.22	5.85	5.49	5.64	6.57	6.89	7.13
Revenue	5,696	4,101	3,742	4,337	4,184	2,896	2,968	2,966
Gross profit	3,093	2,420	2,322	2,878	2,710	1,708	1,606	1,765
Interest	230	(197)	(215)	(265)	27	(257)	(212)	(289)
Net income (loss)	606	93	(199)	623	590	83	2	243
Net income (loss) per share	0.009	0.002	(0.003)	0.009	0.009	0.001	0.000	0.005

The above financial information has been prepared in accordance with Canadian generally accepted accounting principles and is stated in Canadian dollars. The comparative data used, prior to the reverse takeover transaction completed on January 29, 2008, is that of HEL the operating entity.

RESULTS OF OPERATIONS

The Company generated revenues of $17,876,478 for the year ended December 31, 2009 compared to $13,014,236 in the year ended December 31, 2008. This 37% increase can be attributed to the growth in piped gas sales and connection fees as more customers are connected. The gross margin for the year was 60% which is unchanged from the comparable period in 2008.

The table below illustrates the increase in customers connected over the period and volume of gas sold.

YEAR	2009	2008	% CHANGE
RESIDENTIAL			
Customers connected during the year	12,654	13,295	-4.8%
Total customers at the end of the year	50,455	37,801	33.5%
Gas sold V. (m3) during year	3,221,900	2,430,000	32.6%
COMMERCIAL			
Customers connected during the year	65	94	-30.9%
Total customers at the end of the year	440	375	17.3%
Gas sold V. (m3) during the year	21,803,000	17,000,000	28.3%

Residential connections slowed marginally during the year as the rate of residential construction slowed in Sanya City. Year over year growth in total residential customers was a strong 33.5%.

General and administrative costs for the year ended December 31, 2009 were $5,628,096 compared to $3,889,140 for the comparable period in 2008. This increase can be attributed to the revenue growth of the Company and significant business development activities in mainland China and pre revenue administrative costs for our Changsha City CNG project.

Travel and promotion costs for the year ended December 31, 2009 were $1,320,618 compared to $1,193,510 for the comparable period in 2008. Increased travel costs relate to business development in mainland China

Interest on long term debt for the period ended December 31, 2009 was $446,503 compared to $733,414 for the comparable period in 2008. This reduction was due to lower interest rates and reduced principal amounts.

Amortization for the year ended December 31, 2009 was $1,096,689 compared to $920,078 for the comparable period in 2008. The increase was due to the investment in capital assets as the Company's infrastructure increases.

The net income for the year ended December 31, 2009 was $1,122,714 or $0.017 per share compared to a net income of $918,291 or $0.014 per share for the year ended December 31, 2008.

QUARTERLY RESULTS

The table below illustrates the increase in customers connected in the period and the volume of gas sold.

QUARTER	Q4 2009	Q4 2008	% CHANGE
RESIDENTIAL			
Customers connected during the quarter	5,563	3,895	42.8%
Total customers at the end of the quarter	50,455	37,801	33.5%
Gas sold V. (m3) during quarter	1,170,000	810,000	44.4%
COMMERCIAL			
Customers connected during the quarter	22	28	-21.4%
Total customers at the end of the quarter	440	375	17.3%
Gas sold V. (m3) during quarter	6,041,600	4,930,000	22.5%

The Company generated revenues of $5,696,254 for the quarter ended December 31, 2009 compared to $4,184,556 in the quarter ended December 31, 2008. This significant increase can be attributed to the year over year growth in piped gas sales and an increase in gas connection revenue particularly with the residential customers connected during the quarter.

The gross margin for the period decreased from 64.8% in Q4 2008 to 54.2% in Q4 2009. This was due to the significant increase in gas sales and the utilization of the Company's full allowance of 24 million cubic meters per anum. The gas supplied in excess of the 24 million was purchased at a higher price.

COMMITMENTS

STATUTORY RESERVES

In accordance with PRC Company Law, Sanya Changfeng Offshore Natural Gas Supply Co., Ltd. ("CF China") is required to provide for certain statutory reserves commencing from the year it reports retained earnings. Prior to June 6, 2007, as a domestic limited liability company, CF China was required to allocate at least 10% of its after tax profits to a statutory surplus reserve with the right to discontinue allocations to the statutory surplus reserve if such reserves reach 50% of its registered capital. CF China was also required to designate 5% of after tax profit to a statutory welfare reserve to be used only for the collective benefits of CF China's employees. All statutory reserves are required to be calculated based on amounts reported in CF China's PRC statutory financial statements under China GAAP. Effective from June 6, 2007, as CF China became a foreign invested enterprise ("FIE"), in accordance with PRC Company Law for FIEs, CF China is required to provide for a surplus reserve fund, enterprise development fund, and employee welfare fund, each at a percentage of after tax profits, which is a discretionary percentage and is decided by the CF China's board of directors each calendar year. These reserves can only be used for specific purposes and are not transferred to the Company in the form of loans, advances, or cash dividends. These reserves can be distributed to the shareholder of CF China at the time when CF China is wound up.

As of December 31, 2009, CF China had not designated RMB to the above statutory reserve funds.

PIPELINE CONSTRUCTION AND EQUIPMENT

The Company has signed two contracts with a sub-contractor to construct pipelines to extend to the Haitang Bay area of Sanya City, for a total contract amount of RMB 5,922,660 ($902,944) (2008 – RMB 20,893,429; $3,750,371), of which RMB 1,237,980 ($189,782) (2008 – RMB 11,072,870; $1,987,580) was incurred as at December 31, 2009 and included in construction in progress.

The Company has signed two contracts with the same sub-contractor to construct some city pipelines within Sanya City for a total contract amount of RMB 1,968,060 ($301,704) (2008 - $nil). Construction has not commenced as at December 31, 2009.

The Company also has signed seven contracts with several equipment suppliers and construction supervisors for a total amount of RMB 5,940,639 ($910,700), of which RMB 50,000 ($ 7,665) was incurred as at December 31, 2009.

PURCHASE COMMITMENTS

See Note 15 of the December 31, 2009 audited consolidated financial statements.

In connection with the CNG contract described in Note 7 of the December 31, 2009 audited consolidated financial statements, the Company is required to pay a onetime charge of RMB 3,000,000 ($459,900) in addition to the price of the gas. As of December 31, 2009, RMB 1,000,000 ($153,300) has been paid with the balance payable at the time the gas is first supplied. As at December 31, 2009, the Company has not purchased any CNG pursuant to this agreement.

In addition, the Company has acquired the rights to a gas purchase contract from a third party to purchase 10,000 M3 of CNG per day (3,650,000 M3 per year) until September 12, 2027. Pursuant to this contract, the Company made a cash payment of RMB 500,000 ($76,650) that was recorded as part of the long term prepaids and will be required to pay a further one-time payment of RMB 500,000 ($76,650) at the time the gas is first supplied. As at December 31, 2009, the Company has not purchased any CNG pursuant to this agreement.

LEASE COMMITMENT

The Company signed a lease agreement for 3,000 M2 of land for construction of a CNG gas station in Hunan Province. The lease term is for 20 years until October 2028. The annual rent is RMB 470,000 ($72,050) of which a deposit of RMB 100,000 ($15,330) and four years' rent (RMB 1,880,000 or $288,204) need to be made in advance. As at December 31, 2009, the Company has paid RMB 1,300,000 ($199,290). If the Company decides to terminate this agreement, a termination payment of RMB 1,000,000 ($153,300) will be payable. The minimum lease payments in the following years are as:

	RMB	$
2010	580,000	88,914
2014	470,000	72,051
Thereafter	7,050,000	1,080,765

RELATED PARTIES

A corporation controlled by a significant shareholder who is also an officer and director of the Company owed the Company a total of US$76,822 (Cdn$80,740) as at December 31, 2009 (2008 – US$62,889 (Cdn$76,599)) for various expenditures paid by the Company on behalf of this corporation. This amount is unsecured, non-interest bearing with no fixed terms of repayment. The amount is included in accounts receivable.

In addition, the Company owed this individual $200,510 for unpaid salary which amount is included in accounts payable as at December 31, 2009. The Company also had unpaid directors' fees of $33,000 included in accounts payable. These amounts are unsecured, non-interest bearing with no fixed terms of repayment.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During the year ended December 31, 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of RMB 40,000,000 (2009 - $6,132,000) (2008 - $7,180,000) to the Company, through wholly owned corporations, in accordance with a Subordination and Forbearance Agreement dated April 27, 2007, Consignment Loan Agreements dated May 23, 2007 and June 26, 2007, and other ancillary documentation.

These loans are unsecured, non-interest bearing, are subordinate to the claims of all other creditors, including unsecured creditors, of the Company, and are due on demand; however, the lender cannot demand the repayment of the loans at any time until April 27, 2010. These corporations and the Company have entered into Loan Renewal Agreements whereby the parties have agreed to enter into further loan renewal agreements upon the same terms and conditions as the Consignment Loan Agreements every three years, in perpetuity.

A significant shareholder of the Company, who is also an officer and director of the Company, owns 2.4% of the equity in CF Engineering, a subsidiary of CF China, through a corporation which the individual controls.

CAPITAL STOCK AND SHARE ISSUANCES

During the year the Company granted options to new directors of the Company to acquire 400,000 common shares of the Company at an exercise price of $0.55 per share on or before June 28, 2014. The options vested immediately.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents balance at December 31, 2009 was $3,782,250, compared to $5,477,208 at December 31, 2008. The Company had a working capital deficit of $4,383,700 as at December 31, 2009, compared to a working capital deficit of $9,401,191 as at December 31, 2008. The decrease in the working capital deficiency was primarily due to the reclassification of the term loan facility from the Sanya State Assets Management Corporation from current to long term.

The Company has sufficient capital resources generated through operations and the private placement completed in January, 2008 to satisfy its current capital expenditure requirements. The Company announced on January 25, 2010 receipt of a RMB 100 million (Cdn$ 15.3 million) which were used to repay the Sanya State Assets Management Corporation's and Bank of China's existing term loan facility and fund the expected capital expenditures in the Greater Sanya region.

RISK FACTORS

There are certain risks associated with an investment in Changfeng, including those listed below.

Substantial Initial Capital Expenditure Requirement

Due to the nature of the Company's business, the Company is required to make a substantial initial investment in the construction of gas pipeline infrastructure and the construction of its CNG filling stations. The initial investment must be financed by internal resources of the Company, bank loans or equity fund raising. There can be no assurance that external sources of financing will be available to fund the Company's capital expenditure program. The failure to obtain such financing may hinder the Company's ability to continue its existing investments or make new investments. In addition, there are risks associated with the construction of new facilities including risks that costs of construction may be greater than anticipated and that construction may be delayed by factors beyond the control of the Company.

Grant of Additional Licenses

The business objectives of the Company include the expansion of its operations by applying for distribution and construction permits for natural gas distribution rights in other cities in China. Applicants for such licenses are required to meet extensive criteria, and to submit to a detailed examination of their infrastructure and management by a special team appointed by the government body reviewing such applications. Notwithstanding the results of any such review, distribution and construction permits are granted to applicants only at the sole discretion of the government body reviewing such applications, and such grants occur on an infrequent basis. Accordingly, there can be no assurance that the Company will be granted any distribution and construction permits for which it applies, which may in turn have a material adverse effect upon the operations and growth strategy of the Company.

Price Control

Any increase in gas usage charges exceeding the original approved charge requires the approval of the local state price bureau. There is no assurance that any increases (except for an increase to offset the rise in the Company's purchase price of gas) will be approved.

There is no assurance that the Company will be able to offset any increase in the purchase price of gas with an increase in the sales price, with the result that its profitability may be adversely impacted by decisions made by government pricing bureaus.

Obligations to Purchase Gas

The Company currently has an agreement in principle with CNOOC. The Company may, at its option, enter into a take or pay agreement with CNOOC which will leave it financially committed to purchase gas without any assurance that it will have sales to offset the purchase obligations. In addition, the agreement in principle between the Company and CNOOC is conditional upon the completion of a plant to be constructed by CNOOC, which is in turn subject to the receipt of various regulatory and governmental approvals. Failure of CNOOC to obtain the required approvals and/or to complete construction of its proposed plant may have a material adverse effect on the Company.

Reliance on the Suppliers of Natural Gas

At present, the Company purchases natural gas solely from Hainan Petrol pursuant to the Supply Agreement. Currently, the Company has a contract to purchase 24 million M3 gas a year from this supplier until December 31, 2015. There can be no assurance that the Company will be able to obtain natural gas from suppliers on terms similar to those of the Supply Agreement or without material interruption.

Limited Insurance Coverage

As natural gas is an inherently flammable and explosive substance, the Company has implemented strict safety measures for the operation and maintenance of its facilities. However, the Company cannot guarantee that industry-related accidents will not happen in the future. Significant operational hazards and natural disasters may cause interruptions in the Company's operations that could have a material adverse impact on the financial condition of the Company.

Although the Company may maintain insurance to protect against certain risks in such amounts as it considers to be reasonable, its insurance will not cover all the potential risks associated with its operations. The Company may also be unable to maintain insurance to cover these risks at economically feasible premiums. Insurance coverage may not be available or may not be adequate to cover any resulting liability. A successful claim made against the Company that is not covered by any of the Company's insurance policies or is in excess of its insurance coverage could have a material adverse effect on the Company's business and financial position.

Environmental Risks and Hazards

All phases of the Company's operations are subject to environmental regulation in the jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects, and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist in connection with the pipelines and distribution networks in which the Company holds interests which are unknown to the Company at present.

Government approvals and permits are currently and may in the future be required to be obtained or renewed in connection with the Company's operations. To the extent such approvals are required and not obtained or existing permits are not renewed, the Company may be curtailed or prohibited from continuing its operations or from proceeding with planned development of its proposed projects.

Failure to comply with applicable laws, regulations and permitting requirements may result in enforcement actions thereunder, including orders issued by regulatory or judicial authorities causing operations to cease or be curtailed, and may include corrective measures requiring capital expenditures, installation of additional equipment, or remedial actions. The Company may be required to compensate those suffering loss or damage by reason of its activities and may have civil or criminal fines or penalties imposed for violations of applicable laws or regulations.

Amendments to current laws, regulations and permits governing current or proposed operations and activities of the Company, or more stringent implementation thereof, could have a material adverse impact on the Company and cause increases in development expenses, capital expenditures or production costs, or require abandonment or delays in development of new projects.

The Company is subject to the PRC environmental protection laws and regulations which impose fines for violations of laws, regulations or decrees and provide for the shutdown by the central, provisional or municipal governments of any facility not in compliance with governmental orders requiring the cessation or cure of certain activities causing environmental damage. Since natural gas is an environmentally friendly form of fuel, the Company has not adopted any special environmental protection measures other than the measures taken in the ordinary course of business by companies in the industry.

Key Executives

The Company is dependent upon the services of key executives, management of the Company and a small number of highly skilled and experienced executives and personnel. In addition, in the event that the Company expands its operations to other jurisdictions in the Hainan and Guangdong Provinces as presently contemplated, it will be required to hire additional skilled personnel. Due to the relatively small size of the Company, the loss of these persons or the Company's inability to attract and retain additional highly-skilled employees may adversely affect its business and future operations.

Infrastructure

Natural gas distribution activities depend on adequate infrastructure. Reliable roads, bridges, power sources and water supply are important determinants, 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 the Company's operations, financial condition and results of operations. Any increase in the operating costs of the natural gas distribution networks of the Company could have a material adverse effect on the Company.

Competition

The natural gas distribution industry is competitive in all of its phases. The Company faces strong competition from other natural gas distribution companies in connection with the development of pipelines and acquisition of distribution rights for natural gas. Many of these companies have greater financial resources, operational experience and technical capabilities than the Company. As a result of this competition, the Company may be unable to maintain or acquire distribution rights on terms it considers acceptable or at all.

The ability of the Company to acquire natural gas distribution rights depends upon whether the Company is able to meet certain qualifications criteria, the extent of competition, and the discretion of the MCC and other applicable government bodies. Factors beyond the control of the Company may affect its ability to obtain or retain distribution rights, or to secure exclusive concession rights with local municipalities, as well as the marketability of natural gas distributed by the Company.

As a result of these and other factors, competitors of the Company may be granted shared or exclusive natural gas distribution rights in the target markets of the Company, either of which may adversely affect the Company's future growth plans and operations.

The Company also competes for financing with other companies, many of whom have greater financial resources and/or more advanced operations. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favourable to the Company.

Substitute Products

Coal, gas, liquid propane gas, liquid natural gas and electricity are the main substitutes for natural gas. Ultimate consumers will consider factors such as cost, reliability, convenience and safety when choosing a fuel. Connection fees, gas usage charges and heat content are the major factors affecting customers' choice of fuel. Save for newly built residential apartments which are required to be equipped with gas supply for cooking stoves, in most of the locations in which the Company has established a presence, there is no assurance that existing fuel users will shift to use piped natural gas. Continued growth of the Company is dependent upon the continued conversion by Chinese residential and business consumers to natural gas as a fuel source.

Commodity Prices

The price of the securities of the Company, the Company's financial results and development activities may in the future be significantly and adversely affected by declines in the price of natural gas and other commodities. The price of natural gas and other commodities fluctuates widely and is affected by numerous factors beyond the Company's control such as the sale or purchase of natural gas by various central banks and financial institutions, interest rates, exchange rates, inflation or deflation, fluctuation in the value of the United States dollar and foreign currencies, global and regional supply and demand, the political and economic conditions of major oil-producing countries throughout the world, and the cost of substitutes, inventory levels and carrying charges. Future serious price declines in the market value of natural gas and other commodities could cause continued development of the Company's projects to be impracticable. Depending on the price of natural gas and other commodities, cash flow from operations may not be sufficient and the Company could be forced to discontinue development and may lose its interest in, or may be forced to sell, some of its interests.

Political and Economic Considerations

Since substantially all of the business of the Company is operated in the PRC, the profitability, financial position and prospects of the Company may be affected by the PRC's economic, political and regulatory regime.

The PRC economy is currently evolving from a planned economy into a market-oriented economy. Although the PRC has adopted an open door policy, changes in the policies of the PRC government regarding the domestic economy (for example, changes affecting foreign exchange rates, inflation, taxation and trade) may have a material effect on the overall economy. The current reforms are unprecedented, produce effects that are unpredictable, and are subject to further refinement and improvement. New political, economic and social developments and considerations may lead the PRC government to make adjustments to these reform measures. Such amendments and adjustments may not have a favorable effect on the Company's business. Any change, variation or adjustment to the reform measures taken by the PRC government may have a material adverse effect on the business of the Company.

Changes in Laws, Regulations and Policies

The PRC legal system is a civil law system. Unlike the common law system, the civil law system is based on written statutes in which decided legal cases have little precedential value. In 1979, the PRC began to promulgate a comprehensive system of laws and has since introduced many laws and regulations to provide general guidance on economic and business practices in the PRC and to regulate foreign investment. Progress has been made in the promulgation of laws and regulations dealing with economic matters such as corporate organization and governance, foreign investment, commerce, taxation and trade. The promulgation of new changes to existing laws and the abrogation of local regulations by national laws could have a negative impact on the business and prospects of the Company. In addition, as these laws, regulations and legal requirements are relatively recent, their interpretation and enforcement involve significant uncertainty.

In the PRC, gas distribution companies invest in and operate the piped gas supply business in urban areas under the supervision of a number of government ministries and departments, including the Ministry of Commerce, the MCC, the Ministry of Labour and Social Security and the Ministry of Public Security. The Company must comply with the relevant requirements of certain regulations, including the City Fuel Gas Administration Regulations, the Tentative Regulations in relation to the Supervision and Administration of the Safety of Petroleum and Natural Gas Pipelines and the Regulations of the Safety of City Fuel Gas Administration. In addition, the Company must comply with the relevant requirements and policies of local authorities where the Company's projects are situated.

Rights or rights of first refusal to provide piped gas are granted by local governments pursuant to policies of promoting environmental protection and encouraging the use of natural gas and the construction of natural gas supply facilities.

In addition, the natural gas distribution business in the PRC is highly regulated and pricing is controlled by the PRC government. Any change in such laws or regulations could have a material adverse effect on the business of the Company.

There can be no assurance that the above regulatory regime and policies (including the granting of rights or rights of first refusal to supply piped gas) will not be changed. The Company's operations and profitability may be materially adversely affected if changes that occur are not favourable to the Company.

Changes in Foreign Exchange Regulations

Since 1996, the PRC government has promulgated various foreign exchange rules, regulations and notices (the "Policies") to raise the convertibility of renminbi. According to the Policies, a foreign-invested enterprise ("FIE") must open a "current account" and a "capital account" at a bank authorized to trade foreign exchange. A FIE may convert renminbi in the capital account into any foreign currency at any authorized bank with the prior approval of the State Administration for Foreign Exchange ("SAFE").

The income and expenditures of the Company are denominated in renminbi. At present, renminbi cannot be freely converted into other currencies. According to the Policies, upon producing the board resolution on the authorization of the distribution of profits or dividends or the commercial documents evidencing foreign exchange transactions, the Company may purchase the foreign exchange required for the distribution from a designated authorized bank. The Company cannot guarantee that the Policies will not be withdrawn or amended.

The Company continues to have substantial requirements for foreign currency, including foreign currency denominated loans and purchases of imported equipment and materials. Repayment of the principal and interest of loans denominated in foreign currency shall be approved by SAFE in advance. Such approval requirement could affect the Company's ability to obtain foreign exchange through debt financing or to obtain foreign exchange for capital expenditure.

In addition, according to the current foreign exchange control system, there can be no assurance that sufficient foreign exchange can be obtained pursuant to a specific exchange rate in order to satisfy the Company's entire needs. A shortage in the foreign exchange may prevent the Company from obtaining sufficient currency to pay dividends or limit its ability to satisfy its needs for foreign exchange.

Currency, Interest Rate and Exchange Fluctuations

The value of renminbi is subject to changes in the PRC government's policies and depends to a large extent on domestic and international economic and political developments, as well as supply and demand in the local market. Since 1994, the official exchange rate for the conversion of renminbi to US dollars has generally been stable, and renminbi has appreciated slightly against the US dollar. Any devaluation of renminbi may adversely affect the value of, and dividends payable on, the securities of the Company in foreign currency terms since the Company receives its revenues in renminbi. Results of operations and the financial condition of the Company may also be affected by changes in the value of certain currencies other than renminbi in which the Company's obligations are denominated. In particular, a devaluation of the renminbi is likely to increase the portion of the Company's cash flow required to satisfy its foreign currency-denominated obligations.

Government Regulation

The construction and distribution activities of the Company are subject to various laws governing development, construction, distribution, taxes, labour standards and occupational health, toxic substances, land use, water use, and other matters. Although the Company's operations are currently carried out in accordance with all applicable rules and regulations, no assurance can be given that new rules and regulations will not be enacted or that existing rules and regulations will not be applied in a manner which could limit or curtail production or distribution activities. Amendments to current laws and regulations governing natural gas distribution and related matters or more stringent implementation thereof could have a substantial adverse impact on the Company.

SHARE CAPITAL

As of March 24, 2010, the Company has 66,025,000 common shares outstanding and 3,450,000 stock options outstanding at an average exercise price of $.60 per share.

NEW ACCOUNTING POLICIES

ENTITIES SUBJECT TO RATE REGULATION

The Company is a rate regulated natural gas distribution utility and operates within Hainan Province, PRC. The utility operation of the Company is subject to regulation. Rate schedules are approved periodically by the provincial government and are designed to permit a fair and reasonable return on the utility investment.

Effective January 1, 2009, the temporary exemption from CICA Handbook Section 1100, "Generally Accepted Accounting Principles", which permits the recognition and measurement of assets and liabilities arising from rate regulation, was withdrawn. The Company did not have any rate regulated assets or liabilities as at December 31, 2009 and 2008 and the adoption of the revised standard did not impact the Company's earnings or cash flows.

FAIR VALUE HIERARCHY AND LIQUIDITY RISK DISCLOSURE

In June 2009, the Canadian Accounting Standards Board issued an amendment to CICA Section 3862, "Financial Instruments Disclosures" in an effort to make Section 3862 consistent with IFRS Section 7 - Disclosures ("IFRS 7"). The purpose was to establish a framework for measuring fair value under Canadian GAAP and expand disclosures about fair value measurements. To make the disclosures an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels: (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices) (Level 2); and (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). The adoption of the new standard resulted in additional disclosures in the notes to the consolidated financial statements.

GOODWILL AND INTANGIBLE ASSETS

Intangible assets with definitive useful lives are recorded at their fair value at the acquisition date. Amortization is calculated using the straight-line method for all intangibles over their estimated useful lives. In November 2007, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, which replaces the existing Handbook Section 3062, Goodwill and Other Intangible Assets and Handbook Section 3450, Research and Development Costs. This standard was adopted by the Company effective January 1, 2009. The standard provides guidance on the recognition, measurement and disclosure requirements for goodwill and intangible assets. The adoption of this standard did not have a material effect on the Company’s consolidated financial statements.

The Company’s intangible assets consist of gas purchase contract rights, which are amortized over the expected life of the contract.

CREDIT RISK AND THE FAIR VALUE OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

In January 2009, the CICA approved EIC 173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to fiscal periods ending on or after January 12, 2009. The Company is continually evaluating its counterparties and their credit risks and the adoption of this guidance did not have a material effect on the Company’s consolidated financial statements.

BUSINESS COMBINATIONS

CICA Handbook Section 1582 “Business Combinations”, replaces Section 1581 - “Business Combinations” and provides the Canadian equivalent to International Financial Reporting Standards (“IFRS”) 3 - Business Combinations. This applies to a transaction in which the acquirer obtains control of one or more businesses. Most assets acquired and liabilities assumed, including contingent liabilities that are considered to be improbable, will be measured at fair value. Any interest in the acquiree owned prior to obtaining control will be remeasured at fair value at the acquisition date, eliminating the need for guidance on step acquisitions. Additionally, a bargain purchase will result in recognition of a gain and acquisition costs must be expensed. The Company expects to adopt this standard on January 1, 2011. Early adoption is permitted.

CONSOLIDATIONS

CICA Handbook Sections 1601 “Consolidations” and Section 1602 “Non-Controlling Interests” replace Section 1600 “Consolidated Financial Statements”. Section 1602 provides the Canadian equivalent to International Accounting Standard 27 - “Consolidated and Separate Financial Statements”, for non-controlling interests. The Company expects to adopt this standard on January 1, 2011. Early adoption is permitted.

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 expects to adopt EIC 175 effective January 1, 2011.

PREPARING FOR IFRS CONVERSION

International Financial Reporting Standards ("IFRS") Implementation Plan

The AcSB has confirmed that IFRS will replace current Canadian GAAP for publicly accountable enterprises, effective for fiscal years beginning on or after January 1, 2011. Accordingly, the Company will report interim and annual financial statements (with comparatives) in accordance with IFRS beginning with the quarter ended March 31, 2011.

The Company has commenced the development of an IFRS implementation plan to prepare for this transition, and is in the process of analyzing the key areas where changes to current accounting policies may be required. While an analysis will be required for all accounting policies, the initial key areas of assessment will include:

- Plant and equipment
- Stock-based compensation;
- Accounting for income taxes; and
- First-time adoption of International Financial Reporting Standards (IFRS 1).

As the analysis of each of the key areas progresses, other elements of the Company's IFRS implementation plan will also be addressed, including: the implication of changes to accounting policies and processes; financial statement note disclosures on information technology; internal controls; contractual arrangements; and employee training. The table below summarizes the expected timing of activities related to the Company's transition to IFRS.

Initial analysis of key areas for which changes to accounting policies may be required	Completed December 31, 2009
Detailed analysis of all relevant IFRS requirements and identification of areas requiring accounting policy changes or those with accounting policy alternatives	Throughout fiscal 2010
Assessment of first-time adoption (IFRS 1) requirements and alternatives	Throughout fiscal 2010
Final determination of changes to accounting policies and choices to be made with respect to firsttime adoption alternatives	Q2 (June 30, 2010)
Resolution of the accounting policy change implications on information technology, internal controls and contractual arrangements	Q2 (June 30, 2010)
Management and employee education and training	Throughout the transition process
Quantification of the Financial Statement impact of changes in accounting policies	Throughout fiscal 2010

The AcSB has confirmed January 1, 2011 as the date IFRS will replace current Canadian standards and interpretations as Canadian generally accepted accounting principles (Canadian GAAP) for publicly accountable companies. The transition to IFRS may materially affect the Companies reported financial position and results of operations. The Company has initiated the process to identify the differences in accounting standards that are relevant to the Companies business. The Company is currently assessing the future impact of these new standards on its consolidated financial statements.

SUBSEQUENT EVENTS

a) Subsequent to December 31, 2009, 1,000,000 warrants expired unexercised.

b) Subsequent to December 31, 2009, the Company received a long term bank loan from the Bank of China in the amount of RMB 100 million ($15.3 million). The loan bears interest at the prescribed lending rate of the People's Bank of China (5.94% as of January 5, 2010), due monthly, and principal repayments commencing 2012, due January 2019. The loan is secured by 60% of the interest in CF China held by HEL and certain gas connection rights. The proceeds of the loan will be used to advance the Company's Haitang Bay Project and to retire certain existing loans. Subsequent to year-end, the Company repaid its loan from Sanya State Assets Management Corporation in the amount of RMB 42.2 million described in Note 9(b) of the December 31, 2009 audited consolidated financial statements and repaid the Bank of China loan in the amount of RMB 10 million described in Note 9(c) of the December 31, 2009 audited consolidated financial statements.

   Principal payments over successive years ending December 31 are as follows:

	RMB	$
2012	5,000,000	766,500
2013	5,000,000	766,500
2014	10,000,000	1,533,000
2015 and successive years	80,000,000	12,264,000

c) On March 8, 2010, the Company entered into an agreement to purchase liquid natural gas from an arm's length party for a period of five years. Pursuant to this agreement, the Company is not permitted to acquire liquid natural gas from outside suppliers without the consent of the other party to this agreement.

OUTLOOK

The Company continues to add both residential and commercial customers to its existing networks as well as expand its medium pressure pipelines.

The Company has recently commenced construction of a LNG regasification station in conjunction with its planned Haitang Bay extension, which includes a 25 km medium pressure pipeline. Construction has commenced on local distribution pipelines. Currently over 20 km of pipeline has been completed. In addition two major hotels have signed contracts for gas delivery in 2010.

The Company's joint venture with CNPC and other parties to construct CNG filling stations in Changsha continues to progress. The first of a planned 7 CNG stations has commenced operations. A further two have been approved and are expected to start construction shortly. This partnership will establish a solid foundation for Company developing natural gas distribution markets in Mainland China cities and also support securing natural gas supply for future projects.

The Company continues to explore other expansion opportunities both on Hainan Island and in mainland China.

CHANGFENG ENERGY INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009 AND 2008

(Expressed in Canadian currency)

CHANGFENG ENERGY INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2009 AND 2008

(Expressed in Canadian currency)

INDEX PAGE

MHC McGovern, Hurley, Cunningham, LLP
Chartered Accountants

AUDITORS' REPORT

To the Shareholders of
CHANGFENG ENERGY INC.

We have audited the consolidated balance sheets of Changfeng Energy Inc. (“the Company”) as at December 31, 2009 and 2008 and the consolidated statements of operations and deficit, comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2009 and 2008 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

McGOVERN, HURLEY, CUNNINGHAM, LLP

McGovern, Hurley, Cunningham, LLP

Chartered Accountants
Licensed Public Accountants

TORONTO, Canada
March 21, 2010

2005 Sheppard Avenue East, Suite 300, Toronto, Ontario, Canada, M2J 5B4
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(Expressed in Canadian currency)	2009 $	2008 $
ASSETS		
CURRENT		
Cash and cash equivalents (Note 4)	3,782,250	5,477,208
Accounts and sundry receivables	1,305,244	1,350,747
Prepaid expenses, advances and deposits	299,660	111,573
Inventories (Note 5)	581,570	838,989
	5,968,724	7,778,517
PREPAID EXPENSES AND DEPOSITS	307,662	-
PLANT AND EQUIPMENT (Note 6)	29,213,765	31,664,018
INTANGIBLE ASSET (Note 7)	408,800	-
FUTURE INCOME TAX ASSETS (Note 11(b))	169,840	648,400
	36,068,791	40,090,935
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 12)	2,837,830	1,849,610
Deferred revenue (Note 2)	3,586,710	3,156,012
Interest payable (Note 9)	1,996,304	2,337,486
Current portion of long term debt (Note 9)	1,931,580	9,836,600
	10,352,424	17,179,708
LONG TERM DEBT (Note 9)	9,535,260	5,851,700
DUE TO RELATED PARTIES (Note 12)	6,132,000	7,180,000
FUTURE INCOME TAX LIABILITY (Note 11(b))	74,600	-
	26,094,284	30,211,408
NON CONTROLLING INTERESTS (Note 8)	379,397	20,398
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 10(b))	12,121,808	12,121,808
CONTRIBUTED SURPLUS (Note 10(c))	1,190,509	1,071,231
WARRANTS (Note 10(d))	321,724	321,724
	13,634,041	13,514,763
ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME (Note 14)	(778,791)	727,220
DEFICIT	(3,260,140)	(4,382,854)
	(4,038,931)	(3,655,634)
	9,595,110	9,859,129
	36,068,791	40,090,935

GOING CONCERN (Note 1)
ECONOMIC DEPENDENCE (Note 15)
COMMITMENTS AND CONTINGENCIES (Note 17)

APPROVED ON BEHALF OF THE BOARD:

Signed "Wencheng Zhang", Director

Signed "Peter Cheung" , Director

 See accompanying notes to the consolidated financial statements.

(Expressed in Canadian currency)	2009 $	2008 $
REVENUE	17,876,478	13,014,236
COST OF SALES	7,163,810	5,225,306
GROSS MARGIN	10,712,668	7,788,930
EXPENSES		
General and administrative	5,628,096	3,889,140
Interest on long term debt (Note 9)	446,503	733,414
Travel and promotion	1,320,618	1,193,510
Amortization	1,096,689	920,078
Stock based compensation (Note 10(c))	119,278	13,628
	8,611,184	6,749,770
Income before the undernoted	2,101,484	1,039,160
Interest income	11,482	65,443
	2,112,966	1,104,603
Income tax expense (Note 11(a))	(990,252)	(186,312)
NET INCOME FOR THE YEAR	1,122,714	918,291
DEFICIT, BEGINNING OF YEAR	(4,382,854)	(5,301,145)
DEFICIT, END OF YEAR	(3,260,140)	(4,382,854)
NET INCOME PER SHARE - basic and diluted	0.017	0.014
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING - basic and diluted	66,025,000	63,479,372

CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME
FOR THE YEARS ENDED DECEMBER 31,

(Expressed in Canadian currency)	2009 $	2008 $
NET INCOME FOR THE YEAR	1,122,714	918,291
OTHER COMPREHENSIVE (LOSS) INCOME FOR THE YEAR		
Currency translation adjustment	(1,506,011)	1,187,833
COMPREHENSIVE (LOSS) INCOME FOR THE YEAR	(383,297)	2,106,124

(Expressed in Canadian currency)	2009 $	2008 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income for the year	1,122,714	918,291
Adjustments for:		
Income taxes	436,052	109,852
Amortization	1,096,689	920,078
Stock based compensation	119,278	13,628
	2,774,733	1,961,849
Accounts and sundry receivables	(149,620)	(320,432)
Prepaid expenses, advances and deposits	(554,924)	(4,552)
Inventories	147,196	(245,324)
Accounts payable and accrued liabilities	942,375	350,260
Deferred revenue	972,174	596,717
Interest payable	-	(179,660)
Cash flows from operating activities	4,131,934	2,158,858
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant and equipment	(3,148,850)	(3,638,208)
CASH FLOWS FROM FINANCING ACTIVITIES		
Payment of interest on convertible debenture	-	(549,797)
Long term debt	(2,106,720)	(1,935,360)
Cash acquired on RTO (Note 7)	-	6,718,427
Cash paid for transaction costs (Note 7)	-	(477,699)
Cash flows from financing activities	(2,106,720)	3,755,571
Effects of foreign exchange on cash balances	(571,322)	603,111
(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(1,694,958)	2,879,332
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	5,477,208	2,597,876
CASH AND CASH EQUIVALENTS, END OF YEAR	3,782,250	5,477,208
SUPPLEMENTAL INFORMATION		
Interest paid	424,278	1,133,649
Taxes paid	123,750	91,842
Change in accrued plant and equipment expenditures	316,189	85,285

See accompanying notes to the consolidated financial statements.

1. BASIS OF PRESENTATION AND GOING CONCERN

Changfeng Energy Inc. (the "Company") was incorporated under the Canada Business Corporation Act on May 4, 2006. A reorganization was completed on January 29, 2008 as described in Note 7. The Company's core business is the distribution of natural gas in Southern China, mostly in Sanya City of Hainan Province, through its wholly owned subsidiary, Sanya Changfeng Offshore Natural Gas Supply Co., Ltd. ("CF China"). CF China is 100% owned by Hainan Energy Limited ("HEL") and HEL is 100% owned by the Company.

The Company is a rate regulated natural gas distribution utility, serving residential and commercial customers in Hainan Province, the People's Republic of China ("PRC"). The rights of operation of a gas pipeline infrastructure and provision of piped gas business in PRC are established by permits obtained from the city and provincial governments. The plant and equipment of the Company consist primarily of pipeline, storage and compression facilities used in the transportation, storage and distribution of natural gas.

On December 18, 2008, the Company established a new company, Hunan Changfeng CNPC Energy Co. Ltd. ("Hunan CF CNPC"), with a subsidiary of China National Petroleum Corporation ("CNPC") and its associates to pursue compressed natural gas ("CNG") distribution opportunities in Changsha, a major city in China and capital of Hunan Province. The Company holds a 58% equity interest in Hunan CF CNPC through its newly incorporated, 99.92% owned subsidiary, Sanya Changfeng New Energy Investment Co. Ltd. ("Sanya CF NEI") and its 60% owned subsidiary Hunan CNPC New Energy Investment Ltd. (see next paragraph). As of December 31, 2009, the Company has made its capital contribution in Hunan CF CNPC and the other parties are required to make their capital contributions by December 2010. Hunan CF CNPC's business license expires December 24, 2038.

In January 2009, the Company acquired a 60% of the equity interest in Hunan CNPC New Energy Investment Ltd. ("Hunan CNPC NEI"), which has a contract with Hunan CNPC Pipeline Gas Co. Ltd., an arm's length corporation, to purchase 11 million M^3 of CNG per year until September 12, 2027 (see Note 7). The CNG purchased pursuant to this contract will be used to supply the Company's CNG commercial vehicle filling stations in Changsha City, upon completion of construction. Hunan CNPC NEI's business license expires July 22, 2058.

Substantially all of the assets of the Company which are located in the PRC are subject to the risk of foreign investment, including increases in taxes and royalties, renegotiation of contracts and permits, currency exchange fluctuations and political uncertainty. The Company's operations are subject to government legislation, policies and controls relating to transportation, storage, distribution, pricing, environmental protection, taxes and labour standards. In order for the Company to carry out its natural gas distribution activities, the Company is required to hold a business license. CF China's business license expires January 19, 2056. There is no assurance that the Company's existing permits will be renewed or that new permits that have been applied for will be granted.

As at December 31, 2009, the Company had a working capital deficiency of $4,383,700. These consolidated financial statements have been prepared on the basis of accounting principles applicable to a "going concern", which assume that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. If the "going concern" assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary to the carrying values of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. Such adjustments could be material.

2. SIGNIFICANT ACCOUNTING POLICIES

The accounting policies of the Company are in accordance with Canadian generally accepted accounting principles and their basis of application is consistent with the prior year, except where disclosed below. Outlined below are those policies considered particularly significant.

Basis of Consolidation
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries HEL, CF China, its 97.6% interest in Sanya Changfeng Offshore Natural Gas Engineering Construction Co. Ltd. ("CF Engineering"), its 99.92% interest in Sanya CF NEI, its 98% interest in Sanya Changfeng Offshore Natural Gas Design Co. Ltd. ("CF Design"), its 58% interest in Hunan CF CNPC and its 60% interest in Hunan CNPC NEI. These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. All material intercompany balances and transactions have been eliminated.

Cash and Cash Equivalents
Cash and cash equivalents include cash on hand and balances with banks, cashable guaranteed investment certificates, and short-term investments with original maturities of three months or less.

Inventories
Inventories, including construction materials, gas appliances and meters, and spare parts are stated at the lower of cost and net realizable value, with cost being determined using the weighted average cost basis. Costs include the purchase price, transportation costs and other costs to bring the inventories to their present location and conditions. Reversal of previous write-downs is required when there is a subsequent increase in the value of inventories.

Plant and Equipment, Construction in Progress and Amortization
Construction in progress represents machinery and pipelines under construction and is stated at cost. Cost comprises directly attributable costs of acquisition or construction, which include capitalized borrowing costs. Assets under construction are not amortized until they are in use. Completed items are transferred from construction in progress to proper categories of plant and equipment when they are ready for their intended use. Plant and equipment are recorded at cost. Land use rights are recorded at cost and amortized over the term of the land use rights.

Amortization of plant and equipment is provided at the following annual rates based on their estimated useful lives:

Pipelines	30 - 35 years straight line
Land use rights	50 years straight line
Motor vehicles	3 - 10 years straight line
Furniture and equipment	3 - 20 years straight line
Computer equipment	3 - 5 years straight line

Impairment of Long-Lived Assets
The Company reviews and evaluates its long-lived assets subject to amortization for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to its estimated undiscounted future cash flows expected to be generated by the asset. Estimated cash flows include assumptions about long-term natural gas prices, future supply levels, and future operating and capital costs. An impairment loss, if any, would be recorded as the excess of the carrying amount of the asset over its fair value, measured by either market value, if available, or estimated by calculating the present value of expected future cash flows related to the asset.

Management's estimates are subject to risks and uncertainties of changes affecting the recoverability of the Company's investment in its plant and equipment and construction in progress. Management's estimates of these factors are based on current conditions. Nonetheless, it is reasonably possible that in the near term, changes that could adversely affect management's estimate of net cash flows expected to be generated from its plant and equipment could occur, which may necessitate a write-down for asset impairment.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Asset Retirement Obligations

The accounting standard for asset retirement obligations, under normal circumstances, requires companies to recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be determined. The associated asset retirement cost is capitalized as part of the carrying amount of the long-lived asset. The liability is accreted over the estimated useful life of the asset.

The Company's natural gas distribution network is comprised of mains, service lines, measuring and regulating equipment and storage facilities. The Company estimates that it does not have a material legal retirement obligation with respect to its distribution and supply network and therefore no asset retirement obligations have been recorded as at December 31, 2009 and 2008.

Financial Instruments

Financial assets are identified and classified as either available for sale, held for trading, held to maturity, or loans and receivables. Financial liabilities are classified as either held for trading or other liabilities. Initially, all financial assets and financial liabilities are recorded on the balance sheet at fair value with subsequent measurement determined by the classification of each financial asset and liability.

Financial assets and financial liabilities held for trading are measured at fair value with the changes in fair value reported in net income. Financial assets held to maturity, loans and receivables and financial liabilities other than those held for trading are measured at amortized cost. Available-for-sale financial assets are measured at fair value with changes in fair value reported in other comprehensive income until the financial asset is disposed of or becomes impaired. Investments in equity instruments classified as available for sale that do not have quoted market prices in an active market are measured at cost.

Upon initial recognition, the Company may designate financial instruments as held for trading when such financial instruments have a reliably determinable fair value and where doing so eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets and liabilities or recognizing gains and losses on them on a different basis. The Company has designated its cash and cash equivalents and investment in floating rate notes as held for trading. All other non-derivative financial assets not meeting the Company's criteria for designating as held for trading are classified as available for sale, loans and receivables or held to maturity.

Financial assets purchased or sold, where the contract requires the asset to be delivered within an established timeframe, are recognized on a settlement date basis. Transaction costs on financial assets and liabilities classified as other than held for trading are capitalized and amortized over the expected life of the instrument, based on contractual cash flows, utilizing the effective interest method. The effective interest method calculates the amortized cost of a financial asset or liability and allocates the interest income or expense over the term of the financial asset or liability using an effective interest rate.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition
Revenues include revenue from the delivery of natural gas and revenue from the installation and connection of natural gas pipelines for end users. The Company recognizes revenues when gas has been delivered. Gas distribution revenues are recorded on the basis of regular meter readings and estimates of usage since the last meter reading to the end of the reporting period. Revenues of gas are recorded using relatively fixed prices approved by the provincial government.

Gas connection revenue is deferred and only recognized when the outcome of a contract can be estimated reliably and the stage of completion at the balance sheet date can be measured reliably. Revenue from gas connection contracts is recognized on the percentage of completion method, measured by reference to the value of work carried out during the period. When it is probable that total contract costs will exceed contract revenue, the expected loss is recognized as an expense immediately. Sales of gas appliances are recognized when goods are delivered and title has passed.

As at December 31, 2009, the Company had deferred revenue of $3,586,710 (2008 - $3,156,012), with respect to deposits received from customers in excess of the value of work carried out during the period.

Interest income is recorded on an accrual basis.

Income Taxes
The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income taxes are determined based on the differences between the financial reporting and tax bases of assets and liabilities. These income tax assets and liabilities are measured using the enacted or substantively enacted tax rates in which the income tax assets or liabilities are expected to be settled or realized. A valuation allowance is provided to the extent that it is more likely than not that future income tax assets will not be realized.

According to the PRC Tax Administration and Collection Law, the statute of limitations is three years if the underpayment of taxes is due to computational errors made by the taxpayer or the withholding agent. The statute of limitations is extended to five years under special circumstances, which are not clearly defined. There is no statute of limitations in the case of tax evasion. The tax returns of the Company's PRC subsidiaries for the 2009 tax year are subject to examination by the relevant tax authorities.

Foreign Currency Translation
The Canadian dollar is the functional currency of the parent company's operations, and the Chinese Renminbi or ("RMB") is the functional currency of the Company's subsidiaries. The Canadian dollar has been chosen as the reporting currency of the Company. Since the RMB is not a fully convertible currency, all foreign exchange translations involving RMB must take place either through the People's Bank of China or other institutions authorized to buy and sell foreign exchange.

Transaction amounts denominated in foreign currencies are translated into the Company's functional currency at exchange rates prevailing at the transaction dates. Carrying values of foreign currency monetary assets and liabilities are translated at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical exchange rates, unless such items are carried at market, in which case they are translated at the exchange rates in effect on the balance sheet date. Gains and losses arising from the translation of foreign currency monetary assets and liabilities at each period end are included in earnings.

The Company's foreign subsidiaries are considered to be self-sustaining. Assets and liabilities denominated in RMB are translated into Canadian dollars using the exchange rate in effect on the balance sheet date. Operating revenues and expenses are translated at the average exchange rates during the period. Foreign exchange gains and losses arising from translation of the balances are disclosed separately as comprehensive income or loss. The accumulated foreign exchange gains or losses are reported as a separate component of shareholders' equity as accumulated other comprehensive income or loss.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Based Compensation

The Company records compensation cost based on the fair value method of accounting for stock based compensation. The fair value of stock options is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. When options are exercised, the proceeds received, together with any related amount in contributed surplus, will be credited to share capital. The Company's stock option plan is described in Note 10(c).

Income Per Share

Basic income per share is calculated using the weighted average number of shares outstanding. Diluted income per share is calculated using the treasury stock method. In order to determine diluted income per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted income per share calculation. The diluted income per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share. As at December 31, 2009 and 2008, the options and warrants described in Notes 10(c) and (d) were anti-dilutive as the exercise prices of the options and warrants exceeded the average market price of the Company's common shares during the years ended December 31, 2009 and 2008.

Measurement Uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related reported amounts of revenue and expense during the reporting period. Such estimates and assumptions affect the carrying value and useful lives of assets and affect the valuation of investments, intangible assets, deferred revenue, stock based compensation, warrants, and accrued interest with respect to the term loan facility described in Note 9(b), and income tax accounts. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

Government Assistance

Government assistance related to current expenses is recorded as a reduction of these expenses in the period incurred. See Note 9(b).

Comprehensive Income

Comprehensive income includes both net earnings and other comprehensive income. Other comprehensive income includes holding gains and losses on available for sale investments, and foreign currency gains and losses relating to self sustaining foreign operations, all of which are not included in the calculation of net earnings until the period that the related asset or liability affects income.

Transaction Costs

Transaction costs on financial assets and liabilities classified as other than held for trading are capitalized and amortized over the expected life of the instrument, based on contractual cash flows, utilizing the effective interest method. The effective interest method calculates the amortized cost of a financial asset or liability and allocates the interest income or expense over the term of the financial asset or liability using an effective interest rate.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Accounting Policies

Entities Subject to Rate Regulation
The Company is a rate regulated natural gas distribution utility and operates within Hainan Province, PRC. The utility operation of the Company is subject to regulation. Rate schedules are approved periodically by the provincial government and are designed to permit a fair and reasonable return on the utility investment.

Effective January 1, 2009, the temporary exemption from CICA Handbook Section 1100, "Generally Accepted Accounting Principles", which permits the recognition and measurement of assets and liabilities arising from rate regulation, was withdrawn. The Company did not have any rate regulated assets or liabilities as at December 31, 2009 and 2008 and the adoption of the revised standard did not impact the Company's earnings or cash flows.

Fair Value Hierarchy and Liquidity Risk Disclosure
In June 2009, the Canadian Accounting Standards Board issued an amendment to CICA Section 3862, "Financial Instruments Disclosures" in an effort to make Section 3862 consistent with IFRS Section 7 - Disclosures ("IFRS 7"). The purpose was to establish a framework for measuring fair value under Canadian GAAP and expand disclosures about fair value measurements. To make the disclosures an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels: (a) quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1); (b) inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices) (Level 2); and (c) inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3). The adoption of the new standard resulted in additional disclosures in the notes to the consolidated financial statements.

Goodwill and Intangible Assets
Intangible assets with definitive useful lives are recorded at their fair value at the acquisition date. Amortization is calculated using the straight-line method for all intangibles over their estimated useful lives. In November 2007, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, which replaces the existing Handbook Section 3062, Goodwill and Other Intangible Assets and Handbook Section 3450, Research and Development Costs. This standard was adopted by the Company effective January 1, 2009. The standard provides guidance on the recognition, measurement and disclosure requirements for goodwill and intangible assets. The adoption of this standard did not have a material effect on the Company's consolidated financial statements.

The Company's intangible assets consist of gas purchase contract rights, which are recorded at cost and are amortized over their estimated useful life.

Credit Risk and the Fair Value of Financial Assets and Financial Liabilities
In January 2009, the CICA approved EIC 173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to fiscal periods ending on or after January 12, 2009. The Company is continually evaluating its counterparties and their credit risks and the adoption of this guidance did not have a material effect on the Company's consolidated financial statements.

2. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future Accounting Changes

Business Combinations
CICA Handbook Section 1582 "Business Combinations", replaces Section 1581 - "Business Combinations" and provides the Canadian equivalent to International Financial Reporting Standards ("IFRS") 3 - Business Combinations. This applies to a transaction in which the acquirer obtains control of one or more businesses. Most assets acquired and liabilities assumed, including contingent liabilities that are considered to be improbable, will be measured at fair value. Any interest in the acquiree owned prior to obtaining control will be remeasured at fair value at the acquisition date, eliminating the need for guidance on step acquisitions. Additionally, a bargain purchase will result in recognition of a gain and acquisition costs must be expensed. The Company expects to adopt this standard on January 1, 2011. Early adoption is permitted.

Consolidations
CICA Handbook Sections 1601 "Consolidations" and Section 1602 "Non-Controlling Interests" replace Section 1600 "Consolidated Financial Statements". Section 1602 provides the Canadian equivalent to International Accounting Standard 27 - "Consolidated and Separate Financial Statements", for non-controlling interests. The Company expects to adopt this standard on January 1, 2011. Early adoption is permitted.

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 expects to adopt EIC 175 effective January 1, 2011.

International Financial Reporting Standards ("IFRS")
In February 2008, the CICA Accounting Standards Board ("AcSB") confirmed the changeover to IFRS from Canadian GAAP will be required for publicly accountable enterprises effective for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The AcSB issued the "omnibus" exposure draft of IFRS with comments due by July 31, 2008, wherein early adoption by Canadian entities is also permitted. The Canadian Securities Administrators ("CSA") has also issued Concept Paper 52-402, which requested feedback on the early adoption of IFRS as well as the (continued) use of US GAAP by domestic issuers. The eventual changeover to IFRS represents changes due to new accounting standards. The transition from current Canadian GAAP to IFRS is a significant undertaking that may materially affect the Company's reported financial position and results of operations.

The Company is assessing the potential impacts of this changeover and is developing its IFRS changeover plan, which will include project structure and governance, resourcing and training, analysis of key GAAP differences and a phased plan to assess accounting policies under IFRS as well as potential exemptions to the initial adoption of IFRS as permitted by IFRS Statement 1.

3. FINANCIAL INSTRUMENTS

Fair Value

Canadian generally accepted accounting principles require that the Company disclose information about the fair value of its financial assets and liabilities. Fair value estimates are made at the balance sheet date based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties in significant matters of judgment and therefore cannot be determined with precision. Changes in assumptions could significantly affect these estimates.

The carrying amounts for cash and cash equivalents, accounts and sundry receivables, advances, accounts payable and accrued liabilities and interest payable on the balance sheet approximate fair value because of the limited term of these instruments. It is not practicable to estimate the fair value of the amounts due to related parties.

The fair value of long-term debt described in Note 9 approximates carrying value since interest is charged on a floating rate basis, based on the rate of interest as prescribed by the People's Bank of China.

At December 31, 2009, the Company's financial instruments that are carried at fair value, consisting of cash and cash equivalents, have been classified as Level 1 within the fair value hierarchy.

Financial Risk Factors

The Company's risk exposures and the impact on the Company's financial instruments are summarized below:

(a) Foreign Exchange Risk

Substantially all of the assets, liabilities and operations of the Company are denominated in Chinese RMB. RMB is not a freely convertible currency. Future exchange rates of RMB could vary significantly from the current or historical exchange rates as a result of controls that could be imposed by the PRC government. The exchange rates may also be affected by economic developments and political changes domestically and internationally and supply and demand of RMB. The appreciation or devaluation of RMB against the Canadian dollar may have positive or negative impact on the results of operations of the Company.

As at December 31, 2009, the Company held foreign currency cash and cash equivalents of RMB 21,111,585 ($3,236,406) (2008 – RMB 18,046,198 ($3,239,293)) and US $33,310 ($35,009) (2008-US $34,521 ($42,047)). .

b) Regulatory Risks and Uncertainties

The price of natural gas charged by CF China for the supply of natural gas to its customers is fixed by the local state price bureau. Any increase in gas usage charges exceeding the original approved charge requires the approval of the local state price bureau. There is no assurance that any increases, except for an increase to offset the rise in the Company's purchase price of natural gas, will be approved.

Connection fees chargeable by CF China require the approval of the local state price bureau. There is no assurance that CF China will be able to obtain approvals from the relevant state price bureau for an increase in connection fees, which may in turn adversely affect the profits of CF China. Since the price of natural gas and connection fees are all regulated by the local government, the price fluctuation risk is considered minimal.

3. FINANCIAL INSTRUMENTS (Continued)

(c) Interest Rate Risk

The Company has cash balances and interest bearing debt. The Company's current policy is to invest excess cash in investment grade short-term deposit certificates issued by its banking institutions. The Company periodically monitors the investments it makes and is satisfied with the credit ratings of its banks. The Company's interest rate on its debt is based upon the prescribed rate of the People's Bank of China which is subject to fluctuation and may result in an increase or decrease in interest expense. The Company does not use derivative instruments to reduce its exposure to interest rate risk.

As at December 31, 2009, the Company had variable interest rate term loan facilities in the aggregate of $11,466,840 (2008 - $15,688,300) as described in Note 9. Subsequent to December 31, 2009, the Company obtained a variable interest rate long term bank loan in the amount of RMB 100 million ($15.3 million) to retire the loans described in Note 9 (b) and (c).

(d) Credit Risk

Credit risk arises from exposure to customers including outstanding accounts receivable. Historically, the Company has not had collection issues associated with its receivables and the aging of receivables is reviewed on a regular basis to ensure the timely collection of amounts owing to the Company. The Company manages its credit risk by entering into purchase and connection agreements with creditworthy parties and through regular review of accounts receivable. Payments are usually required in advance for gas purchases and connection services. The maximum exposure to credit risk is represented by the net carrying amount of these financial assets. Management believes that the credit risk concentration with respect to financial instruments included in accounts and sundry receivables is remote.

(e) Liquidity Risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. The contractual maturities of the Company's long term financial liabilities are described in Note 9 and the remaining financial liabilities consisting of accounts payable are expected to be realized within one year. As at December 31, 2009, the Company had a cash and cash equivalents balance of $3,782,250 (2008 - $5,477,208), to settle current liabilities of $10,352,424 (2008 - $17,179,708).

(f) Sensitivity Analysis

The Company has designated its cash and cash equivalents as held for trading, which are measured at fair value. Financial instruments included in accounts and sundry receivables are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities, interest payable and long-term debt are classified as other financial liabilities, which are measured at amortized cost. As at December 31, 2009, the carrying and fair value amounts of the Company's financial instruments are approximately the same.

A 1% increase or decrease in the average interest rate charged on the term loan facilities described in Note 9 for the year ended December 31, 2009 would have had the following impact on the Company's net income.

	Impact on Net Income
Interest rate +1%	$ 136,000
Interest rate -1%	($136,000)

4. CASH AND CASH EQUIVALENTS

	December 31, 2009 $	December 31, 2008 $
Cash	3,782,250	5,460,904
Cashable guaranteed investment certificate, bearing interest of 1.9%	-	16,304
	3,782,250	5,477,208

5. INVENTORIES

	December 31, 2009 $	December 31, 2008 $
Construction materials	410,682	601,571
Gas appliances, meters, and spare parts	170,888	237,418
	581,570	838,989

The amount of inventory recognized as an expense during the year ended December 31, 2009 was $2,799,130 (2008 - $2,416,634). As at December 31, 2009 and 2008, all inventory is recorded at cost.

6. PLANT AND EQUIPMENT

	December 31, 2009 Cost $	Accumulated Amortization $	December 31, 2009 Net $
Pipelines	28,847,022	5,635,309	23,211,713
Land use rights	1,136,260	260,985	875,275
Motor vehicles	818,958	212,430	606,528
Furniture and equipment	370,345	74,606	295,739
Computer equipment	100,418	49,028	51,390
Construction in progress	4,173,120	-	4,173,120
	35,446,123	6,232,358	29,213,765

	December 31, 2008 Cost $	Accumulated Amortization $	December 31, 2008 Net $
Pipelines	32,302,722	5,623,911	26,678,811
Land use rights	1,330,454	264,197	1,066,257
Motor vehicles	771,710	145,307	626,403
Furniture and equipment	346,164	54,427	291,737
Computer equipment	82,510	34,824	47,686
	34,833,560	6,122,666	28,710,894
Construction in progress	2,953,124	-	2,953,124
	37,786,684	6,122,666	31,664,018

As at December 31, 2009, the Company held four land use rights certificates. They all have a 50 year term and expire February 28, 2051. No new land use rights were acquired in 2009.

Included in plant and equipment as at December 31, 2009 is cumulative capitalized interest of $87,800 (RMB 572,715) (2008 - $102,802; RMB 572,715).

7. ACQUISITIONS AND REVERSE TAKEOVER TRANSACTIONS

Acquisition of Hunan CNPC NEI

During the year ended December 31, 2009, the Company acquired a 60% equity interest in Hunan CNPC NEI for cash consideration of $766,500 (RMB 5,000,000). At the time of acquisition, Hunan CNPC NEI had obtained the rights to a CNG purchase contract. These contract rights, valued at $306,600, plus a related future tax liability of $102,200 (for a total of $408,800) has been reflected as an intangible asset on the balance sheet and will be amortized over the contract period once the CNG stations commence operations. The assets acquired as at the date of acquisition are as follows:

Cash	$ 459,900
CNG purchase contract rights	408,800
Future tax liability	(102,200)
Cash consideration paid	$ 766,500

Reverse Takeover Transactions

Pursuant to an acquisition agreement dated November 28, 2007, the Company issued 32,750,000 common shares to CF Energy (BVI) Limited on January 29, 2008 in consideration for all of the issued and outstanding shares of HEL not otherwise held by the Company. HEL holds a 100% interest in CF China.

Following the transaction, the former shareholder of HEL held more than 50% of the issued and outstanding common shares of the Company. The substance of the transaction was a capital transaction and was accounted for as a reverse takeover in accordance with EIC-10 “Reverse Takeover Accounting” of the Canadian Institute of Chartered Accountants (“CICA”) Handbook. HEL, the legal subsidiary is considered to have acquired the assets and liabilities of the Company, the legal parent. Prior to the transaction, the legal parent had outstanding 7,000,000 common shares, 3,750,000 options to purchase common shares at an exercise price of $0.60 per share valued at $1,057,603 and 1,000,000 warrants to purchase common shares at an exercise price of $0.60 valued at $321,724. The 3,750,000 options and 1,000,000 warrants granted by the legal parent were exchanged for an equivalent number of options and warrants of the legal subsidiary. The options and warrants granted by the legal subsidiary were valued at fair value at the time of the reverse takeover, and form part of the cost of the acquisition.

The net assets that were acquired by HEL were as follows:

Cash	$ 6,718,427
Non cash working capital (deficiency)	(309,482)
Advances and deferred costs	766,537
Interest payable	(549,797)
Net assets acquired	$ 6,625,685

7. ACQUISITIONS AND REVERSE TAKEOVER TRANSACTIONS (Continued)

Immediately following the HEL reverse take over ("RTO"), the Company and McBroom Resources Inc. ("McBroom") completed their previously announced combination to form Amalco. McBroom filed Articles of Continuance effective January 14, 2008 to continue from the Province of Ontario to the federal jurisdiction of Canada, and McBroom and the Company filed Articles of Amalgamation effective January 29, 2008 to complete the combination, with Amalco issuing one common share for each share of the Company and McBroom outstanding on January 29, 2008. Prior to the transaction, McBroom had 1,775,000 common shares outstanding. In accordance with EIC-10, the substance of the transaction was a capital transaction and was accounted for as an RTO. The Company, the legal subsidiary, was considered to have acquired the assets and liabilities of McBroom, the legal parent.

The net liabilities that were assumed by the Company were as follows:

Non cash working capital (deficiency)	$ (28,831)
Net liabilities assumed	$ (28,831)

As a result of the transactions described above and in accordance with RTO accounting, the consolidated financial statements are a continuation of HEL and the comparative figures presented in the consolidated financial statements are those of HEL.

Costs related to these transactions of $525,720, were charged to equity during the year ended December 31, 2008.

8. NON CONTROLLING INTEREST

Non controlling interest represents remaining equity interests not held by the Company in its subsidiaries. These interests were recorded at the carrying value of the net assets at the time of the acquisition and adjusted for their share of income and losses incurred after the acquisition. Non controlling interest was not separately presented in the consolidated statements of operations and deficit and the amount was not adjusted in the consolidated balance sheet as the effect from income and losses since the acquisition was minimal.

9. LONG-TERM DEBT

	December 31, 2009 $	December 31, 2008 $
a) Term Loan Facility – China Development Bank RMB 22,600,000 (2008 – RMB 35,200,000), advanced from the China Development Bank to Sanya State Assets Management Corporation (an intermediary company controlled by the municipality of Sanya City, see Note 9(b), and loaned to the Company, bearing interest at the floating prescribed rate of the People's Bank of China (5.76% as at December 31, 2009 and 2008) due quarterly, principal repayments commencing February 2008, due November 2012, secured by all pipelines and land use rights of the Company with a net book value as at December 31, 2009 of $24,086,988 (2008 - $27,745,068) and gas distribution rights.	3,464,580	6,318,400
b) Term Loan Facility – Sanya State Assets Management Corporation RMB 42,200,000 (2008 – RMB 42,200,000), representing principal repayments of the term loan facility described in Note 9(a) made by Sanya State Assets Management Corporation on behalf of the Company, unsecured, with no fixed terms of repayment. Interest is calculated at the floating prescribed rate of the People's Bank of China (5.76% as at December 31, 2009 and 2008). Sanya State Assets Management Corporation waived interest for the years ended December 31, 2009 and 2008 which has been accounted for as government assistance. See Note 19(b).	6,469,260	7,574,900
c) Term Loan Facility – Bank of China RMB 10,000,000 (2008 - RMB 10,000,000), bears interest at a rate of 110% of the floating prescribed rate of the People's Bank of China prime lending rate (6.34% as at December 31, 2009 and 2008), interest due monthly with principal repayable in 20 monthly payments of RMB 500,000 ($76,650), commencing April 30, 2011. The interest rate is adjusted semi-annually based on the floating prescribed rate at that time. This loan is secured by gas connection fees. See Note 19(b).	1,533,000	1,795,000
	11,466,840	15,688,300
Less: current portion	(1,931,580)	(9,836,600)
	9,535,260	5,851,700

Principal payments over successive years ending December 31 are as follows:

	RMB	$
2010	12,600,000	1,931,580
2011	10,500,000	1,609,650
2012	9,500,000	1,456,350
	32,600,000	4,997,580

9. LONG-TERM DEBT (Continued)

As at December 31, 2008, the entire balance of the loan described in Note 9(b) was classified as current due to the fact that no fixed terms of repayment have been established. Subsequent to December 31, 2009, the Company received a long term loan from the Bank of China (see Note 19(b)) of which, a portion of the loan proceeds was used to repay the loans described in Notes 9(b) and (c) in full. Accordingly, the balance of the loan described in Note 9(b), which would otherwise have been classified as current as at December 31, 2009, has been classified as long-term.

As at December 31, 2009, the Company had accrued interest of $1,996,304 (RMB 13,022,204) (2008 - $2,337,486; RMB 13,022,204) with respect to the loan facilities described in Notes 9(a) and (b).

10. CAPITAL STOCK

a) Authorized
Unlimited number of common shares

b) Issued
66,025,000 common shares

Transactions during the periods are as follows:

	Number of Shares	Amount $
Balance, December 31, 2007	100,000	7,430,001
Adjustments to give effect to RTO transactions (Note 7)		
Adjust number of common shares outstanding to that of the legal parent immediately prior to the RTO	6,900,000	-
Share exchange to effect RTO (Note 7) and conversion of subscription receipts (i) and convertible debentures (ii)	59,025,000	5,217,527
RTO transaction costs (Note 7)	-	(525,720)
Balance, December 31, 2008 and December 31, 2009	66,025,000	12,121,808

(i) Immediately prior to the RTO transactions in 2008, the legal parent completed a private placement and issued 12,500,000 subscription receipts for gross proceeds of $7,500,000. These subscription receipts were subsequently converted into 12,500,000 common shares for no additional consideration. The legal parent paid cash commission of $600,000 and issued 1,000,000 agents warrants valued at $321,724. The legal parent also incurred additional costs of $585,000 relating to the private placement.

(ii) In 2007, the legal parent issued 12,000,000 common shares upon the conversion of convertible debentures (the “Debentures”) at a conversion price of $0.50 per common share. The Debentures were issued by the legal parent during the year ended December 31, 2006 for gross proceeds of $6,000,000 less related costs of $314,530. The Debentures bore simple interest at an annual rate of 12% of the principal amount payable upon the earlier of:

i. the conversion of the Debentures; and
ii. May 19, 2012.

On January 29, 2008, the Company paid interest of $549,797 to the Debenture holders in full settlement of the interest payable, upon conversion of the Debentures.

10. CAPITAL STOCK (Continued)

c) Stock Options and Contributed Surplus

The maximum number of shares reserved for issuance under the stock option plan was increased to 6,600,000 in 2008. The options are not assignable and may be granted for a term not exceeding ten years. The exercise price is fixed by the board of directors of the Company at the time of grant, subject to all applicable regulatory requirements.

On June 29, 2009, the Company granted options to new directors of the Company to acquire 400,000 common shares of the Company at an exercise price of $0.55 per share on or before June 29, 2014. The options vested immediately. The grant date fair value of the options was estimated to be $119,278.

On August 25, 2008 the Company granted options to a consultant of the Company to acquire 50,000 common shares of the Company at an exercise price of $0.60 per share on or before August 28, 2013. The options vested immediately. The grant date fair value of the options granted was estimated to be $13,628.

On January 22, 2008 prior to the RTO transactions described in Note 7, the Company granted options to directors, officers and consultants of the Company to acquire 3,750,000 common shares of the Company at an exercise price of $0.60 per share on or before January 22, 2013. The options vested immediately. The grant date fair value of the options was estimated to be $1,057,603.

The weighted average grant date fair value of options granted during the year ended December 31, 2009 of $0.30 (2008 - $0.28) was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2009	2008
Expected dividend yield	0%	0%
Expected volatility	74%	66%
Risk free interest rate	2.5	3.0%
Expected life	60 months	60 months

A continuity of stock options is as follows:

	Number of Stock Options Issued and Exercisable	Weighted Average Exercise Price	Expiry Date
	#	$	
Balance, December 31, 2007	-	-	
Options granted prior to RTO (Note 7)	3,750,000	0.60	January 22, 2013
Granted	50,000	0.60	August 25, 2013
Balance, December 31, 2008	3,800,000	0.60	
Granted	400,000	0.55	June 28, 2014
Expired	(750,000)	0.60	
Balance, December 31, 2009	3,450,000	0.60	

The weighted average remaining contractual life of options outstanding as at December 31, 2009 is 3.24 years.

A continuity of contributed surplus is as follows:

	Balance
	$
Balance, December 31, 2007	-
Options granted prior to RTO (Note 7)	1,057,603
Options granted	13,628
Balance, December 31, 2008	1,071,231
Options granted	119,278
Balance, December 31, 2009	1,190,509

10. CAPITAL STOCK (Continued

d) Warrants

Pursuant to the private placement mentioned in Note 10(b)(i) and prior to the RTO described in Note 7, the legal parent granted 1,000,000 warrants to the Agent to acquire 1,000,000 common shares of the Company at an exercise price of $0.60 per share on or before January 29, 2010. As of December 31, 2008 and 2009, these warrants were outstanding. The grant date fair value of warrants was estimated to be $321,724 using the Black-Scholes option pricing model with the following assumptions:

Expected dividend yield	0%
Expected volatility	66%
Risk free interest rate	3%
Expected life	24 months

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e) Shares and Options Held in Escrow

Pursuant to Escrow Agreements entered into during the year ended December 31, 2008, 36,725,000 common shares of the Company and 1,750,000 options issued to certain officers and directors of the Company were held in escrow and released as follows: one quarter were released on February 4, 2008, the date on which the common shares were listed on a Canadian stock exchange; one third of the remaining securities were released nine months following the listing date; one half of the remaining securities were released twelve months following the listing date; and the remaining securities were released eighteen months following the listing date. As at December 31, 2009, all common shares and options were released from escrow.

11. INCOME TAXES

a) Provision for Income Taxes

Major items causing the Company's income tax rate to differ from the federal statutory rate of 33% (2008 - 34%) were as follows:

	2009	2008
	$	$
Income before taxes:	2,112,966	1,104,603
Expected income tax provision based on statutory rate	697,300	370,000
Non-deductible (deductible) expenditures	89,800	(229,600)
Tax assets acquired in RTO	-	(648,400)
Change in expected tax rates	(190,531)	(138,700)
Capital loss	(34,400)	(34,400)
Change in foreign exchange rates	94,600	(105,900)
Utilization / expiration of losses	260,000	50,700
Other	8,683	101,412
Change in valuation allowance	64,800	821,200
Income tax expense	990,252	186,312
Current income tax expense	884,527	76,460
Future income tax expense	105,725	109,852
	990,252	186,312

11. INCOME TAXES (Continued)

b) Future Tax Balances

The tax effects of temporary differences that give rise to future income tax assets are as follows:

	2009 $	2008 $
Future income tax assets (liabilities):		
Non capital losses	649,500	713,500
Plant and equipment	102,600	279,900
Intangible asset	(102,200)	-
Share issue and transaction costs	205,200	441,800
Capital losses	27,300	34,400
Other	98,800	-
	981,200	1,469,600
Valuation allowance	(886,000)	(821,200)
	95,200	648,400
Less: amount classified as future tax liability	(74,600)	-
Future income tax asset	169,800	648,400

c) Tax Loss Carry Forwards

As at December 31, 2009, the Company has approximately $2,219,000 of non-capital losses, which can be used to reduce taxable income in Canada in future periods that expire on December 31 of the following years:

Year	$
2013	10,000
2014	10,000
2025	24,000
2026	383,000
2027	28,000
2028	793,000
2029	971,000
	2,219,000

The Company has capital losses of $237,000 and other deductible pools of $395,000 which may be used to reduce taxable income in Canada in future periods. The Company also has approximately $379,000 (RMB 2,475,000) of non-capital losses in China, which can be used to reduce taxable income in China in future periods, of which $1,000 (RMB 8,000) expires in 2013, and $378,000 (RMB 2,467,000) expires in 2014.

12. RELATED PARTY TRANSACTIONS

A corporation controlled by a significant shareholder who is also an officer and director of the Company owed the Company a total of US$76,822 (Cdn$80,740) as at December 31, 2009 (2008 – US$62,889 (Cdn$76,599)) for various expenditures paid by the Company on behalf of this corporation. This amount, included in the consolidated balance sheet, is unsecured, non-interest bearing with no fixed terms of repayment. The amount is included in accounts receivables.

In addition, the Company owed this individual $200,510 for unpaid salary which amount is included in accounts payable as at December 31, 2009. The Company also had unpaid directors' fees of $33,000 included in accounts payable. These amounts are unsecured, non-interest bearing with no fixed terms of repayment.

These transactions were in the normal course of operations and were measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

During the year ended December 31, 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of RMB 40,000,000 (2009 - $6,132,000) (2008 - $7,180,000) to the Company, through wholly owned corporations, in accordance with a Subordination and Forbearance Agreement dated April 27, 2007, Consignment Loan Agreements dated May 23, 2007 and June 26, 2007, and other ancillary documentation.

These loans are unsecured, non-interest bearing, are subordinate to the claims of all other creditors, including unsecured creditors, of the Company, and are due on demand; however, the lender cannot demand the repayment of the loans at any time until April 27, 2010. These corporations and the Company have entered into Loan Renewal Agreements whereby the parties have agreed to enter into further loan renewal agreements upon the same terms and conditions as the Consignment Loan Agreements every three years, in perpetuity.

A significant shareholder of the Company, who is also an officer and director of the Company, owns 2.4% of the equity in CF Engineering, a subsidiary of CF China, through a corporation which the individual controls.

13. SEGMENTED INFORMATION

For management purposes, the Company is currently organized into two operating divisions: gas connections and piped gas sales. These principal operating activities are the basis on which the Company reports its primary segment information. As at December 31, 2009, the Company had not commenced the sale of CNG through commercial vehicle filling stations in Changsha City, Hunan. Expenses and assets of non-operational divisions are allocated to the gas connection and piped gas sales divisions based on their portion of consolidated revenue. Transactions between reportable segments, namely the transfer of certain pipeline assets from the gas connection segment to the piped gas sale segment, have been accounted for based on the carrying values of the assets transferred. The gas connection and piped gas sales operating divisions are based in the PRC.

FOR THE YEAR ENDED DECEMBER 31, 2009

	Gas Connection	Piped Gas Sales	Consolidated
	$	$	$
REVENUE	7,103,288	10,773,190	17,876,478
COST OF SALES	4,055,320	3,108,490	7,163,810
	3,047,968	7,664,700	10,712,668
EXPENSES			
General and administrative	2,084,441	3,543,655	5,628,096
Interest on long-term debt	-	446,503	446,503
Travel and promotion	505,268	815,350	1,320,618
Amortization	39,429	1,057,260	1,096,689
Stock based compensation	47,139	72,139	119,278
	2,676,277	5,934,907	8,611,184
Income before the under-noted	371,691	1,729,793	2,101,484
Interest income	4,538	6,944	11,482
	376,229	1,736,737	2,112,966
Income tax expense	(251,405)	(738,847)	(990,252)
NET INCOME FOR THE YEAR	124,824	997,890	1,122,714
ACQUISITION OF PLANT AND EQUIPMENT DURING THE YEAR	277,150	3,188,170	3,465,320
AS AT DECEMBER 31, 2009 ASSETS	3,509,916	32,558,875	36,068,791

Substantially all of the Company's assets are located in the PRC. As at December 31, 2009, there was cash of $363,582 (2008 - $973,250) and other current assets of $135,946 (2008 - $102,084) held in Canada.

13. SEGMENTED INFORMATION (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2008

	Gas Connection	Piped Gas Sales	Consolidated
	$	$	$
REVENUE	5,290,950	7,723,286	13,014,236
COST OF SALES	3,347,796	1,877,510	5,225,306
	1,943,154	5,845,776	7,788,930
EXPENSES			
General and administrative	1,390,511	2,498,629	3,889,140
Interest on long-term debt	-	733,414	733,414
Travel and promotion	416,584	776,926	1,193,510
Amortization	29,878	890,200	920,078
Stock based compensation	5,540	8,088	13,628
	1,842,513	4,907,257	6,749,770
Income before the under-noted	100,641	938,519	1,039,160
Interest income	26,606	38,837	65,443
	127,247	977,356	1,104,603
Income tax expense - current	(76,460)	-	(76,460)
Income tax expense - future	(10,471)	(99,381)	(109,852)
NET INCOME FOR THE YEAR	40,316	877,975	918,291
ACQUISITION OF PLANT AND EQUIPMENT DURING THE YEAR	25,283	3,612,925	3,638,208
AS AT DECEMBER 31, 2008 ASSETS	2,405,294	37,685,641	40,090,935

Substantially all of the Company's assets were located in the PRC as at December 31, 2008.

14. ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME

	December 31, 2009	December 31, 2008
	$	$
Balance, at the beginning of the period	727,220	(460,613)
Currency translation adjustment during the period	(1,506,011)	1,187,833
Balance, at the end of the period	(778,791)	727,220

15. ECONOMIC DEPENDENCE

Currently, one gas field in the South China Sea supplies all of the Company's natural gas. There may be no alternative supply in the short-term. Interruption of this gas field could affect the Company's ability to operate. Currently, the Company has a contract to purchase up to 24 million M^3 gas a year (which represents less than 1% of the field's total capacity) from this supplier until June 30, 2015. The Company is currently exploring other possible sources of natural gas. See Notes 17 and 19.

16. CAPITAL MANAGEMENT

The Company considers its capital structure to consist of share capital, contributed surplus, warrants, and long-term debt. The Company manages its capital structure and makes adjustments to it, based on the funds available to the Company, in order to support the ongoing operations of the business. The Board of Directors does not establish quantitative return on capital criteria for management, but rather relies on the expertise of the Company's management to sustain future development of the business.

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable. The Company is currently in compliance with all capital requirements including requirements relating to its bank loans.

There were no changes in the Company's approach to capital management during the period ended December 31, 2009.

17. COMMITMENTS AND CONTINGENCIES

Statutory Reserves

In accordance with PRC Company Law, CF China is required to provide for certain statutory reserves commencing from the year it reports retained earnings. Prior to June 6, 2007, as a domestic limited liability company, CF China was required to allocate at least 10% of its after tax profits to a statutory surplus reserve with the right to discontinue allocations to the statutory surplus reserve if such reserves reach 50% of its registered capital. CF China was also required to designate 5% of after tax profit to a statutory welfare reserve to be used only for the collective benefits of CF China's employees. All statutory reserves are required to be calculated based on amounts reported in CF China's PRC statutory financial statements under China GAAP. Effective from June 6, 2007, as CF China became a foreign invested enterprise ("FIE"), in accordance with PRC Company Law for FIEs, CF China is required to provide for a surplus reserve fund, enterprise development fund, and employee welfare fund, each at a percentage of after tax profits, which is a discretionary percentage and is decided by the CF China's board of directors each calendar year. These reserves can only be used for specific purposes and are not transferred to the Company in the form of loans, advances, or cash dividends. These reserves can be distributed to the shareholder of CF China at the time when CF China is wound up. As of December 31, 2009, CF China had not designated RMB to the above statutory reserve funds.

Pipeline Construction and Equipment

The Company has signed two contracts with a sub-contractor to construct pipelines to extend to the Haitang Bay area of Sanya City, for a total contract amount of RMB 5,922,660 ($907,944) (2008 – RMB 20,893,429;$3,750,371), of which RMB 1,237,980 ($189,782) (2008 – RMB 11,072,870; $1,987,580) was incurred as at December 31, 2009 and included in construction in progress.

The Company has signed two contracts with the same sub-contractor to construct some city pipelines within Sanya city for a total contract amount of RMB 1,968,060 ($301,704) (2008 - $nil). Construction under these contracts has not commenced as at December 31, 2009.

The Company also has signed seven contracts with several equipment suppliers and construction supervisors for a total amount of RMB 5,940,639 ($910,700), of which RMB 50,000 ($7,665) was incurred as at December 31, 2009.

Purchase Commitments
See Note 15.

17. COMMITMENTS AND CONTINGENCIES (Continued)

In connection with the CNG contract described in Note 7, the Company is required to pay a one time charge of RMB 3,000,000 ($459,900) in addition to the price of the gas and has the right to acquire up to 11 million M^3 per year for a period of 19 years ending September 12, 2027. As of December 31, 2009, RMB 1,000,000 ($153,300) has been paid with the balance payable at the time the gas is first supplied. As at December 31, 2009, the Company has not purchased any CNG pursuant to this agreement.

In addition, the Company has acquired the rights to a gas purchase contract from a third party to purchase 10,000 M^3 of CNG per day (3,650,000 M^3 per year) until September 12, 2027. As consideration for the rights to this contract, the Company made a cash payment of RMB 500,000 ($76,650) that was recorded as part of the long term prepaids and will be required to pay a further one-time payment of RMB 500,000 ($76,650) at the time the gas is first supplied. As at December 31, 2009, the Company has not purchased any CNG pursuant to this agreement.

Lease Commitment

On September 8, 2008, the Company signed a lease agreement for 3,000 M^2 of land for construction of a CNG gas station in Hunan Province. The lease term is for 20 years until October 2028. A deposit of RMB 100,000 ($15,330) and four years' rent (RMB 1,880,000 or $288,204) need to be made in advance. As at December 31, 2009, the Company has paid RMB 1,300,000 ($199,290). If the Company decides to terminate this agreement, a termination payment of RMB 1,000,000 ($153,300) will be payable. The minimum lease payments in successive years are as follows:

	RMB	$
2010	580,000	88,900
2012	82,250	12,910
2013	493,500	75,650
2014	493,500	75,650
Thereafter	7,438,900	1,140,400
Total	9,088,150	1,393,510

Environmental Contingencies

All phases of the Company's operations are subject to environmental regulation in the jurisdictions in which it operates. Environmental legislation is evolving in a manner which will require stricter standards and enforcement, increased fines and penalties for non-compliance, more stringent environmental assessments of proposed projects, and a heightened degree of responsibility for companies and their officers, directors and employees. There is no assurance that future changes in environmental regulation, if any, will not adversely affect the Company's operations. Environmental hazards may exist in connection with the pipelines and distribution networks in which the Company holds interests which are unknown to the Company at present.

The Company is subject to the PRC environmental protection laws and regulations which impose fines for violations of laws, regulations or decrees and provide for the shutdown by the central, provisional or municipal governments of any facility not in compliance with governmental orders requiring the cessation or cure of certain activities causing environmental damage. Since natural gas is an environmentally friendly form of fuel, the Company has not adopted any special environmental protection measures other than the measures taken in the ordinary course of business by companies in the industry.

18. COMPARATIVE FIGURES

Certain of the 2008 comparative figures have been reclassified to conform to the financial statement presentation adopted in 2009.

19. SUBSEQUENT EVENTS

a) Subsequent to December 31, 2009, 1,000,000 warrants described in Note 10(d) expired unexercised.

b) Subsequent to December 31, 2009, the Company received a long term bank loan from the Bank of China in the amount of RMB 100 million ($15.3 million). The loan bears interest at the prescribed lending rate of the People's Bank of China (5.94% as of January 5, 2010), due monthly, and principal repayments commencing 2012, due January 2019. The loan is secured by 60% of the interest in CF China held by HEL and certain gas connection rights. The proceeds of the loan will be used to advance the Company's Haitang Bay Project and to retire certain existing loans. Subsequent to year-end, the Company repaid its loan from Sanya State Assets Management Corporation in the amount of RMB 42.2 million described in Note 9(b) and repaid the Bank of China loan in the amount of RMB 10 million described in Note 9(c).

Principal payments over successive years ending December 31 are as follows:

	RMB	$
2012	5,000,000	766,500
2013	5,000,000	766,500
2014	10,000,000	1,533,000
2015 and successive years	80,000,000	12,264,000

c) On March 8, 2010, the Company entered into an agreement to purchase liquid natural gas from an arm's length party for a period of five years. Pursuant to this agreement, the Company is not permitted to acquire liquid natural gas from outside suppliers without the consent of the other party to this agreement.

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