

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.

For the year ended December 31, 2010

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"). Pingxiang 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 m³/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".

For the year ended December 31, 2010

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

<i>(In thousands of Canadian dollars except per share amounts)</i>	2010	2009	Change
Revenue	22,135	17,876	24%
Gross profit	11,546	10,482	10%
<i>% of revenue</i>	52.2%	58.6%	-6.5%
General and administrative	4,356	4,071	7%
<i>% of revenue</i>	19.7%	22.8%	-3.1%
Interest on long term debt	642	447	44%
<i>% of revenue</i>	2.9%	2.5%	0.4%
Travel and business development	3,171	2,647	20%
<i>% of revenue</i>	14.3%	14.8%	-0.5%
Amortization	1,163	1,097	6.1%
<i>% of revenue</i>	5.3%	6.1%	-0.9%
Stock based compensation	250	119	110%
<i>% of revenue</i>	1.1%	0.7%	0.5%
Interest income	5	11	-57%
<i>% of revenue</i>	0.0%	0.1%	0.0%
Income tax expense	(958)	(990)	-3%
<i>% of revenue</i>	-4.3%	-5.5%	-1.2%
EBITDA (Note a)	4,443	3,764	18%
<i>% of revenue</i>	20.1%	21.1%	-1.0%
Non-controlling interest	10	-	
<i>% of revenue</i>	0.0%	0.0%	
Net income	1,020	1,123	-9%
<i>% of revenue</i>	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	

For the year ended December 31, 2010

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.

<i>In thousands of Canadian dollars</i>	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 [Results of Operations](#) and [Liquidity and Capital Resources](#) 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.

	2010	2009	% Change
Residential customers			
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

For the year ended December 31, 2010

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

For the year ended December 31, 2010

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

For the year ended December 31, 2010

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) except per share amounts	2010				2009			
	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 (\$000's)	December 31, 2010	December 31, 2009
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

37,508

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 m³. 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

For the year ended December 31, 2010

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 Policies, upon producing the board resolution on the authorization of the distribution of profits or dividends or the commercial documents evidencing foreign exchange transactions, the Company may purchase the foreign exchange required for the distribution from a designated authorized bank. The Company cannot guarantee that the Policies will not be withdrawn or amended. The Company continues to have substantial requirements for foreign currency, including foreign currency denominated loans and purchases of imported equipment and materials. Repayment of the principal and interest 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 West-East Gas Pipeline.