CHANGFENG ENERGY INC
长丰能源有限公司

ANNUAL REPORT 2010

INVESTING IN ENERGY INFRASTRUCTURE IN CHINA

ChangFeng Energy Inc
长丰能源有限公司

EXECUTIVE MANAGEMENT & DIRECTORS

HUAJUN LIN
Chairman and CEO

LARRY JEREMIAS
Executive Vice President, Corporate Development

KEVIN MING ZHANG
Chief Financial Officer

GRAHAM WARREN
Director

WENCHENG ZHANG
Director

DAN LIU
Director

HUI CAI
Director

ANN SIYIN LIN
Corporate Secretary

CHANGFENG ENERGY INC

长丰能源有限公司

TABLE OF CONTENTS

CHAIRMAN'S MESSAGE

Dear fellow shareholders,

Our Company has never been stronger and I am optimistic about our prospects as we move into 2011. I would like to highlight some of the significant progress we made during 2010 and the opportunities going forward.

Our Company saw anther year of significant growth in 2010. Revenue grew 24% to $22.1 million and EBITDA grew 18% to $4.4 million, net of a 10% negative foreign exchange adjustment. We now have a proven track record of growth and profitability. Our four year compound annual revenue growth rate is 41%. Our three year compound annual EBITDA growth rate is 31%.

In early 2010, we received a 15.0 million long term bank loan from the Bank of China which allowed us to retire our loan from the Sanya State Asset Management Corporation and make significant investments in our pipeline network in the Sanya Region and in our first CNG retail refueling station (the "CNG Station") in Changsha.

In 2010, we invested approximately $8.0 million expanding our existing pipeline network in the Sanya Region. We completed the extension of a 26.6 km of high-to-medium pressure pipeline linking Sanya City with Haitang Bay region and laid 21.2 km of low pressure pipeline. In addition, we completed the majority of a LNG/CNG storage facility, as well as a gasification processing station which will effectively lower our cost of gas. We think there is significant growth ahead in the Sanya Region driven by tourism and real estate development in the "Hawaii of China". We believe that Changfeng is well positioned to take advantage of this opportunity. Going forward, our top priority in Sanya region is to focus on maximizing the value of our existing assets, ensure they continue to operate safely and reliably, and deliver stable and growing cash flows for decades to come.

With such strong growth come inevitable growing pains. In the Sanya Region, demand has far exceeded our 24 million m3 gas quota. In 2010, we sold 29.1 million m3 of gas representing 16% growth over 2009. We have had to source gas at higher market prices to cope with the growth in demand. As a result, the net result has been that our gross margin percentage on marginal gas sales beyond 24 million m3 has been squeezed somewhat in the short run. In September 2010, with the help of the Government, we were able to secure a 3 million m3 at a relatively low price. In addition, we received a significant price increase in July 2010 for commercial (22%) and residential (8%) gas, partly to compensate us for the increased gas cost. We will continue to work with the Government and others to source long term gas supplies beyond the 24 million m3 quota at lower prices to meet increasing demand.

In 2010, significant progress was also made in business development on mainland China - the CNG Station in Changsha City and a natural gas distribution utility operation in Xiangdong District. Both lie along the second West-East Pipeline which will bring billions of cubic meters of new gas to new markets. We believe both have significant potential.

The CNG Station in Changsha was completed in early 2010 and commenced full operation in mid 2010. Unfortunately, due to a gas shortage in the Changsha region, we were not able to buy any gas under our low cost, gas supply contract. We have been forced to buy gas on an ad hoc basis from other suppliers at market prices. At the same time, the gas shortage also delayed taxis from converting to dual use engines (CNG and gasoline). As a result, gas volumes fell well below expectations in 2010. We believe the gas shortage in the Changsha region will be alleviated with the arrival of gas from the second West-East Pipeline. We are working to secure a gas source with favorable pricing to make the station viable and to make our stations initiative (up to 6 stations) viable.

In 2010, in Xiangdong District of Pingxiang City, we won a 50 year preliminary, exclusive concession right to an area that is considered one of the ceramic capitals of China (the “Xiangdong Project”). The potential demand for natural gas is large within the area of our concession rights. We are working closely with the Government and PetroChina to secure a gas source at favorable pricing as the second West-East Pipeline comes on stream.

Going forward, we will continue leveraging our track record of growth and strength to develop projects on mainland China. I believe that we have the right strategy, the right team, the right skills, and the financial capacity to compete and win a reasonable share of the quality opportunities available along the second West-East Pipeline.

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

Sincerely,

Huajun Lin
Chairman & CEO

Changfeng Energy Inc.

Management's Discussion and Analysis
For the year ended December 31, 2010

Dated April 25, 2011

Introduction

The Management's Discussion and Analysis ("MD&A") provides an analysis to enable readers to assess material changes in financial condition and results of operations of Changfeng Energy Inc. ("Changfeng" or the "Company") for the year ended December 31, 2010. This information should be read in conjunction with the accompanying audited Consolidated Financial Statements of the Company and the notes thereto for the year ended December 31, 2010 and 2009 which are prepared in accordance with Canadian generally accepted accounting principles (GAAP). Additional information relating to Changfeng is available at www.sedar.com.

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 reported amounts of sales and expenses during the reporting period. Changfeng bases its estimates on historical experience, current trends and various other assumptions that are believed to be reasonable under the circumstances. Actual results could differ from those estimates.

Unless otherwise indicated, all references to "$" or "dollars" in this report refer to the Canadian dollar.

Caution Regarding Forward-Looking Information

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 subsidiaries, 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.

Overview

Changfeng is a Canadian public company currently trading on the TSX Ventures Exchange (TSX-V) under the stock symbol "CFY". The Company is a natural gas distribution utility in the People's Republic of China ("China"). The Company's business is in three segments. The first two segments are Gas Connections and Pipeline Gas which together combine to form a natural gas distribution utility (the "Natural Gas Distribution Utility"). It is more particularly described as the design, construction, ownership and operation of a natural gas pipeline network in Sanya City, Hainan Province in China where the Company markets and distributes natural gas to residential, commercial and industrial customers. The Company also owns and operates a Compressed Natural Gas ("CNG") refueling station in Changsha City, Hunan Province in China, which is the third segment of the Company's business.

Changfeng's 2010 key accomplishments

In 2010, the Company made significant progress including:

- Completing the extension of a 26.6 km sub-high pressure pipeline to Haitang Bay from the existing network in Sanya City, together with 21.2 km of low pressure pipeline;
  - Connecting three commercial customers to our pipeline network in Haitang Bay;
  - Commencing gas supply to Haitang Bay in late 2010;
- Completing construction of its first retail CNG refueling station in Changsha City and commencing gas supply in April 2010;
- Close to completing construction of a CNG/LNG storage and gasification facility in Haitang Bay;
  - Expanding its pipeline network in Sanya City Adding 17,326 residential and 80 commercial customers;
- Receiving regulatory approval to implement gas price increases in July 2010;
- Growing revenue from $17.9 million to $22.1 million, representing a 24% increase net of a 10% unfavorable foreign exchange impact;
- Growing EBITDA (as defined below) from $3.8 million to $4.6 million, representing a 23% increase net of a 10% unfavorable foreign exchange impact;
- Receiving a 50-year preliminary exclusive concession right to operate a natural gas construction and distribution business in Pingxiang city and its Industrial Ceramic Park located in Xiangdong District;
- Receiving a 10-year bank loan of RMB 100 million (approximately $15.4 million) from the Bank of China;

Business Segments

Changfeng's businesses are organized into three segments- — Gas Connections, Pipeline Gas (together the Natural Gas Distribution Utility) and CNG refueling station.

Natural Gas Distribution Utility Segment (Gas Connections and Pipeline Gas)

The Company operates as a Natural Gas Distribution Utility by selling gas connections to its pipeline network and selling gas through its pipelines. The Company currently derives the majority of its revenue from the distribution of natural gas through its pipeline network in Sanya City, Hainan Province, China. The Company holds a 30-year exclusive concession right (until 2037) to operate a natural gas construction and distribution business in Sanya City.

Since 2003, the Company has been building an extensive pipeline network in the main district of Sanya City. Over the last two years, the Company has committed significant resources to extend its gas pipeline network from the main district of Sanya City to the Haitang Bay district, a newly developing, high growth tourist district in Sanya City. The rapid growth of the Haitang Bay district is mainly attributable to China Central Government's determination made in late 2009, to build Hainan province into an international tourism destination by 2020. The Company expects that as more hotels and other customers are constructed and connected to the Company's pipeline network in this region, revenue growth will take place in the form of increased connection fees and gas sales.

The Company's pipeline network in greater Sanya City begins with a primary gas station used mainly for its connection with a state-owned natural gas processing plant which is directly connected via a high pressure sub-sea pipeline to the CNOOC (Hainan) Limited Ya13-1 gas field that is located approximately 100-km offshore in the South China Sea. The Company's network then consists of 38-km of high pressure gas pipelines, more than 100-km of medium to low pressure gas pipelines and more than 600-km of branch/customer pipelines. In addition, the Company's network includes two gate gas processing stations and three gas pressure regulating stations. The network also includes a two gasification stations including a newly constructed station in Haitang Bay that is in the testing phase in late 2010.

Since 2008, the Company has been actively pursuing its gas connections and pipeline gas business in selected cities in Jiangxi, Hunan and Hubei provinces in mainland China. These provinces represent potentially large, rapidly growing emerging markets for the Company due to the construction of the second West-East Gas Pipeline, which will supply a significant volume of natural gas to new markets in Hunan, Jiangxi and Hubei provinces.

In addition to the Company's business in Sanya City, its other Gas Connections and Pipeline Gas business is in Pingxiang City, Jiangxi province, China. It is in the development phase. In May 2010, the Xiangdong District Government, one of the three administrative districts in Pingxiang City, granted Changfeng a 50-year preliminary, exclusive concession right to operate a natural gas construction and distribution business (including liquefied natural gas (LNG), liquefied petroleum gas (LPG), pipeline gas, and CNG refueling stations) in its existing administrative region and its Pingxiang Industrial Ceramic Park (the "Ceramic Park"). Pinxiang City is well known as the "Ceramic city" and is considered the industrial ceramic capital of China.

In 2006, the Xiangdong District government started construction of the Ceramic Park in order to strengthen the competitiveness of its ceramic industry, as well as to alleviate environmental problems. Many ceramic manufacturing plants in the Ceramic Park are expected to use/convert to natural gas as their heating energy source when the second West-East Gas Pipeline begins to supply natural gas to the area.

CNG Refueling Station Segment

CNG refueling stations in Changsha City, Hunan province, China

Changsha is the capital of Hunan Province, China with a population of approximately 6.5 million. It is an important commercial and trade center in central-south China. In 2006, the

Changsha municipal government began to encourage taxicab and public bus vehicles to be dual-fuel natural gas vehicles (gasoline and natural gas). The purpose of this measure is to alleviate a serious air pollution problem.

The construction of the Company's first CNG refueling station was completed in Changsha City and commenced supply of gas in April 2010. It serves mainly taxis.

Nature of Operations

Natural Gas Distribution Utility (Gas Connections and Pipeline Gas Business)

Concession operating rights
China's natural gas distribution has been operated mainly by local distribution companies that are awarded exclusive concession rights by local governments to design, construct, own and operate natural gas pipelines which distribute natural gas in a specified geographic area. These distribution companies also perform services such as billing, safety inspection, and providing natural gas hookups for new customers. The Company's concession rights are listed above under, "Business Segments".

Entities subject to rate regulation:
The Company operates in an environment subject to certain regulations as a natural gas distribution utility. The price of natural gas is subject to approval by the provincial government and is designed to permit a fair and reasonable return on investment. Currently, natural gas retail prices in China remain below international market prices. In June 2010, the National Development and Reform Commission (NDRC), the top policymaker in China, raised wholesale domestic onshore natural gas prices by 24.9%, the first increase in more than two years. In order to encourage the development of the urban natural gas distribution industry and to curb wasteful consumption, the central government has allowed passing this increased cost through the gas supply chain to the retail customer. Accordingly, natural gas retail price increases by local price authorities in individual provinces and major cities were made as of July 1,2010. Natural gas retail prices in China may continue to increase because of the higher expected costs for China to purchase liquefied natural gas and/or piped gas to meet growing demand.

Natural gas quota
Most natural gas distribution utilities have a gas quota. A gas quota is the maximum volume of natural gas a city or a local gas distributor can purchase from one of three state-owned gas suppliers in China: (i) PetroChina, a subsidiary of CNPC, China's largest state-owned onshore natural gas supplier; (ii) CNOOC, the largest offshore natural gas supplier in China; and (iii) Sinopec, the second largest onshore natural gas supplier. PetroChina and Sinopec own and operate mostly onshore pipelines, and CNOOC owns and operates virtually all offshore pipelines. Normally, gas quotas represent a long term agreement to purchase significant volumes at relatively low prices. Gas quotas differ from city to city and are generally predetermined between the local government and one or more of the three state-owned gas suppliers based on a series of factors, such as population, general industrial development level, industrial sector and so on. Without a gas quota, a gas distribution utility would normally face a high operating risk of gas shortage or higher purchase pricing because it would need to purchase gas from third party gas suppliers at higher prices.

In Sanya City, the Company has a 24 million m^3/year gas quota with CNOOC to purchase gas at approximately RMB 0.6/M3. The quota expires at the end of 2015. In addition, the Company has secured other gas via long term gas contracts listed below under the heading, "Long Term Natural Gas Contracts".

Construction and operation of pipeline network

The design and construction of natural gas pipeline networks for a given region is the responsibility of the gas distribution utility that is granted the exclusive concession operating right. Upon completion of the natural gas pipeline network, that distributor also typically retains ownership of the network and continues to maintain its operations to ensure that natural gas can be delivered to customers without interruption. The distribution utility is also responsible for sales, marketing and billing. One-time initial connection fees are usually charged to customers for their connection to the Company's pipeline network.

CNG refueling stations business

CNG is a fossil fuel substitute for gasoline. Although its combustion does produce greenhouse gases, it is a more environmentally clean alternative to gasoline fuel. CNG is starting to be used in traditional gasoline internal combustion engine vehicles that have been converted into bi-fuel vehicles (gasoline/CNG). In Changsha City, CNG is less expensive than gasoline.

Consolidated Financial Review

Selected Consolidated Financial Data

(In thousands of Canadian dollars except per share amounts)	**2010**	**2009**	**Change**
Revenue	22,135	17,876	24%
Gross profit	11,546	10,482	10%
% of revenue	52.2%	58.6%	-6.5%
General and administrative	4,356	4,071	7%
% of revenue	19.7%	22.8%	-3.1%
Interest on long term debt	642	447	44%
% of revenue	2.9%	2.5%	0.4%
Travel and business development	3,171	2,647	20%
% of revenue	14.3%	14.8%	-0.5%
Amortization	1,163	1,097	6.1%
% of revenue	5.3%	6.1%	-0.9%
Stock based compensation	250	119	110%
% of revenue	1.1%	0.7%	0.5%

Interest income	5	11	-57%
% of revenue	0.0%	0.1%	0.0%
Income tax expense	(958)	(990)	-3%
% of revenue	-4.3%	-5.5%	-1.2%
EBITDA (Note a)	4,443	3,764	18%
% of revenue	20.1%	21.1%	-1.0%
Non-controlling interest	10	-	
% of revenue	0.0%	0.0%	
Net income	**1,020**	**1,123**	**-9%**
% of revenue	4.6%	6.3%	-1.7%
Basic and diluted EPS	0.016	0.017	-9%
Weighted average number of common shares outstanding			
Basic and Diluted	66,025	66,025	

Note a: For the year ended December 31, 2010, as well as the comparative periods in 2009, the Company disclosed EBITDA, a non-GAAP financial measure, as a supplementary indicator of operating performance. Management believes its use provides more insight into the Company's performance. EBITDA is defined herein as earnings before income tax benefit (expense), (loss) gain on sale of assets, interest income (expense), capitalized interest expenses and financing fees, depreciation and amortization, non-controlling interest and non-cash stock-based compensation expense. EBITDA is a non-GAAP measure and it is not intended as a substitute for GAAP measures. This definition may not be the same definition used by other companies. The table below shows the reconciliation EBITDA to Net Income.

In thousands of Canadian dollars	2010	2009	Change	%
Net Income	1,020	1,123	(103)	-9%
Add:				
Non-controlling interest	(10)	0	(10)	
Income tax expense	958	990	(33)	-3%
Interest income	(5)	(11)	7	-57%
Stock based compensation (% of revenue)	250	119	131	110%
Amortization	1,163	1,097	67	6%
Interest on long term debt	642	447	195	44%
Interest capitalized	425	0	425	
EBITDA	4,443	3,764	679	18%

Financial Highlights

Earnings

Net Income was $1.0 million or $0.016 per share in 2010 compared to $1.1 million or $0.017 per share, respectively, in 2009.

Cash flow

Cash Generated from Operations was $4.8 million in 2010, an increase of $0.6 million or 15% from 2009.

Changfeng invested $10.7 million in its natural gas pipelines, gas connection and CNG refueling stations in 2010, as follows:

- capital expenditures of $9.4 million for city natural gas pipeline in Sanya city, as well as natural gas pipeline extension to Haitang Bay, Sanya City and a LNG/CNG gasification facility in Haitang Bay, Sanya City;
- capital expenditures of $0.6 million for its first CNG refueling station in Changsha City and natural gas pipeline project in Pingxiang City;
- deposits of $0.8million for due diligence for potential acquisitions in Changsha and Pingxiang City;

In 2010, Changfeng received approximately $15 million in the form of a ten-year bank loan. The proceeds were used for capital expenditures and to retire previously outstanding bank loans.

Balance sheet

Total assets increased by $8.7 million to $45.0 million in 2010 from 2009.

Shareholders' Equity increased by $1.2 million to $10.8 million in 2010 from 2009.

Refer to the <u>Results of Operations</u> and <u>Liquidity and Capital Resources</u> sections in this MD&A for further discussion of these highlights.

Results of Operations

Revenue

Sales for fiscal 2010 were $22.1 million, an increase of $4.2 million, or 24%, from $17.9 million in 2009. The increase reflects higher continued growth of piped gas sales from Sanya City as more customers were connected. The table below illustrates the increase in customers connected during the periods and presents the volume of natural gas sold for the years ended December 31, 2010 and 2009.

Residential customers	**2010**	**2009**	**% Change**
Customers connected during the year	17,326	12,654	37%
Total customers at the end of year	67,781	50,455	34%
Gas volume sold (m3) during the year	4,340,000	3,221,900	35%
Commercial customers			
Customers connected during the year	80	65	23%
Total customers at the end of year	520	440	18%

Gas volume sold (m3) during the year	24,780,000	21,803,000	14%
Total Gas volume sold (m3) during the year	**29,120,000**	**25,024,900**	**16%**

In addition, the Company's first CNG refueling retail station commenced initial operation in April 2010 with full commercial operation beginning in June 2010. The total sales from this station were $0.9 million in 2010, or 4% of consolidated revenue, representing a gas volume of approximately 7,000 m3 a day.

Natural gas retail price

Natural gas retail prices in China were increased on July 1, 2010 as a response to gas wholesale price increases in June 2010 by the National Development and Reform Commission (NDRC), China's top economic policy planning agency. As a result, a natural gas retail price adjustment by local price authorities in individual provinces was made in Sanya City, Hainan province and Changsha City, Hunan province. Effective July 1, 2010, gas retail prices increased 8% to RMB 2.60 per cubic meter for residential customers; increased 22% to RMB 3.80 per cubic meter to commercial customers in Sanya City, Hainan Province; and increased 14% to RMB 3.75 per cubic meter at CNG refueling retail stations, in Changsha City, Hunan province.

Foreign exchange rates

Changfeng reports in Canadian dollars but earns all of its revenues and incurs most of its expenses in Chinese RMB. Accordingly, any fluctuation in the exchange rate between these two currencies will affect the Company's reported financial information. All of the Company's subsidiaries in China are considered to be self sustaining; therefore, any impact of the changes in foreign exchange rates has been recognized as other comprehensive income, and not in net income. Excluding foreign exchange effect, revenues for fiscal 2010 were RMB145 million, an increase of RMB39 million (37%), from RMB 106 million in 2009.

The exchange rate between Chinese RMB and the Canadian dollar is summarized below.

One Canadian dollar to Chinese RMB	**2010**	**2009**	**% change**
Average rate for the year	6.57	5.98	10%
Spot rate at December 31	6.63	6.52	2%

Gross profits

Gross profits for fiscal 2010 were $11.6 million, an increase of $1.1 million, or 10%, from $10.5 million in 2009. Gross profits as a percentage of sales for 2010 decreased by 6.5% to 52.2% compared to 58.6% for 2009. The decrease in gross margin percentage is mainly due to a relatively higher procurement price for purchases of additional natural gas in the form of LNG and CNG in Sanya City caused by growing demand in excess of our annual 24 million m3 quota. The decrease is also due to relatively lower gross margins on CNG sales from the retail station.

Changfeng's annual natural gas quota in Sanya city is 24 million cubic meters which was initially contracted in 2006 with CNOOC. This annual quota is currently insufficient to meet strong market demand due to both urban expansion and rapid development of coastal tourism in Sanya City. As a result, the Company has to purchase additional volumes of gas in the form of CNG or LNG from time to time to fill its pipeline to keep an even monthly supply from the annual contract volume, and most importantly, to avoid gas shortages in peak seasons. All of the CNG or LNG purchased is at higher market prices through two long term natural gas contracts that were entered into in early 2010. For the nine-month period ended September 30, 2010, 1.76 million m3 of LNG and 0.67 million m3 of CNG were purchased compared to nil for the same period of 2009.

Gross margin on gas sales from its CNG retail station is normally much lower than the gross margin on piped natural gas sales. Gross margin for CNG sales was 6% in 2010. It was mainly attributable to relatively higher gas purchase prices and an unstable source of gas supply. Due to gas shortage in Changsha City, CNPC did not honor its long term gas supply agreement with the Company. As a result, the Company has to purchase gas on an ad hoc basis from other parties at higher purchase prices than the CNPC agreement.

Operating expenses

General and administrative expenses for fiscal 2010 were $4.4 million, an increase of $0.3 million, or 7%, from $4.1 million in 2009. General and administrative expenses as a percentage of sales for 2010 was 19.7%, compared to 22.8% in 2009, representing a decrease of 3.1% as a result of increases in revenue.

Travel and business development expenses for fiscal 2010 were $3.2 million, an increase of $0.6 million, or 20%, from $2.6 million in 2009. This increase for 2010 is primarily attributable to travel and business development activities in Hunan and Jiangxi provinces in mainland China as the Company seeks to develop new projects in close proximity to the new national pipelines. Travel and business development expenses as a percentage of sales for 2010 decreased to 14.3% from 14.8% in 2009 as a result of increases in revenue. The majority of travel and business development expenses do not relate to the Company's business in Sanya City or the CNG retail station but instead relate to projects under consideration or development in mainland China.

Amortization for fiscal 2010 was $1.2 million, an increase of $0.1 million, or 6%, from $1.1 million in 2009. Amortization as a percentage of sales for 2010 was 5.3%, compared to 6.1% in 2009, representing a decrease of 0.9% as a result of increases in revenue.

Interest on long term debt for fiscal year 2010 and 2009 was $0.6 million and $0.4 million, respectively, an increase of $0.2 million as a result of increased bank loans. In addition, the Company had $0.6 million in capitalized interest in 2010 versus nil in 2009.

Stock based compensation expenses for fiscal year 2010 and 2009 were $0.3 million and $0.1 million, respectively, as a result of options being granted and having vested in the respective years.

EBITDA for fiscal 2010 was $4.4 million, an increase of $0.6 million, or 18%, from $3.8 million for 2009 as a result of sales increases. EBITDA as a as a percentage of sales for 2010 was 20.1%, compared to 21.1% in 2009, representing an increase of 1% as a result of increases in revenue, partially offset by lower gross margin and increased business development expenses.

Expansion Projects

The Company is expanding its existing pipeline network in Sanya City as the geographic boundaries of Sanya City are expanding and with it the Company's exclusive concession rights. This allows the Company to connect to smaller towns in the area and add residential and commercial customers. In addition, Changfeng is focusing on pipeline gas and CNG refueling station opportunities in selected cities in mainland China along the second West-East Gas Pipeline where it fits the Company's growth strategies.

Changfeng's growth strategies continue to evolve with the Company's natural gas operating experiences with the emerging opportunities in natural gas infrastructure in mainland China through acquisitions or joint ventures. As such, the Company's growth strategies currently are:

1. Maximize operating cash flow from its Natural Gas Distribution Utility in Sanya through securing additional gas quotas with more competitive purchase pricing;
2. Focus on commercial-intensive, underdeveloped markets in medium and small cities in mainland China; and
3. Cultivate a focused portfolio of high-quality development projects along the Second West to East Gas Pipeline;

Haitang Bay pipeline gas project, Sanya City, Hainan province

In late 2009, China Central Government authorized developing Hainan province into an international tourist destination by 2020. Haitang Bay is one of the five major bays in Sanya City, Hainan province. It is a flagship project being promoted by the Hainan provincial government. The size of Haitang Bay development area is estimated at 98.7 square kilometers and includes approximately 24 km of beachfront.

In December 2010, the Company completed extension of a 26.6 km of high-to-medium pressure pipeline linking Sanya City with Haitang Bay region together with 21.2 km of low pressure pipeline. During 2010, the Company connected three hotels to its pipeline network: Double Tree by Hilton Sanya Haitang Bay, Conrad Haitang Bay, and Renaissance Sanya Resort & Spa. The Company commenced supplying gas to Haitang Bay in late 2010. In addition, the Company has completed the majority of a LNG/CNG storage facility, as well as a gasification processing station in this region. The Company believes that as more hotels and other customers are constructed and connected to the Company's pipeline network, it will drive revenue growth in the form of new connection fees and increased gas sales.

The pace of development in Haitang Bay and Sanya City has slowed in 2010 and early 2011 due to the tightening of credit by the Central Government to address growing inflation in China.

CNG refueling stations project, Changsha City, Hunan province

In 2006, the Changsha municipal government started to encourage new taxicab and public bus vehicles to be dual-fuel natural gas vehicles. The local government has proposed that a total of approximately 25 CNG refueling stations be constructed in Changsha region by 2015, of which 7 stations can be owned and operated by Changfeng.

In late 2008, Changfeng entered the CNG refueling station market in Changsha City, Hunan province. Currently, the Company owns a business certificate to operate CNG refueling stations in Changsha City, and holds a long term natural gas supply agreement with CNPC which allows the Company to purchase up to 14.6 million m3 annually until September 2027. The Company's first CNG refueling station in Changsha City was completed and commenced gas supply in April 2010. However, as of December 31, 2010, the Company had not been able to purchase any CNG pursuant to its long term CNG gas purchase contract, mainly attributable to gas shortage in this region as a result of surging demand and limited gas supply pending the arrival of the Second West-East Pipeline to the region. As a result, the Company has had to purchase gas at relatively higher market prices and with unstable daily volume from other third parties. Consequently, gross margin for the year has fallen short of expectations (6% in 2010).

The Company believes the gas shortage in Changsha City has affected demand for its gas as taxis do not want to convert to dual use (CNG/gasoline) engines if there is not enough gas available. As a result, daily volumes are well below capacity of 12,000 to 15,000 m3 per day (approximately 7,000 m3 per day). The Company believes the gas shortage will be alleviated with the arrival of new gas from the Second East-West Pipeline.

In September, 2010, the Company entered into a land lease agreement for construction of its second CNG refueling station in Changsha City, Hunan Province. However, further expansion and development of CNG retail stations in Changsha beyond the first station is delayed pending the arrival of the Second West-East Pipeline and a long term, secure gas supply contract at a price that will provide for a reasonable margin. The Company is working on securing such a contract. In addition, other issues such as pricing, market size/development and capital budgeting are expected to play a role in the evolution of the Company's CNG station initiative in Changsha City.

CNG and pipelined gas project, Xiangdong district, Pingxiang City, Jiangxi province

Pingxiang city is located in the west of Jiangxi Province. It is approximately 50 km from Changsha City. It is considered the industrial ceramic capital of China.

In May 2010, the Xiangdong District government, one of the three administrative districts in Pingxiang City, granted Changfeng a 50-year preliminary exclusive concession right to operate a natural gas construction and distribution business in its existing administrative region and in its Pingxiang Industrial Ceramic Park (the "Ceramic Park"). The Company refers to this as the Xiangdong Project.

The Xiangdong District government started construction of the Ceramic Park in 2006 in order to strengthen the competitiveness of its ceramic industry, as well as to alleviate environmental problems. Currently, coal and coal methane gas, a by-product that is produced by two local metallurgy manufacturers and water gas, are the main sources of energy for ceramic manufacturing companies in this region. The reliance on coal and coal methane gas not only contribute to serious air pollution problems, but also affects the quality and value of ceramics due to the low temperature and unstable supply of coal methane gas. The Company believes that many ceramic manufacturing plants in the Park will convert/use natural gas as their heating energy when the Second West-East Gas Pipeline begins to commence supply of natural gas to the region. Natural gas is not only cleaner but it will allow the ceramic companies to produce higher quality, more differentiated products that are higher value and less like commodities.

In May 2010, Changfeng registered an 80%-owned subsidiary, Pingxiang CF. This is a major step forward for Changfeng in the construction and operation of a gas distribution business in this area. Pingxiang CF plans to build a high pressure pipeline linking the city gate station in Xiangdong District with the gas transmission substation of the branch of the Second West-East Gas Pipeline, a gate station, pressure regulators and a medium pressure pipeline network in this area.

In July 2010, the Company entered into an agreement with Pingxiang Ceramic Industry Park Management Committee to purchase 20 mu (approximately 1.33 hectare) of land. This land will be used for construction of one gas gate station to link Xiangdong District with a branch of the Second West-East Pipeline through a high pressure pipeline that is expected to be constructed by the Company. Currently, the pre-construction preparation of the site has commenced.

The Company is working to secure a long term gas source for the Xiangdong Project.

Pending Business Acquisitions or Joint Ventures

In order to seize the rapid growing market of natural gas business in China, in early 2010, the Company entered into the following business acquisitions or joint venture agreements, however, moving forward with these potential acquisitions depend upon, among other factors, acquisition of a secure, long term gas contract satisfactory to the Company that will come from gas supplied by the Second West-East Pipeline.

1. In 2010, the Company paid a good faith deposit to the existing shareholder of Hunan CNPC, Guangda Gas Co., Ltd. ("Guangda Gas"), a company that Changfeng is considering for acquisition. Guangda Gas owns a CNG primary filling station in Changsha City. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.

2. In 2010, the Company paid a good faith deposit to the existing shareholders of Jiangxi Pingxiang Huaneng Energy Co. Ltd. ("Pingxiang Huaneng"), a company that Changfeng is considering for acquisition. Pingxiang Huaneng is a natural gas distributor in the Xiangdong district, Pingxiang City, Jiangxi Province. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.

3. In 2010, the Company paid a good faith deposit and received the Certificate entitling it to own a 60% interest in Jiangxi Gaoan Huaneng Pipeline Gas Co. Ltd. ("Gaoan Huaneng"). Pursuant to the letter of intent agreement between the Company and the shareholders of Gaoan Huaneng, the Company agreed to acquire a 60% equity

interest in Gaoan Huaneng for a total purchase price of RMB 9 million (approximately $1.35 million) in cash. Gaoan Huaneng plans to set up a joint venture company with a wholly-owned subsidiary of PetroChina to develop a gas distribution business in Bajing Town of Gaoan City. The gas is to be supplied from a branch of the second West-East Pipeline.

Based on the Company's further analysis of the economic feasibility of the project, the Company decided not to proceed with this project and is not required to make any further payments under the letter of intent. In addition, the Company plans to return the certificate entitling it to a 60% interest Gaoan Huaneng and expects the return of its RMB 500,000 deposit (approximately $75,000).

Selected Quarterly Results

The following sets out the Company's consolidated quarterly results for the most recently completed quarters:
In thousands of Canadian dollars, except per share amounts:

Quarterly data ($000's)	2010				2009			
except per share amounts	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Foreign exchange rate RMB	6.57	6.51	6.64	6.56	6.46	6.22	5.85	5.49
Revenue	7,157	5,393	4,495	5,089	5,696	4,101	3,742	4,337
Gross profit	3,635	2,626	2,113	3,172	3,093	2,420	2,322	2,878
Interest	153	166	185	138	230	(197)	(215)	-265
Net income (loss)	607	298	(330)	446	606	93	(199)	623
Net income (loss) per share	0.009	0.005	($0.005)	0.007	0.009	0.002	-0.003	0.009

Liquidity and Capital Resources

Key Financial Data and Comparative Figures	December 31, 2010	December 31, 2009
($000's)		
Cash and cash equivalents	2,670	3,782
Working capital (deficit)	(5,994)	(4,174)
Plant and equipment	37,508	29,214
Total assets	45,047	36,371
Long term liabilities	21,588	15,742
Shareholders' equity	10,801	9,595

Cash and cash equivalents at December 31, 2010 were $2.7 million, a decrease of $1.1 million from $3.8 million as at December 31, 2009. Working capital deficit at December 31, 2010 increased to $6.0 million from $4.2 million at December 31, 2009.

For the year ended December 31, 2010, the Company had net income of $1.0 million and, as at December 31, 2010, had $4.7 million of deferred revenue in connection with gas connection fees. Gas connection fees are deferred when the Company receives the payments from customers, and are recognized on the percentage of completion method, measured by reference to the value of work carried out during the period. Excluding deferred revenue, the Company's working capital deficit as at December 31, 2010, was $1.3 million (December 31, 2009 – $0.6 million working capital deficit). In addition, the Company has interest payable to Sanya State Assets Management Corporation (a state owned company) of $2.0 million (RMB 13.0 million) for years ending in 2007. However, Sanya State Assets Management Corporation has not requested payment for more than three years.

The Company does not expect to face any liquidity problems given the fact that Changfeng has $4.7 million in deferred revenue, growing, positive cash flow from operations and the ability to raise additional debt capital to fund its working capital needs and new projects in mainland China.

Cash flow from operations

In 2010, the Company generated $2.7 million in cash from operations before changes in non-cash operating assets and liabilities, a decrease of $0.1 million from $2.8 million in 2009. This decrease was mainly attributable to the drop in gross margin, partially offset by the increase in sales.

Changes in non-cash working capital accounts generated $2.1 million in cash in fiscal 2010, compared to $1.4 million in 2009. Increased accounts receivable, accounts payable and increased deferred revenue generated cash in 2010 as a result of substantial increases in sales volume and increases in gas retail prices. In late 2010, Changfeng began providing gas services to hotels in Haitang Bay, Sanya City that were newly connected to the Company's pipeline, resulting in gas and connection-fee revenue. Overall, cash from operating activities increased by $0.6 million in 2010, compared to $4.1 million in 2009.

Investing activities

Capital expenditures in 2010 increased to $10.7 million, from $3.1 million in 2009. The significant increase is driven by capital expenditures on the extension of the pipeline network to Haitang Bay, including a CNG/LNG degasification processing station, an increase in the pipelines built to connect new residential and commercial clients, capital expenditures on the Company's first CNG refueling station and good faith deposits relating to potential future acquisitions.

Financing activities

Cash generated from financing activities in 2010 was $4.9 million, compared to cash used $2.1 million in 2009. The significant increase is mainly attributable to a new 10-year long term bank loan of $15 million (RMB 100 million) that was obtained in January 2010. The loan bears interest at the prescribed lending rate of the People's Bank of China (5.81% as of December 31, 2010), and is due monthly with principal repayments commencing in 2012, maturing on January 2019. The proceeds of the loan were used in part to retire existing bank loans and for capital expenditures. The Company paid to Bank of China a one-time fee of $0.5 million (RMB 3 million).

The Company continuously reviews acquisition and investment opportunities in selected cities in mainland China as a result of impending full commercial supply of natural gas by the not yet fully completed Second West-East Gas Pipeline. We expect that the funding for any such acquisitions and, depending on capital required, could be funded from cash from operations, debt and/or equity financing.

Long Term Natural Gas Supply Contracts

Changfeng secures its gas supply primarily through long term contracts with stated-own gas suppliers as described below:

Sanya City, Hainan Province
The table below sets out the long term gas purchase contracts secured for Sanya operation:

Year	Gas source supplier	Gas volume quota
2006-2015	Ya13-1 Gas Well (CNOOC)	24 million m^3 a year
2010-2015	Shennan LNG (CNPC)	LNG unlimited supply is variable within Changfeng's forecast demand
2010-2014	Xinxing CNG (CNPC)	CNG unlimited supply is variable within Changfeng's forecast demand
2015 and beyond	Yangpu LNG Receiving terminal (CNOOC)	Letter of intent for up to 150 million m^3 a year

Changsha City, Hunan Province
The table below sets out the gas purchase contract secured for our CNG refueling station business:

Year	Gas source supplier	Gas volume quota
2008-2027	CNPC (a)	14.6 million m^3 a year

(a) As of December 31, 2010, the Company had not been able to purchase any CNG pursuant to its long term CNG gas purchase contract, due to a gas shortage in this region as a result of surging demand and limited gas supply pending the arrival of the Second West-East Pipeline to the region.

Subsequent Events

1. On March 3, 2011, the Bank of China agreed to increase the Company's bank loan by $4,527,000 (RMB 30,000,000) in the form of a one year line of credit (the "Credit Line"). The Credit Line is secured by the same collateral as that for its $15,090,000 (RMB 100,000,000) long-term loan announced on January 25, 2010 (note 7(b)). As a result, Bank of China has increased the Company's total loan to $19,617,000 (RMB 130,000,000).

In March 2011, the Company's drawing on the Credit Line amounted to $3,018,000 (RMB 20,000,000), and is due in March 2012. The interest rate on the loan is the variable rate set by the People's Bank of China.

2. On March 31, 2011, the Company paid $1,090,726 (RMB 7,344,956) in cash to utilize 4,183 square metres of land in Sanya City to build a monitoring and control centre and administrative office (the "Centre"). A one-year construction permit was initially issued by the government in March 2010 for the construction of the Centre, and construction is expected to begin now that this payment has been made. On April 12, 2011, the Company subsequently paid another $74,522 (RMB 522,226) to secure the use of the land.

Commitments and Contingencies

Estimated losses from contingencies are accrued by a charge to income when information available prior to the issuance of the financial statements indicates that it is likely that a future event will confirm that an asset has been impaired or a liability incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

1. Pipeline construction and equipment:

   The Company has signed contracts with several equipment suppliers and construction supervisors for a total amount of $8,649,910 (RMB 57,322,135) (2009 - $2,163,000 (RMB 13,831,359)), of which $7,462,336 (RMB 49,452,193) has been paid as at December 31, 2010.

2. Natural gas purchase commitments:

   In 2006, the Company entered into a 10-year long term natural gas supply agreement with CNOOC (Hainan) Limited ("CNOOC") related to its distribution operations in Sanya City, Hainan Province. Pursuant to the agreement, CNOOC is committed to supply up to 24,000,000 cubic metres ("m3") of natural gas annually until 2015 with a fixed contractual price. As at December 31, 2010, $42,252 (RMB 280,000) (2009 - $42,924 (RMB 280,000)) was paid as a deposit on the contract that was recorded in long-term deposits and is expected to be refunded when the agreement expires.

   In late 2006, the Company further entered into a letter of intent with CNOOC for the supply of natural gas. Pursuant to the letter of intent, CNOOC would commit to continuously supplying natural gas to Changfeng from its new liquefied natural gas ("LNG") receiver terminal in Hainan Island, which is now under construction and is expected to be completed and commence operation in 2015.

   In connection with the acquisition of 60% equity interest in Hunan CNPC NEI in 2009, the Company is required to pay a one-time charge of $469,200 (RMB 3,000,000) for a long-term CNG purchase contract related to its operations in Changsha City, Hunan Province. This CNG purchase contract gives the Company the right to acquire up to 11,000,000 m3 of gas per year for a period of 19 years ending September 12, 2027. As of December 31, 2010, $150,900 (RMB 1,000,000) (2009 - $153,300 (RMB 1,000,000)) was paid and recorded in long-term deposits with the balance payable at time the gas is first supplied. As at December 31, 2010, the Company had not purchased any CNG pursuant to this agreement.

In 2008, the Company 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 related to its operations in Changsha City. As consideration for the rights to this contract, the Company made a cash payment of $75,450 (RMB 500,000) (2009 - $76,650 (RMB 500,000)) that was recorded in long-term deposits, and will be required to pay a further one-time payment of $75,450 (RMB 500,000) at the time the gas is first supplied. As at December 31, 2010, the Company had not purchased any CNG pursuant to this agreement.

On March 8, 2010, the Company entered into a five year agreement to purchase LNG from a third party for a period of five years related to its operations in Sanya City. Pursuant to this agreement, LNG will be supplied 24 hours a day, and the daily volume of LNG delivered will depend on the Company's forecast demand for the next day. As at December 31, 2010, $75,450 (RMB 500,000) (2009 - nil) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.

On April 7, 2010, the Company entered into a four year CNG supply agreement from a third party to purchase compressed natural gas for its operations in Sanya City, up to 3,650,000 m3 until 2014 with the annual volume of CNG to be based on Changfeng's annual demand forecast. As at December 31, 2010, $60,360 (RMB 400,000) (2009 - nil) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.

3. Lease commitment:

On September 8, 2008, the Company signed a land lease agreement for 3,000 m2 of land for the construction of a CNG refuelling retail station in Changsha City, Hunan Province. The lease term is for 20 years until October 2028. A deposit of $15,090 (RMB 100,000) and four years' rent of $283,692 (RMB 1,880,000) were required to be made in advance.

As at December 31, 2010, the Company has paid $283,692 (RMB 1,880,000) (2009-$199,290 (RMB1,300,000)). On September 28, 2010, the Company signed a land lease agreement for the construction of its second CNG refuelling station in Changsha City, Hunan Province. The lease term is for 21 years, ending September 27, 2032. A deposit of $15,200 (RMB 100,000) and the first year's rent of $51,000 (RMB 336,000) is required to be paid upon commencement of construction. If the Company decides to terminate this agreement, a termination payment of $152,000 (RMB 1,000,000) will be payable. As of December 31, 2010, no payment had been made.

The minimum lease payments in successive years are as follows:

	RMB	Cdn. $
2011	436,000	$ 65,792
2012	418,250	63,114
2013	829,500	125,172
2014	829,500	125,172
2015	829,500	125,172
Thereafter	14,310,016	2,159,381

	17,652,766	$ 2,663,803

Other obligations and commitments are incurred in the normal course of business operations.

Off-Balance Sheet Arrangements

As a policy, Changfeng does not enter into off-balance sheet arrangements with special purpose entities in the normal course of its business, nor does it have any unconsolidated affiliates.

Related Parties Transactions

1. A corporation controlled by a significant shareholder who is also an officer and director of the Company owed the Company a total of $78,501 (US $78,928) as at December 31, 2010 (2009 - $80,740 (US $76,822) for various expenditures paid by the Company on behalf of this corporation. This amount, included in accounts receivable on the consolidated balance sheets, is unsecured, non-interest bearing and with no fixed terms of repayment.

   In addition, the Company owed this individual $320,879 (2009 - $200,510) for unpaid salary which is included in accounts payable and accrued liabilities as at December 31, 2010. These amounts are unsecured, non-interest bearing and with no fixed terms of repayment.

2. In 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of $6,036,000 (RMB 40,000,000) (2009 - $6,132,000 (RMB 40,000,000)) 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 could not demand the repayment of the loans before April 27, 2010 per the original agreement. The shareholder 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. On April 27, 2010, these loans were renewed for another three years with the same terms and conditions.

3. The Company made a loan of $301,800 (RMB 2,000,000) (2009 - $304,400 (RMB 2,000,000)) to a minority shareholder of Hunan CF CNPC, which used the funds to contribute the capital it owed to that subsidiary. The loan is unsecured and non-interest bearing. The minority shareholder has waived its right to the any future profit that it would otherwise be allocated until the loan is repaid. The Company will begin

recording this shareholder's profit allocation prospectively at the time the loan has been repaid.

Share Capital

As at the date of this report, the Company has 66,025,000 common shares outstanding, 4,650,000 stock options outstanding and 4,618,263 stock options outstanding and exercisable at a weighted average exercise price of $0.60 per share. The Company has no warrants outstanding.

Seasonality of Operations

Seasonality can impact the Company's pipeline line natural gas sales. The Company's current operations are mainly located in Sanya City, a tourist city in the PRC's only tropical province that attracts more tourists in winter and spring than the rest of the year. As a large portion of the Company's natural gas sales are made to hotels, the Company's sales are affected by tourism. Sanya City is also a popular tourist destination for short stays so that during the days when the country has long public holidays gas sales are usually higher.

Seasonality can also impact the Company's CNG sales due to vehicles needing more gas during the warmer seasons for air conditioning.

Risks and Uncertainties

The Company is exposed to a variety of risks in the normal course of operations that could significantly affect its operating cash flow and profitability of operations and could cause its actual results to differ in material respects from our anticipated results. These risks may include, but are not limited to, those listed below. The Company seeks to manage the risks associated with its business operations; however, many of the factors affecting these risks are beyond the Company's control. The future effect of these risks and uncertainties cannot be quantified or predicted.

Development projects and acquisitions

Changfeng continues to focus on growing its business segments through organic development projects or acquisitions. The Company capitalizes costs incurred on certain of its projects during the development period when the project meets specific criteria and is expected to proceed through to completion. The related capital costs of a project that does not proceed through to completion are expensed at the time it is discontinued to the extent that these costs and underlying materials cannot be utilized on another project. With respect to the Company's acquisition of assets and operations, there is a risk that certain business opportunities may not materialize as expected, resulting in asset impairment.

Substantial initial capital expenditure requirement

The nature of the Company's operations require it to make a substantial initial investment in the construction of gas pipeline infrastructure and the construction of CNG filling stations. The initial investment must be financed by internal resources of the Company, bank loans and/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 due to 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 to 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 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 or 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, such that its profitability may be adversely impacted.

Obligations to purchase gas

The Company currently has a letter of intent with CNOOC for the purchase of 150 million m^3. 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 by 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 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 that 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 that 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. As 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 segments. 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, 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. Changfeng 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 favorable 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 that are required to be equipped with natural 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 other 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 of, 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, producing 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 Labor 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 favorable 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 the Chinese renminbi ("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 Polices, 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 on loans denominated in foreign currency shall be approved by SAFE in advance. Such approval requirements 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 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 that 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.

Financial Instruments

The Company does not have complex financial instruments, and the various risks related to these financial instruments, including foreign currency risk, commodity price risk, interest rate risk, concentration of credit risk and liquidity risk have been disclosed in the notes to the Consolidated Financial Statements.

Significant Accounting Policies and Critical Accounting Estimates

To prepare financial statements that conform to Canadian GAAP, Changfeng is required to make estimates and assumptions that affect both the amount and timing of recording assets, liabilities, revenues and expenses, since the determination of these items may be dependent on future events. The Company uses the most current information available and exercises reasonable judgment in making these estimates and assumptions. Changfeng regularly assesses the assets and liabilities associated with these estimates and assumptions, and believe that no material adjustments are required. The Company believes the following accounting policies and estimates require it to make assumptions about highly uncertain matters and changes in these estimates could have a material impact on the Company's financial information.

Valuation of intangible assets

The Company has intangible assets acquired in a business acquisition that were recorded at their fair values at the acquisition date. The identification and valuation of these intangible assets at the time of acquisition require the use of management judgment and estimates, which were believed to be reasonable under the circumstances. The use of alternative estimates and assumptions could increase or decrease the estimated fair value of recorded intangible assets, and potentially result in a different impact to our results of operations.

The Company's intangible assets consist of gas purchase contract rights, which are amortized over their contractual useful lives. As at December 31, 2010 and 2009, the Company had intangible assets of $402,400 and $408,800, respectively.

Revenue recognition

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 year. 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, 2010 and 2009, the Company had deferred revenue of $4,683,502 and $3,586,710, respectively, with respect to deposits received from customers in excess of the value of work carried out during the year.

Amortization expense

The Company's plant and equipment are amortized on a straight-line basis over their estimated useful lives once they are ready for their intended use. The estimation of useful lives requires management's judgment regarding the period of time the assets will be in use based on engineering studies, experience and industry practice.

Plant and equipment are recorded at cost. Land use rights are recorded at cost and amortized over the term of the agreement. The useful lives of the Company's assets are as follows:

Pipelines	30 - 35 years
Land use rights	Term of agreement
Motor vehicles	3 - 10 years
Furniture and equipment	3 - 20 years
Computer equipment	3 - 5 years
CNG refuelling station	20 years

Amortization expense in 2010 was $1.16 million (2009 — $1.10 million).

Impairment of long-lived assets

The Company reviews long-lived assets including plant and equipment and intangible assets, for impairment whenever events or changes in circumstances indicate the carrying value may not be recoverable. If the total of the estimated undiscounted future cash flows is less than the carrying value of the assets, an impairment loss is recognized for the excess of the carrying value over the fair value of the assets.

The impairment evaluation process is based on a discounted future cash flows approach, which uses management's estimates of growth opportunities, market supply and demand assumptions, revenue and costs, regulatory changes, as well as appropriate discount rates. Significant changes in these assumptions could affect the Company's impairment assessment.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, current income taxes are recognized for the estimated taxes payable for the current year. Future income taxes are determined based on the temporary differences between the accounting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. 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 2010 tax year are subject to examination by the relevant tax authorities.

Future Accounting Changes

Business combinations:

CICA Handbook Section 1582, Business Combinations, replaces Section 1581, Business Combinations, and is effective for business combinations with an acquisition date after January 1, 2011. This standard, which is aligned with International Financial Reporting Standards ("IFRS") 3, Business Combinations, requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition-related and restructuring costs are recognized separately from the business combination and are included in the statement of operations and deficit. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after January 1, 2011.

(b) Consolidations:

CICA Handbook Section 1601, Consolidated Financial Statements ("Section 1601"), which together with Section 1602, Non-Controlling Interests ("Section 1602"), replace Section 1600, Consolidated Financial Statements. Section 1601 establishes the requirements for the preparation of consolidated financial statements. Section 1602, which is aligned with IFRS 7, Consolidated and Separate Financial Statements, establishes the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The standard requires a non-controlling interest in a subsidiary to be classified as a separate component of equity. In addition, net earnings and components of other comprehensive income are attributed to both the parent and non-controlling interest. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

(c) IFRS:

In February 2009, the CICA Accounting Standards Board confirmed that Canadian GAAP will cease to apply and will be replaced by IFRS, as published by the International Accounting Standards Board. Publicly accountable enterprises will be required to adopt IFRS on or by January 1, 2011.

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 has confirmed it will adopt IFRS for its interim and annual consolidated financial statements effective January 1, 2011. The adoption date of January 1, 2011 will require the restatement for comparative purposes of all quarterly results reported by the Company for the year ended December 31, 2010, as well as an opening IFRS consolidated balance sheet as of January 1, 2010.

In our MD&A for the year ended December 31, 2009, we presented a table summarizing the key activities and milestones required to convert to IFRS by January 1, 2011. We also provided a detailed discussion of our implementation plan and progress towards convergence with IFRS in our MD&A for each interim quarterly report of 2010. We also discussed the exemptions that we have elected for initial adoption of IFRS. These documents are available at www.sedar.com.

We are nearing completion of our IFRS transition project. The majority of the work identified in our implementation plan is complete, although work will continue throughout 2011 as we begin reporting our unaudited consolidated interim financial results for the year.

We are preparing the preliminary comparative interim financial results for the first three quarters of 2010 in accordance with IFRS. The Audit Committee and our external auditors will review the comparative interim results and reconciliations to GAAP, together with the policy choices and elections that we will consider as part of our convergence project. This process is expected to expedite the preparation of our quarterly financial statements under IFRS in 2011.

The preparation of comparative interim financial statements under IFRS has helped management to identify those areas that potentially will be most significantly affected by our transition to IFRS. This preliminary assessment is based on currently enacted standards, available information and expectations as of the date of this MD&A; however, the below should not be regarded as a complete list of changes that will result from our transition to IFRS. Rather, it is intended to highlight the areas management believes to be the most significant in respect of our consolidated financial statements. As we finalize the transition project, we will confirm additional changes.

Plant and equipment
Under IFRS, the Company will be required to apply componentization concepts to its plant and equipment, and will be required to perform an annual review of the estimates of useful lives, residual values and depreciation methods, in addition to the annual review for impairment. As a result of this difference, the Company determined that certain assets should have separately capitalized components under IFRS. The Company is currently in the process of quantifying the impact of this difference.

Stock based compensation
Under Canadian GAAP, stock based compensation is measured using the fair market value method under which the cost is recognized on a straight-line basis over the vesting period of the underlying security. The Company has not estimated a forfeiture rate for stock options that may not vest; rather the Company accounts for actual forfeitures as they occur. Under IFRS, stock based compensation will be measured using the fair market value method under which the cost will be recognized on a graded vesting basis over the vesting period of the underlying security. In addition, the Company must estimate a forfeiture rate for stock options that may not vest. The Company is currently in the process of quantifying the impact of this difference.

Presentation and disclosure
The presentation, including disclosures, of the Company's consolidated financial statements will change as a result of implementing the IFRS presentation and disclosure requirements. These changes could result in significant differences in the presentation of the Company's consolidated balance sheet and consolidated statements of operations, shareholders' equity and cash flows. In addition, it is expected that the Company will disclose additional information in the notes to the consolidated financial statements in order to comply with the requirements of IFRS.

Income taxes

The above changes are expected to impact the amounts recorded for income tax under IFRS; however, management is in the process of finalizing its quantification of the transition adjustments, such that it is not certain whether there will be a material adjustment to income taxes.

We have also considered the impact of the transition on our financial expertise. In 2010, we hired an accounting firm that brings extensive experience in IFRS in other jurisdictions. We expect the implementation phase of our conversion project to continue through 2011; however, although all significant assessments and quantifications will be completed prior to the issuance of our consolidated interim financial results for the first quarter of 2011. Management expects to meet all milestones in its project plan as the Company completes its conversion effort.

Outlook

The Company continues to add both residential and commercial customers to its existing pipeline network in the Greater Sanya region, including the Haitang Bay district, which commenced supplying gas in December 2010.

In addition to organic growth in the Sanya region, Changfeng is continuing its efforts to expand its natural gas distribution business in mainland China. The Company's strategic growth priorities focus on selected cities in Jiangxi and Hunan province, mainland China, which represent large, rapidly growing emerging markets as a result of impending full commercial supply of large volumes of new natural gas via the second

Consolidated Financial Statements
(Expressed in Canadian dollars)

CHANGFENG ENERGY INC.

Years ended December 31, 2010 and 2009

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INDEPENDENT AUDITORS' REPORT

To the Shareholders of Changfeng Energy Inc.

We have audited the accompanying consolidated financial statements of Changfeng Energy Inc., which comprise the consolidated balance sheet as at December 31, 2010, the consolidated statements of operations and deficit, comprehensive income and cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with Canadian generally accepted accounting principles, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Changfeng Energy Inc. as at December 31, 2010, and its consolidated results of operations and its consolidated cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

Other Matter

The consolidated financial statements of Changfeng Energy Inc. as at and for the year ended December 31, 2009 were audited by another auditor who expressed an unmodified opinion on those statements on March 21, 2010.

"KPMG LLP"

Chartered Accountants, Licensed Public Accountants

April 29, 2011
Toronto, Canada

CHANGFENG ENERGY INC.

Consolidated Balance Sheets
(Expressed in Canadian dollars)

December 31, 2010 and 2009

	2010	2009
Assets		
Current assets:		
Cash and cash equivalents	$ 2,670,113	$ 3,782,250
Accounts receivable	2,034,762	1,129,924
Prepaid expenses and deposits (note 4)	334,887	299,660
Inventories (note 3)	572,566	581,570
Due from related parties (note 10)	380,301	385,140
	5,992,629	6,178,544
Long-term deposits (note 6)	1,144,007	399,642
Plant and equipment (note 5)	37,508,110	29,213,765
Intangible asset	402,400	408,800
Future income taxes (note 9)	–	169,840
	$ 45,047,146	$ 36,370,591
Liabilities and Shareholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 4,262,759	$ 2,637,320
Deferred revenue	4,683,502	3,586,710
Interest payable (note 7)	1,965,051	1,996,304
Current portion of long-term debt (note 7)	754,500	1,931,580
Due to related parties (note 10)	320,879	200,510
	11,986,691	10,352,424
Long-term debt (note 7)	15,451,037	9,535,260
Due to related parties (note 10)	6,036,000	6,132,000
Future income taxes (note 9)	100,600	74,600
Non-controlling interest	671,444	681,197
Shareholders' equity:		
Share capital (note 8(a) and (b))	12,121,808	12,121,808
Contributed surplus (note 8(d))	1,762,168	1,190,509
Warrants (note 8(c))	–	321,724
Accumulated other comprehensive loss (note 18)	(842,553)	(778,791)
Deficit	(2,240,049)	(3,260,140)
	10,801,374	9,595,110
Commitments and contingencies (note 12)		
Economic dependence (note 15)		
Subsequent events (note 19)		
	$ 45,047,146	$ 36,370,591

See accompanying notes to consolidated financial statements.

On behalf of the Board:

"Wencheng Zhang" Director "Peter Cheung" Director

CHANGFENG ENERGY INC.

Consolidated Statements of Operations and Deficit
(Expressed in Canadian dollars)

Years ended December 31, 2010 and 2009

	2010	2009
Revenue	$ 22,135,218	$ 17,876,478
Cost of sales	10,589,346	7,394,683
Gross margin	11,545,872	10,481,795
Expenses:		
General and administrative	4,356,492	4,071,148
Interest on long-term debt (note 7)	641,838	446,503
Travel and business development	3,171,278	2,646,693
Amortization	1,163,229	1,096,689
Stock-based compensation (note 8(d))	249,935	119,278
	9,582,772	8,380,311
Income before the undernoted	1,963,100	2,101,484
Interest income	4,937	11,482
Income before income taxes	1,968,037	2,112,966
Income taxes (note 9)	957,700	990,252
Non-controlling interest	(9,754)	–
Net income	1,020,091	1,122,714
Deficit, beginning of year	(3,260,140)	(4,382,854)
Deficit, end of year	$ (2,240,049)	$ (3,260,140)
Net income per share:		
Basic and diluted	$ 0.016	$ 0.017
Weighted average number of shares outstanding:		
Basic and diluted	66,025,000	66,025,000

Consolidated Statements of Comprehensive Income
(Expressed in Canadian dollars)

Years ended December 31, 2010 and 2009

	2010	2009
Net income	$ 1,020,091	$ 1,122,714
Other comprehensive loss (note 18):		
Currency translation adjustment	(63,762)	(1,506,011)
Comprehensive income (loss)	$ 956,329	$ (383,297)

See accompanying notes to consolidated financial statements.

CHANGFENG ENERGY INC.

Consolidated Statements of Cash Flows
(Expressed in Canadian dollars)

Years ended December 31, 2010 and 2009

	2010	2009
Cash provided by (used in):		
Operating activities:		
Net income	$ 1,020,091	$ 1,122,714
Items not involving cash:		
Future income taxes	195,840	436,052
Amortization	1,163,229	1,096,689
Stock-based compensation	249,935	119,278
Long-term debt accretion	31,069	–
Non-controlling interest	(9,754)	–
Change in non-cash operating working capital (note 11)	2,104,429	1,357,201
Cash flows from operating activities	4,754,839	4,131,934
Financing activities:		
Long-term debt	4,452,040	(2,106,720)
Increase in financing costs	452,700	–
	4,904,740	(2,106,720)
Investing activities:		
Purchase of interest in subsidiary (note 6)	–	(766,500)
Plant and equipment	(9,963,290)	(2,382,350)
Long-term deposits	(756,446)	–
Cash flows used in investing activities	(10,719,736)	(3,148,850)
Decrease in cash and cash equivalents	(1,060,157)	(1,123,636)
Effects of foreign exchange on cash balances	(51,980)	(571,322)
Cash and cash equivalents, beginning of year	3,782,250	5,477,208
Cash and cash equivalents, end of year	$ 2,670,113	$ 3,782,250
Supplemental cash flow information:		
Interest paid	$ 1,456,904	$ 424,278
Income taxes paid	566,717	123,750

See accompanying notes to consolidated financial statements.

Nature of operations

Changfeng Energy Inc. (the "Company" or "Changfeng") was incorporated under the Canada Business Corporation Act on May 4, 2006. A reorganization was completed on January 29, 2008. The Company's core business is the distribution of natural gas for industrial, commercial and residential users in the People's Republic of China ("China" or "PRC").

The Company distributes natural gas in Hainan Province, China, 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. In 2010, the Company opened its first compressed natural gas ("CNG") refuelling station in Hunan Province, through its newly-incorporated, majority-owned subsidiary in mainland China. The Company further owns an 80% interest in a subsidiary that will primarily engage in the construction and distribution of urban pipeline natural gas in Jiangxi Province, China. The Company is currently organized for management reporting purposes into three principal business segments: gas connection, pipeline gas sales and CNG refuelling sales.

The utility operation in China is subject to certain government approvals for sale prices of natural gas. The ability to operate gas pipeline infrastructure and distribute piped gas in China are established by concession rights obtained from the municipal and provincial governments.

1. Significant accounting policies:

The accounting policies of the Company are in accordance with Canadian generally accepted accounting principles ("GAAP") and their basis of application is consistent with the prior year, except where disclosed below. All amounts in these consolidated financial statements are stated in Canadian dollars unless indicated with "RMB" to represent the Chinese Renminbi or "US" to represent the United States dollar. Outlined below are those policies considered significant:

(a) Basis of consolidation:

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries HEL, CF China, its 99.4% interest in Sanya Changfeng Offshore Natural Gas Engineering Construction Co. Ltd. ("CF Engineering"), its 99.99% 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, its 60% interest in Hunan CNPC NEI and its 80% interest in Pingxiang Changfeng Natural Gas Co. Ltd. ("Pingxiang CF"). All material intercompany balances and transactions have been eliminated.

1. **Significant accounting policies (continued):**

(b) 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.

(c) 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. Cost includes the purchase price, transportation costs and other costs to bring the inventories to their present locations and conditions. Reversal of previous write-downs is required when there is a subsequent increase in the value of inventories.

(d) 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 classified as construction in progress are not amortized until they are ready for their intended uses, at which point they are transferred to plant and equipment. Plant and equipment are recorded at cost. Amortization of plant and equipment is recorded on a straight-line basis over their estimated useful lives:

Pipelines	30 - 35 years
Land use rights	Term of agreement
Motor vehicles	3 - 10 years
Furniture and equipment	3 - 20 years
Computer equipment	3 - 5 years
CNG station	20 years

(e) Intangible assets:

Intangible assets are recorded at their fair values at the acquisition date. Intangible assets are amortized over the useful life of the assets on a straight-line basis. The Company's intangible assets consist of gas purchase contract rights, which are recorded at cost and are amortized over their contractual useful lives.

1. Significant accounting policies (continued):

(f) Impairment of long-lived assets:

The Company reviews and evaluates its tangible long-lived assets for impairment when events or changes in circumstances indicate that the related carrying amounts may not be recoverable. 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.

Intangible assets are tested for impairment when events or changes in circumstances indicate that their carrying values may not be recoverable. Any impairment loss will be charged against current period income.

(g) 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 consolidated balance sheets at fair value with subsequent measurement determined by the classification of each financial asset and liability.

Financial assets and financial liabilities classified as held-for-trading are measured at fair value with the changes in fair value reported in net income. Financial assets classified as 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.

1. **Significant accounting policies (continued):**

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. The Company does not engage in derivative trading or speculative activities.

(h) Revenue recognition:

Revenue is derived from the delivery of natural gas and from the installation and connection of natural gas pipelines for end users.

The Company recognizes revenue when gas has been delivered and is recorded on the basis of regular meter readings and estimates of usage since the last meter reading to the end of the reporting period. Revenue of gas is 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 year.

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, 2010 and 2009, the Company had deferred revenue of $4,683,502 and $3,586,710, respectively, with respect to deposits received from customers in excess of the value of work carried out during the year.

Interest income is recorded on an accrual basis.

1. **Significant accounting policies (continued):**

(i) Income taxes:

The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, current income taxes are recognized for the estimated taxes payable for the current year. Future income taxes are determined based on the temporary differences between the accounting and tax bases of assets and liabilities, as well as for the benefit of losses available to be carried forward to future years for tax purposes that are more likely than not to be realized. 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.

(j) Foreign currency translation:

The Canadian dollar is the functional currency of the parent company's operations, and the Chinese Renminbi is the functional currency of the Company's subsidiaries. The Canadian dollar is the reporting currency of the Company. Since the RMB is not a fully convertible currency, all foreign exchange transactions 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 consolidated balance sheet dates.

Non-monetary assets and liabilities are translated at historical exchange rates, unless such items are carried at market value, in which case they are translated at the exchange rates in effect on the consolidated balance sheet dates.

Gains and losses arising from the translation of foreign currency monetary assets and liabilities at each year end are included in income.

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 consolidated balance sheet dates. Operating revenue and expenses are translated at the average exchange rates during the year. Foreign exchange gains and losses arising from translation of the balances are disclosed separately as other 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.

1. Significant accounting policies (continued):

(k) Stock-based compensation:

The Company records stock-based compensation based on the fair value method. 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 8(d). The Company recognizes the forfeiture of options as it occurs.

(l) Income per share:

Basic income per share is calculated using the weighted average number of shares outstanding during the year. 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 income per share or decrease loss per share. During December 31, 2010 and 2009, the options and warrants described in note 8(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, 2010 and 2009.

(m) Measurement uncertainty:

The preparation of financial statements 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 year. 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 described in note 7, and income tax accounts. Actual results could differ materially from those estimates. Management believes that the estimates are reasonable.

1. **Significant accounting policies (continued):**

(n) Comprehensive income (loss):

Comprehensive income (loss) includes net income and other comprehensive income (loss). Other comprehensive income (loss) 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 income until the year that the related asset or liability affects income.

(o) 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.

(p) Fair value hierarchy and liquidity risk disclosure:

Effective January 1, 2009, the Company adopted the amendment to The Canadian Institute of Chartered Accountants' ("CICA") Handbook Section 3862, Financial Instruments Disclosures. 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 has the following levels:

- Level 1 - quoted prices (unadjusted) in active markets for identical assets or liabilities;

- Level 2 - 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); and

- Level 3 - inputs for the asset or liability that are not based on observable market data (unobservable inputs).

(q) Certain 2009 comparative figures have been reclassified to conform to the presentation of the consolidated financial statements adopted for 2010. The changes do not affect prior period's income.

2. Future accounting changes:

(a) Business combinations:

CICA Handbook Section 1582, Business Combinations, replaces Section 1581, Business Combinations, and is effective for business combinations with an acquisition date after January 1, 2011. This standard, which is aligned with International Financial Reporting Standards ("IFRS") 3, Business Combinations, requires assets and liabilities acquired in a business combination, contingent consideration and certain acquired contingencies to be measured at their fair values as of the date of acquisition. In addition, acquisition-related and restructuring costs are recognized separately from the business combination and are included in the statement of operations and deficit. The section applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after January 1, 2011.

(b) Consolidations:

CICA Handbook Section 1601, Consolidated Financial Statements ("Section 1601"), which together with Section 1602, Non-Controlling Interests ("Section 1602"), replace Section 1600, Consolidated Financial Statements. Section 1601 establishes the requirements for the preparation of consolidated financial statements. Section 1602, which is aligned with IFRS 7, Consolidated and Separate Financial Statements, establishes the accounting for a non-controlling interest in a subsidiary in consolidated financial statements subsequent to a business combination. The standard requires a non-controlling interest in a subsidiary to be classified as a separate component of equity. In addition, net earnings and components of other comprehensive income are attributed to both the parent and non-controlling interest. These standards apply to interim and annual consolidated financial statements relating to fiscal years beginning on or after January 1, 2011.

(c) IFRS:

In February 2009, the CICA Accounting Standards Board confirmed that Canadian GAAP will cease to apply and will be replaced by IFRS, as published by the International Accounting Standards Board. Publicly accountable enterprises will be required to adopt IFRS on or by January 1, 2011.

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 will adopt IFRS for its interim and annual consolidated financial statements effective January 1, 2011.

The adoption date of January 1, 2011 will require the restatement for comparative purposes of all quarterly results reported by the Company for the year ended December 31, 2010, as well as an opening IFRS consolidated balance sheet as of January 1, 2010.

3. Inventories:

	2010	2009
Construction materials	$ 392,970	$ 410,682
Gas appliances, meters and spare parts	179,596	170,888
	$ 572,566	$ 581,570

The amount of inventory recognized as an expense during the years ended December 31, 2010 and 2009 was $2,946,702 and $2,799,130, respectively.

4. Prepaid expenses and deposits:

Included in prepaid expenses and deposits was a deposit of $75,000 (RMB 500,000). This deposit was made in early 2010 pursuant to a signed letter of intent (the "LOI") to acquire a 60% interest in Jiangxi Gaoan Huaneng Pipeline Gas Co. Ltd. ("Gaoan Huaneng") for a total purchase price of $1,350,000 (RMB 9,000,000) in cash.

Based on the Company's further analysis of the economic feasibility of the project, the Company has decided to abandon this project and is not required to make any further payments under the LOI. In addition, the Company plans to return the certificate entitling it to a 60% interest Gaoan Huaneng and expects the return of its deposit of $75,000 (RMB 500,000).

5. Plant and equipment:

2010	Cost	Accumulated amortization	Net book value
Pipelines	$ 38,873,116	$ 6,343,841	$ 32,529,275
Land use rights (b)	1,118,471	286,608	831,863
Motor vehicles	1,236,936	356,639	880,297
Furniture and equipment	368,626	84,536	284,090
Computer equipment	165,210	95,550	69,660
CNG station	737,990	11,878	726,112
	42,500,349	7,179,052	35,321,297
Construction in progress (c)	2,186,813	–	2,186,813
	$ 44,687,162	$ 7,179,052	$ 37,508,110

5. **Plant and equipment (continued):**

2009	Cost	Accumulated amortization	Net book value
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
	31,273,003	6,232,358	25,040,645
Construction in progress	4,173,120	–	4,173,120
	$ 35,446,123	$ 6,232,358	$ 29,213,765

(a) Included in plant and equipment as at December 31, 2010 and 2009 is cumulative capitalized interest of $512,430 (RMB 3,366,823) and $87,800 (RMB 572,715), respectively.

(b) As at December 31, 2010, the Company held five land use rights certificates. They all have a 50 year term and expire in 2051.

(c) In July 2010, Pingxiang CF, an 80%-owned subsidiary of the Company, entered into an agreement with Pingxiang Ceramic Industry Park Management Committee to purchase the land use rights for 20 mu (approximately 1.33 hectare) of land. This land is expected to be used for construction of one gas gate station to link Xiangdong District with a high pressure pipeline that is expected to be constructed by Pingxiang CF in 2011.

Pursuant to the agreement, the total purchase price is $290,000 (RMB 1,920,000), of which $200,000 (RMB 1,320,000) is expected to be refunded by the local government when the construction of the gas gate station is completed. A deposit of $30,000 (RMB 200,000) was paid upon signing the agreement, which was included in construction in progress in the consolidated financial statements, with the remaining balance to be paid when the ownership of land use right is transferred to Pingxiang CF.

6. Acquisitions and long-term deposits:

Good faith deposits in connection with potential acquisitions and other long-term prepaid expenses and deposits are summarized below:

	2010	2009
Deposits towards the purchase of natural gas (note 12(c))	$ 178,062	$ 42,924
Advance on natural gas quote fee (note 12(c))	226,350	229,950
Good faith deposits towards pending business acquisitions (a)	605,833	–
Advance on long-term lease of land (note 12(d))	133,762	126,768
	$ 1,144,007	$ 399,642

(a) Included in long-term deposits were $605,833 (RMB 4,014,796) in advance payments for potential acquisitions as described below:

(i) In 2010, the Company paid a good faith deposit to the existing shareholder of Hunan CNPC, Guangda Gas Co., Ltd. ("Guangda Gas"), a company that Changfeng is considering for acquisition. Guangda Gas owns a CNG primary filling station in Changsha City. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.

(ii) In 2010, the Company paid a good faith deposit to the existing shareholders of Jiangxi Pingxiang Huaneng Energy Co. Ltd. ("Pingxiang Huaneng"), a company that Changfeng is considering for acquisition. Pingxiang Huaneng is a natural gas distributor in the Xiangdong district, Pingxiang City, Jiangxi Province. The deposit is refundable if the Company is not satisfied with its due diligence procedures or a reasonable purchase price cannot be negotiated.

In 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. This contract, valued at $408,800 (RMB 2,000,000), which includes a future tax liability of $102,200, 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
Intangible asset-CNG purchase contract	408,800
Future tax liability	(102,200)
Cash consideration paid	$ 766,500

7. Long-term debt:

	2010	2009
Term loan facility - China Development Bank (a)	$ 1,509,000	$ 3,464,580
Term loan facility - Bank of China (b)	14,696,537	–
Term loan facility - Sanya State Assets Management Corporation (c)	–	6,469,260
Term loan facility - Bank of China (d)	–	1,533,000
	16,205,537	11,466,840
Less current portion	754,500	1,931,580
	$ 15,451,037	$ 9,535,260

(a) This term loan from the China Development Bank of $1,509,000 (RMB 10,000,000) (2009 - $3,464,580 (RMB 22,600,000) was advanced from the China Development Bank to Sanya State Assets Management Corporation (an intermediary company controlled by the municipality of Sanya City, see (c)), and loaned to the Company, bearing interest at the floating prescribed rate of the People's Bank of China (5.81% and 5.76% as at December 31, 2010 and 2009), with payments due quarterly. The loan matures on November 2012, secured by all pipelines, land use rights and gas distribution rights of the Company.

(b) This term loan from the Bank of China of $15,090,000 (RMB 100,000,000) (2009 - nil), bears interest at the prescribed lending rate of the People's Bank of China (5.81% as of December 31, 2010) and is due monthly, with principal repayments commencing in 2012. The loan matures in 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 were used, in part, to retire existing loans described in (c) and (d) below. The Company paid to Bank of China a fee of $452,700 (RMB 3,000,000), of which a portion is being accreted to operations, and the balance accreted to plant and equipment over the term of the loan. As of December 31, 2010, $59,237 (RMB 392,560) (2009 - nil) has been cumulatively accreted.

(c) This term loan from the Sanya State Assets Management Corporation of nil (2009 - $6,469,260 (RMB 42,200,000)) was unsecured, with no fixed terms of repayment. Interest was calculated at the floating prescribed rate of the People's Bank of China (5.76% as at December 31, 2009). The loan was repaid in January 2010 using the proceeds from Bank of China loan described in (b) above.

(d) This term loan from Bank of China of nil (2009 - $1,533,000 (RMB 10,000,000)), bore 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). The loan was repaid in January 2010 using the proceeds from Bank of China loan described in (b) above.

7. Long-term debt (continued):

Long-term loan principal payments are as follows:

	RMB	Cdn. $
2011	5,000,000	$ 754,500
2012	10,000,000	1,509,000
2013	5,000,000	754,500
2014	10,000,000	1,509,000
2015	10,000,000	1,509,000
Thereafter	70,000,000	10,563,000
	110,000,000	16,599,000
Long-term debt discount, net of accretion	(2,607,440)	(393,463)
	107,392,560	$ 16,205,537

As at December 31, 2010, the Company had accrued interest of $1,965,051 (RMB 13,022,204) (2009 - $1,996,304 (RMB 13,022,204)) in connection with the bank loan as described in (a) and (c) above.

8. Share capital:

(a) Authorized:

Unlimited number of common shares.

(b) Issued common shares:

	Number of shares	Amount
Balance, December 31, 2010 and 2009	66,025,000	$ 12,121,808

8. Share capital (continued):

(c) Warrants:

As at December 31, 2010, there were no warrants outstanding. As at December 31, 2009, there were 1,000,000 warrants outstanding, each of which entitled the holder to acquire one common share. All of these warrants expired on January 29, 2010.

	Number of warrants	Weighted average exercise price	Expiry date
Balance, December 31, 2008 and 2009	1,000,000	$ 0.60	January 29, 2010
Balance, December 31, 2010	–	–	–

(d) Contributed surplus and stock-based compensation:

(i) Contributed surplus:

Balance, December 31, 2008	$ 1,071,231
Stock-based compensation	119,278
Balance December 31, 2009	1,190,509
Warrants expired	321,724
Stock-based compensation	249,935
Balance, December 31, 2010	$ 1,762,168

(ii) Stock-based compensation:

Under the Company's stock option plan (the "Plan"), the Company may grant stock options to directors, senior officers, employees and advisors, and is authorized to issue up to 10% of the issued and outstanding shares of the Company. The Board of Directors, or such other persons designated by the Board, administers the Plan and determines the vesting and terms of each award.

8. Share capital (continued):

A summary of the Company's options granted and exercised is presented below:

	Options outstanding	Weighted average exercise price
Balance, December 31, 2008	3,800,000	$ 0.60
Granted	400,000	0.55
Expired	(750,000)	0.60
Balance, December 31, 2009	3,450,000	0.60
Granted	1,200,000	0.60
Balance, December 31, 2010	4,650,000	0.60

The following table summarizes information about the options outstanding and exercisable at December 31, 2010:

Number outstanding	Number outstanding and exercisable	Remaining contractual life (in years)	Exercise price	Expiry date
3,000,000	3,000,000	2.06	$ 0.60	2013
50,000	50,000	2.65	0.60	2013
400,000	400,000	3.49	0.55	2014
1,200,000	1,168,263	4.41	0.60	2015
4,650,000	4,618,263	2.79		

On May 28, 2010, the Company granted options to directors, senior officers, employees and advisors of the Company to acquire 1,200,000 common shares of the Company at an exercise price of $0.60 per share on or before May 27, 2015, of which 800,000 vested immediately, and the remaining balance will vest within a year.

Assumptions used to determine the value of the options using the Black-Scholes Option Pricing Model were: dividend yield 0%; risk-free interest rate 2.64%; expected volatility 69%; and expected life of five years.

For the year ended December 31, 2010, $249,935 (2009 - $119,278) of stock-based compensation expense was recorded due to the vesting of granted options.

9. Income taxes:

Provision for income taxes:

Major items causing the Company's income tax rate to differ from the federal statutory rate of 31% (2009 - 33%) were as follows:

	2010	2009
Income before income taxes	$ 1,968,037	$ 2,112,966
Expected income tax provision based on statutory rate	$ 610,100	$ 697,300
Non-deductible expenditures and other permanent differences	279,300	150,000
Foreign tax rate differential	(251,400)	(190,531)
Change in valuation allowance	333,100	324,800
Other	(13,400)	8,683
Income taxes	$ 957,700	$ 990,252
Current income taxes	$ 761,900	$ 884,527
Future income taxes	195,800	105,725
	$ 957,700	$ 990,252

Future income taxes (liabilities):

	2010	2009
Non-capital losses	$ 1,055,500	$ 649,500
Accounts receivable	(48,900)	–
Plant and equipment	(60,600)	102,600
Intangible asset	(100,600)	(102,200)
Accounts payable and accrued liabilities	122,100	–
Share issue and transaction costs	128,000	205,200
Capital losses	29,700	27,300
Other	20,300	98,800
Valuation allowance	(1,246,100)	(886,000)
	(100,600)	95,200
Less amount classified as future income tax liability	(100,600)	74,600
Future income tax asset	$ –	$ 169,800

9. Income taxes (continued):

As at December 31, 2010, the Company has approximately $3,304,000 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:

2013	$ 10,000
2014	10,000
2025	24,000
2026	383,000
2027	28,000
2028	793,000
2029	971,000
2030	1,085,000
	$ 3,304,000

10. Related party transactions:

(a) A corporation controlled by a significant shareholder who is also an officer and director of the Company owed the Company a total of $78,501 (US $78,928) as at December 31, 2010 (2009 - $80,740 (US $76,822) for various expenditures paid by the Company on behalf of this corporation. This amount, included in accounts receivable on the consolidated balance sheets, is unsecured, non-interest bearing and with no fixed terms of repayment.

In addition, the Company owed this individual $320,879 (2009 - $200,510) for unpaid salary which is included in accounts payable and accrued liabilities as at December 31, 2010. These amounts are unsecured, non-interest bearing and with no fixed terms of repayment.

(b) In 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of $6,036,000 (RMB 40,000,000) (2009 - $6,132,000 (RMB 40,000,000)) 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.

10. Related party transactions (continued):

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 could not demand the repayment of the loans before April 27, 2010 per the original agreement. The shareholder 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. On April 27, 2010, these loans were renewed for another three years with the same terms and conditions.

(c) The Company made a loan of $301,800 (RMB 2,000,000) (2009 - $304,400 (RMB 2,000,000)) to a minority shareholder of Hunan CF CNPC, which used the funds to contribute the capital it owed to that subsidiary. The loan is unsecured and non-interest bearing. The minority shareholder has waived its right to the any future profit that it would otherwise be allocated until the loan is repaid. The Company will begin recording this shareholder's profit allocation prospectively at the time the loan has been repaid.

11. Change in non-cash operating working capital:

	2010	2009
Accounts receivable and due from related parties	$ (679,077)	$ (57,640)
Prepaid expenses and deposits	(39,910)	(646,904)
Inventories	(101)	147,196
Accounts payable and accrued liabilities and due to related parties	1,660,640	942,375
Deferred revenue	1,162,877	972,174
	$ 2,104,429	$ 1,357,201

12. Commitments and contingencies:

(a) General:

Estimated losses from contingencies are accrued by a charge to income when information available prior to the issuance of the financial statements indicates that it is likely that a future event will confirm that an asset has been impaired or a liability incurred at the date of the financial statements and the amount of the loss can be reasonably estimated.

12. Commitments and contingencies (continued):

(b) Pipeline construction and equipment:

The Company has signed contracts with several equipment suppliers and construction supervisors for a total amount of $8,649,910 (RMB 57,322,135) (2009 - $2,163,000 (RMB 13,831,359)), of which $7,462,336 (RMB 49,452,193) has been paid as at December 31, 2010.

(c) Natural gas purchase commitments:

In 2006, the Company entered into a 10-year long term natural gas supply agreement with CNOOC (Hainan) Limited ("CNOOC") related to its distribution operations in Sanya City, Hainan Province. Pursuant to the agreement, CNOOC is committed to supply up to 24,000,000 cubic metres ("m^3") of natural gas annually until 2015 with a fixed contractual price. As at December 31, 2010, $42,252 (RMB 280,000) (2009 - $42,924 (RMB 280,000)) was paid as a deposit on the contract that was recorded in long-term deposits and is expected to be refunded when the agreement expires.

In late 2006, the Company further entered into a letter of intent with CNOOC for the supply of natural gas. Pursuant to the letter of intent, CNOOC would commit to continuously supplying natural gas to Changfeng from its new liquefied natural gas ("LNG") receiver terminal in Hainan Island, which is now under construction and is expected to be completed and commence operation in 2015.

In connection with the acquisition of 60% equity interest in Hunan CNPC NEI in 2009, the Company is required to pay a one-time charge of $469,200 (RMB 3,000,000) for a long-term CNG purchase contract related to its operations in Changsha City, Hunan Province. This CNG purchase contract gives the Company the right to acquire up to 11,000,000 m^3 of gas per year for a period of 19 years ending September 12, 2027. As of December 31, 2010, $150,900 (RMB 1,000,000) (2009 - $153,300 (RMB 1,000,000)) was paid and recorded in long-term deposits with the balance payable at time the gas is first supplied. As at December 31, 2010, the Company had not purchased any CNG pursuant to this agreement.

In 2008, the Company 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 related to its operations in Changsha City. As consideration for the rights to this contract, the Company made a cash payment of $75,450 (RMB 500,000) (2009 - $76,650 (RMB 500,000)) that was recorded in long-term deposits, and will be required to pay a further one-time payment of $75,450 (RMB 500,000) at the time the gas is first supplied. As at December 31, 2010, the Company had not purchased any CNG pursuant to this agreement.

12. Commitments and contingencies (continued):

On March 8, 2010, the Company entered into a five year agreement to purchase LNG from a third party for a period of five years related to its operations in Sanya City. Pursuant to this agreement, LNG will be supplied 24 hours a day, and the daily volume of LNG delivered will depend on the Company's forecast demand for the next day. As at December 31, 2010, $75,450 (RMB 500,000) (2009 - nil) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.

On April 7, 2010, the Company entered into a four year CNG supply agreement from a third party to purchase compressed natural gas for its operations in Sanya City, up to 3,650,000 m^3 until 2014 with the annual volume of CNG to be based on Changfeng's annual demand forecast. As at December 31, 2010, $60,360 (RMB 400,000) (2009 - nil) was paid as a deposit on the contract and was recorded in long-term deposits, and is expected to be refunded when the agreement expires.

(d) Lease commitment:

On September 8, 2008, the Company signed a land lease agreement for 3,000 m^2 of land for the construction of a CNG refuelling retail station in Changsha City, Hunan Province. The lease term is for 20 years until October 2028. A deposit of $15,090 (RMB 100,000) and four years' rent of $283,692 (RMB 1,880,000) were required to be made in advance. As at December 31, 2010, the Company has paid $283,692 (RMB 1,880,000) (2009 - $199,290 (RMB 1,300,000)).

On September 28, 2010, the Company signed a land lease agreement for the construction of its second CNG refuelling station in Changsha City, Hunan Province. The lease term is for 21 years, ending September 27, 2032. A deposit of $15,200 (RMB 100,000) and the first year's rent of $51,000 (RMB 336,000) is required to be paid upon commencement of construction. If the Company decides to terminate this agreement, a termination payment of $152,000 (RMB 1,000,000) will be payable. As of December 31, 2010, no payment had been made.

The minimum lease payments in successive years are as follows:

	RMB	Cdn. $
2011	436,000	$ 65,792
2012	418,250	63,114
2013	829,500	125,172
2014	829,500	125,172
2015	829,500	125,172
Thereafter	14,310,016	2,159,381
	17,652,766	$ 2,663,803

12. Commitments and contingencies (continued):

(e) 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, 2010, CF China had not designated RMB to the above statutory reserve funds.

13. Capital management:

The Company considers its capital structure to consist of share capital, contributed surplus 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 is responsible for overseeing the process undertaken by the Company's management to sustain future development of the business.

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

There were no changes in the Company's approach to capital management during the years ended December 31, 2010 and 2009.

14. Financial instruments and risk management:

(a) Fair value:

Canadian GAAP requires 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 instruments. 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 Company has designated its cash and cash equivalents as held for trading, which are measured at fair value. Accounts receivable and due from related parties are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities, due to related parties, interest payable and long-term debt are classified as other financial liabilities, which are measured at amortized cost.

As at December 31, 2010, the carrying amounts for cash and cash equivalents, accounts receivable, accounts payable and accrued liabilities and interest payable on the balance sheet approximate fair value because of the limited term of these instruments.

The fair value of long-term debt described in note 7 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. It is not practicable to estimate the fair value of the amounts due to related parties. 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.

(b) Financial risk factors:

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

(i) Foreign exchange risk:

Foreign exchange risk is the risk that changes in foreign exchange rates will affect the Company's income or value of its holdings of financial instruments. Substantially all of the assets, liabilities and operations of the Company are denominated in 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.

14. Financial instruments and risk management (continued):

The Company and its subsidiaries do not use derivative instruments to reduce their exposure to foreign currency risk.

As at December 31, 2010, the Company held foreign currency cash and cash equivalents of RMB 17,524,478 (2009 - RMB 21,111,585) and US $23,768 (2009 - US $33,310).

As at December 31, 2010, with other variables unchanged, a +/-1% change in the US dollar to Canadian dollar exchange rate would increase/decrease net income for the year by $283 (US $285), and a +/-1% change in the exchange rate of RMB would increase/decrease the net income by $30,158 (RMB 198,150).

(ii) Regulatory risks and uncertainties:

The price of natural gas charged by CF China for the supply of natural gas to its customers is approved 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 significantly influenced by the local government, the price fluctuation risk and commodity price risk is considered minimal.

(iii) Interest rate risk:

Interest rate risk is the risk that changes in interest rates will affect the Company's income or value of the holdings of financial instruments. 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.

14. Financial instruments and risk management (continued):

A 1% increase or decrease in the average interest rate charged on the term loans described in note 7 for the year ended December 31, 2010 would have had the following impact on the Company's net income:

	Impact on net income
Interest rate +1%	$ (140,633)
Interest rate -1%	140,633

As at December 31, 2010 and 2009, the Company had variable interest rate term loans in the aggregate of $16,599,000 and $11,466,840, respectively, as described in note 7.

(iv) 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 receivable is remote.

(v) Liquidity risk:

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they become due. The Company's approach to managing liquidity risk is to ensure that sufficient cash and credit facilities are available to meet liabilities when due. The contractual maturities of the Company's long-term financial liabilities are described in note 7 and the remaining financial liabilities, consisting of accounts payable, are expected to be realized within one year.

Management continuously forecasts cash flows for a period of 12 months to identify financing requirements. These requirements are then managed through a combination of committed and demand credit facilities and access to capital markets. The Company has also maintained continuous efforts to access intermediate or long-term bank financing on competitive terms.

14. Financial instruments and risk management (continued):

As at December 31, 2010, the Company had a cash and cash equivalents balance of $2,670,113 (2009 - $3,782,250) to settle current liabilities of $11,816,832 (2009 - $10,352,424). The Company intends to settle its current liabilities from cash generated from its operations, its debt facilities and/or equity financing.

15. Economic dependence:

Currently, one gas field in the South China Sea supplies the majority of the Company's natural gas in Sanya City. Interruption of this gas field could materially affect the Company's ability to operate. Currently, the Company has a contract to purchase up to 24,000,000 m^3 gas a year (which represents less than 1% of the field's total capacity) from this supplier until December 30, 2015. The Company has maintained continuous efforts to explore other possible sources of natural gas (note 12(c)).

16. Seasonality of operations:

Seasonality can impact the Company's piped line natural gas sales. The Company's current operations are located mainly in Sanya City, a tourist city in the PRC's only tropical province that attracts more tourists in winter and spring than the rest of the year. As a large portion of the Company's natural gas sales are made to hotels, the Company's sales are affected by the tourism season.

17. Segmented information:

The Company's operating segments are identified by grouping together businesses that deliver similar products and provide similar services, which is the basis for assessing the financial performance of the business segments and for allocating resources to the business segments.

Prior to 2010, the Company had two principal businesses: gas connection and pipeline gas sales in Sanya City, Hainan province, China. In the first half year of 2010, the Company completed construction of its first CNG retail station in Hunan province, China, and commenced full operation. As a result, for management reporting purposes, the Company is segregated into three principal business segments: gas connection, pipeline gas sales and CNG refuelling sales. Expenses and assets of non-operational divisions are allocated to the gas connection, pipeline gas sales and CNG refuelling sales based on their portions 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.

17. Segmented information (continued):

Comparative information for 2009 has been represented to reflect these changes.

2010	Gas connection	Pipeline gas sales	CNG refuelling sales	Consolidated
Revenue	$ 8,229,301	$ 12,972,926	$ 932,991	$ 22,135,218
Cost of sales	4,839,964	4,876,748	872,634	10,589,346
	3,389,337	8,096,178	60,357	11,545,872
Expenses:				
General and administrative	1,292,990	2,507,648	555,854	4,356,492
Interest on long-term debt	–	641,838	–	641,838
Travel and business development	1,233,873	1,829,192	108,213	3,171,278
Amortization	83,947	975,711	103,571	1,163,229
Stock-based compensation	92,919	146,481	10,535	249,935
	2,703,729	6,100,870	778,173	9,582,772
Income (loss) before the undernoted	685,608	1,995,308	(717,816)	1,963,100
Interest income	3,370	–	1,567	4,937
Income tax expenses	(422,345)	(535,355)	–	(957,700)
Non-controlling interest	(4,809)	–	14,563	9,754
Net income (loss)	$ 261,824	$ 1,459,953	$ (701,686)	$ 1,020,091
Acquisition of plant and equipment during the year	$ 317,393	$ 9,130,797	$ 515,100	$ 9,963,290
Total assets, December 31, 2010	$ 2,626,340	$ 39,506,784	$ 2,914,022	$ 45,047,146

2009	Gas connection	Pipeline gas sales	Consolidated
Revenue	$ 7,103,288	$ 10,773,190	$ 17,876,478
Cost of sales	4,286,193	3,108,490	7,394,683
	2,817,095	7,664,700	10,481,795
Expenses:			
General and administrative	1,403,138	2,668,010	4,071,148
Interest on long-term debt	–	446,503	446,503
Travel and business development	955,698	1,690,995	2,646,693
Amortization	39,429	1,057,260	1,096,689
Stock-based compensation	47,139	72,139	119,278
	2,445,404	5,934,907	8,380,311
Income before the undernoted	371,691	1,729,793	2,101,484
Interest income	4,538	6,944	11,482
Income tax expenses	(251,405)	(738,847)	(990,252)
Net income	$ 124,824	$ 997,890	$ 1,122,714
Acquisition of plant and equipment during the year	$ 277,150	$ 2,105,200	$ 2,382,350
Total assets, December 31, 2009	$ 3,509,916	$ 32,860,675	$ 36,370,591

18. Accumulated other comprehensive loss:

		2010		2009
Balance, beginning of year	$	(778,791)	$	727,220
Currency translation adjustment		(63,762)		(1,506,011)
Balance, end of year	$	(842,553)	$	(778,791)

19. Subsequent events:

(a) On March 3, 2011, the Bank of China agreed to increase the Company's bank loan by $4,527,000 (RMB 30,000,000) in the form of a one year line of credit (the "Credit Line"). The Credit Line is secured by the same collateral as that for its $15,090,000 (RMB 100,000,000) long-term loan announced on January 25, 2010 (note 7(b)). As a result, Bank of China has increased the Company's total loan to $19,617,000 (RMB 130,000,000).

In March 2011, the Company's drawing on the Credit Line amounted to $3,018,000 (RMB 20,000,000), and is due in March 2012. The interest rate on the loan is the variable rate set by the People's Bank of China.

(b) On March 31, 2011, the Company paid $1,090,726 (RMB 7,344,956) in cash to utilize 4,183 square metres of land in Sanya City to build a monitoring and control centre and administrative office (the "Centre"). A one-year construction permit was initially issued by the government in March 2010 for the construction of the Centre, and construction is expected to begin now that this payment has been made. On April 12, 2011, the Company subsequently paid another $74,522 (RMB 522,226) to secure the use of the land.

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