CHANGFENG ENERGY INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 31, 2008 AND 2007

(Expressed in Canadian currency)

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McGovern, Hurley, Cunningham, LLP
Chartered Accountants

AUDITORS' REPORT

To the Shareholders of
CHANGFENG ENERGY INC.

We have audited the consolidated balance sheets of Changfeng Energy Inc. ("the Company") as at December 31, 2008 and 2007 and the consolidated statements of operations and deficit, comprehensive income, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2008 and 2007 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

McGOVERN, HURLEY, CUNNINGHAM, LLP

McGovern, Hurley, Cunningham, LLP

Chartered Accountants
Licensed Public Accountants

TORONTO, Canada
March 24, 2009

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CONSOLIDATED BALANCE SHEETS
AS AT DECEMBER 31,

(Expressed in Canadian currency)	2008 $	2007 $
ASSETS		
CURRENT		
Cash and cash equivalents (Note 4)	5,477,208	2,597,876
Accounts and sundry receivables	1,350,747	691,372
Prepaid expenses, advances and deposits	111,573	85,947
Inventories (Note 5)	838,989	416,301
	7,778,517	3,791,496
PLANT AND EQUIPMENT (Note 6)	31,664,018	21,547,918
FUTURE INCOME TAX (Note 9(b))	648,400	585,500
	40,090,935	25,924,914
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities (Note 10(a))	1,849,610	1,320,861
Short term loans (Note 7)	-	200,000
Deferred revenue	3,156,012	1,853,253
Interest payable (Note 7)	2,337,486	1,920,159
Current portion of long term debt (Note 7)	9,836,600	7,549,740
	17,179,708	12,844,013
LONG TERM DEBT (Note 7)	5,851,700	5,980,260
DUE TO RELATED PARTIES (Note 10(a))	7,180,000	5,412,000
	30,211,408	24,236,273
NON CONTROLLING INTEREST	20,398	20,398
SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 8(b))	12,121,808	7,430,001
CONTRIBUTED SURPLUS (Note 8(c))	1,071,231	-
WARRANTS (Note 8(d))	321,724	-
	13,514,763	7,430,001
ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS) (Note 13)	727,220	(460,613)
DEFICIT	(4,382,854)	(5,301,145)
	(3,655,634)	(5,761,758)
	9,859,129	1,668,243
	40,090,935	25,924,914

GOING CONCERN (Note 1)
ECONOMIC DEPENDENCE (Note 14)
COMMITMENTS (Note 16)

APPROVED ON BEHALF OF THE BOARD:

Signed "Christopher J.F. Harrop", Director

Signed "Jack Duffy", Director

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
FOR THE YEARS ENDED DECEMBER 31,

(Expressed in Canadian currency)	2008 $	2007 $
REVENUE	13,014,236	9,240,497
COST OF SALES	5,225,306	3,764,871
GROSS MARGIN	7,788,930	5,475,626
EXPENSES		
General and administrative	3,889,140	2,548,820
Interest on long term debt (Note 7)	733,414	972,760
Travel and promotion	1,193,510	944,260
Amortization	920,078	702,358
Stock based compensation (Note 8(c))	13,628	-
	6,749,770	5,168,198
Income before the undernoted	1,039,160	307,428
Interest income	65,443	-
	1,104,603	307,428
Income tax (expense) recovery (Note 9(a))	(186,312)	610,600
NET INCOME FOR THE YEAR	918,291	918,028
DEFICIT, BEGINNING OF YEAR	(5,301,145)	(5,309,173)
Equity distribution (Note 2)	-	(910,000)
DEFICIT, END OF YEAR	(4,382,854)	(5,301,145)
NET INCOME PER SHARE - basic and diluted	0.014	0.031
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING		
- basic and diluted	63,479,372	29,233,822

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

(Expressed in Canadian currency)	2008 $	2007 $
NET INCOME FOR THE YEAR	918,291	918,028
OTHER COMPREHENSIVE INCOME (LOSS) FOR THE YEAR		
Currency translation adjustment	1,187,833	(129,050)
COMPREHENSIVE INCOME FOR THE YEAR	2,106,124	788,978

See accompanying notes to the consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31,

(Expressed in Canadian currency)	2008 $	2007 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income for the year	918,291	918,028
Adjustments for:		
Future income taxes expense (recovery)	109,852	(610,600)
Amortization	920,078	702,358
Stock based compensation	13,628	-
	1,961,849	1,009,786
Accounts and sundry receivables	(320,432)	(318,475)
Prepaid expenses, advances and deposits	(4,552)	(9,676)
Inventories	(245,324)	(73,141)
Accounts payable and accrued liabilities	350,260	522,327
Deferred revenue	596,717	951,120
Interest payable	(179,660)	253,606
Cash flows from operating activities	2,158,858	2,335,547
CASH FLOWS FROM INVESTING ACTIVITIES		
Plant and equipment	(3,638,208)	(2,892,348)
Equity distribution (Note 2)	-	(5,800,000)
Cash flows from investing activities	(3,638,208)	(8,692,348)
CASH FLOWS FROM FINANCING ACTIVITIES		
Short term loans	-	(228,932)
Payment of interest on convertible debenture (Note 8(b)(iii))	(549,797)	-
Long term debt	(1,935,360)	(2,426,920)
Cash acquired on RTO (Note 2)	6,718,427	-
Cash paid for transaction costs (Note 2)	(477,699)	-
Due to related parties	-	5,654,000
Shares issued for cash	-	5,800,000
Cash flows from financing activities	3,755,571	8,798,148
Effects of foreign exchange on cash balances	603,111	(132,419)
INCREASE IN CASH AND CASH EQUIVALENTS	2,879,332	2,308,928
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	2,597,876	288,948
CASH AND CASH EQUIVALENTS, END OF YEAR	5,477,208	2,597,876

SUPPLEMENTAL INFORMATION		
Interest paid	1,133,649	719,153
Taxes paid	91,842	-
Change in accrued plant and equipment expenditures	85,285	-

1. BASIS OF PRESENTATION AND GOING CONCERN

Changfeng Energy Inc. (the “Company”) was incorporated under the Canada Business Corporation Act on May 4, 2006. The reorganization described in Note 2 was completed on January 29, 2008 and the Company’s core business is the distribution of natural gas in Southern China, mostly in Sanya City of Hainan Province, through its wholly owned subsidiary, Sanya Changfeng Offshore Natural Gas Supply Co., Ltd. (“CF China”). CF China is 100% owned by Hainan Energy Limited (“HEL”) and HEL is 100% owned by the Company.

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

On December 25, 2008, the Company established a new company, Hunan Changfeng - CNPC Energy Co. Ltd. ("Hunan CF CNPC"), with China National Petroleum Corporation (“CNPC”) and its associates to pursue compressed natural gas ("CNG") distribution opportunities in Changsha, a major city in China and capital of Hunan Province. The Company has 55% of the equity interests of Hunan CF CNPC through its newly incorporated, wholly owned subsidiary, Sanya Changfeng New Energy Investment Co. Ltd. (“Sanya CF NEI”). As at December 31, 2008, Hunan CF CNPC was inactive.

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

As at December 31, 2008, the Company had a working capital deficiency of $9,401,191. These consolidated financial statements have been prepared on the basis of accounting principles applicable to a “going concern”, which assume that the Company will continue in operation for the foreseeable future and will be able to realize its assets and discharge its liabilities in the normal course of operations. There is no guarantee that at the Company’s current level of operations, it would be able to discharge its liabilities should Sanya State Assets Management Corporation decide to demand repayment of its loan in full (See Note 7(b)). If the “going concern” assumption was not appropriate for these consolidated financial statements, then adjustments would be necessary to the carrying values of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. Such adjustments could be material.

2. REVERSE TAKEOVER TRANSACTIONS

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

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2. REVERSE TAKEOVER TRANSACTIONS (Continued)

Following the transaction, the former shareholder of HEL held more than 50% of the issued and outstanding common shares of the Company. The substance of the transaction was a capital transaction and was accounted for as a reverse takeover in accordance with EIC-10 "Reverse Takeover Accounting" of the Canadian Institute of Chartered Accountants ("CICA") Handbook. HEL, the legal subsidiary is considered to have acquired the assets and liabilities of the Company, the legal parent. Prior to the transaction, the legal parent had outstanding 7,000,000 common shares, 3,750,000 options to purchase common shares at an exercise price of $0.60 per share valued at $1,057,603 (Note 8(c)), and 1,000,000 warrants to purchase common shares at an exercise price of $0.60 valued at $321,724 (Note 8(e)). The 3,750,000 options and 1,000,000 warrants granted by the legal parent were exchanged for an equivalent number of options and warrants of the legal subsidiary. The options and warrants granted by the legal subsidiary were valued at fair value at the time of the reverse takeover, and form part of the cost of the acquisition.

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

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

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

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

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

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

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

During the year ended December 31, 2007, HEL acquired 100% of the registered capital of CF China for cash consideration of $5,800,000 (RMB 40,000,000). Since, at the time of the transaction, CF China and HEL were subject to common control, the acquisition was accounted for using the continuity-of-interests method and the net assets acquired were recorded at their carrying values and the cash consideration was accounted for as a distribution of equity with $4,890,000 charged against the contributed surplus balance with the excess of $910,000 charged to deficit. Subsequent to the acquisition, the Company's financial statements presented for comparative purposes reflect the financial position, results of operations and cash flows as if HEL and CF China had been combined since the inception of CF China.

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3. SIGNIFICANT ACCOUNTING POLICIES

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

Basis of Consolidation
The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries HEL, CF China, Sanya Changfeng Offshore Natural Gas Engineering Construction Co. Ltd., Sanya CF NEI, its 98% interest in Sanya Changfeng Offshore Natural Gas Design Co. Ltd., and its 55% interest in Hunan CF CNPC. These consolidated financial statements have been prepared by management in accordance with Canadian generally accepted accounting principles. All material intercompany balances and transactions have been eliminated.

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

Inventories
Inventories, including construction materials, gas appliances and meters, consumables and spare parts are stated at the lower of cost and net realizable value, with cost being determined using the weighted average cost basis.

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

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

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

The Company tests its long-lived assets for recoverability whenever events or changes in circumstances indicate that its carrying amount may not be recoverable.

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

The Company's natural gas distribution network is comprised of mains, service lines, measuring and regulating equipment and storage facilities. The Company estimates that it does not have a material legal retirement obligation with respect to its distribution and supply network.

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue Recognition

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

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

As at December 31, 2008, the Company had deferred revenue of $3,156,012 (2007 - $1,853,253), with respect to deposits received from customers in excess of the value of work carried out during the period.

Interest income is recorded on an accrual basis.

Income Taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method of tax allocation, future income taxes are determined based on the differences between the financial reporting and tax bases of assets and liabilities. These income tax assets and liabilities are measured using the 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 2008 tax year are subject to examination by the relevant tax authorities.

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Entities Subject to Rate Regulation

In May 2005, the CICA issued Accounting Guideline 19 (“AcG-19”) to establish disclosure guidelines for entities subject to rate regulation. AcG-19 provides guidance for the disclosure of general information regarding the nature and economic effects of rate regulation, as well as additional information on how rate regulation has affected the financial statements. The guideline does not address recognition and measurement issues associated with the accounting for rate-regulated operations.

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

The Company follows Canadian GAAP, which may differ for regulated operations from those otherwise expected in non-regulated businesses. As a result, the Company may record assets and liabilities that result from the regulated rate making process that would not have been recorded under GAAP for non-regulated entities. Regulatory assets generally represent incurred costs that have been deferred because future recovery in customer rates is probable. Regulatory liabilities generally represent obligations to make refunds to customers for previous collections for costs that are not likely to be incurred. The Company did not have any rate regulated assets or liabilities as at December 31, 2007 and 2008.

Foreign Currency Translation

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

Monetary assets and liabilities are translated into Canadian dollars at exchange rates in effect at the balance sheet date. Non-monetary assets and liabilities are translated at historical exchange rates, unless such items are carried at market, in which case they are translated at the exchange rates in effect on the balance sheet date. The Company’s foreign subsidiaries are defined as self-sustaining. Assets and liabilities denominated in RMB are translated into Canadian dollars using the exchange rate in effect on the balance sheet date. Operating revenues and expenses are translated at the average exchange rates during the period. Foreign exchange gains and losses arising from translation of the balances are disclosed separately as comprehensive income or loss. The accumulated foreign exchange gains or losses are reported as a separate component of shareholders’ equity as accumulated other comprehensive income or loss.

Stock Based Compensation

The Company records compensation cost based on the fair value method of accounting for stock based compensation. The fair value of stock options is determined using the Black-Scholes option pricing model. The fair value of the options is recognized over the vesting period as compensation expense and contributed surplus. When options are exercised, the proceeds received, together with any related amount in contributed surplus, will be credited to share capital. The Company’s stock option plan is described in Note 8(c).

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Per Share
Basic income per share is calculated using the weighted average number of shares outstanding. Diluted income per share is calculated using the treasury stock method. In order to determine diluted income per share, the treasury stock method assumes that any proceeds from the exercise of dilutive stock options and warrants would be used to repurchase common shares at the average market price during the period, with the incremental number of shares being included in the denominator of the diluted income per share calculation. The diluted income per share calculation excludes any potential conversion of options and warrants that would increase earnings per share or decrease loss per share. As at December 31, 2008, the options and warrants described in Notes 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 year ended December 31, 2008.

Measurement Uncertainty
The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the related reported amounts of revenue and expense during the reporting period. Such estimates and assumptions affect the carrying value and useful lives of assets and affect the valuation of investments, stock based compensation, warrants, and accrued interest with respect to the term loan facility described in Note 7(b), and income tax accounts. Actual results could differ from those estimates. Management believes that the estimates are reasonable.

Government Assistance
Government assistance related to current expenses is recorded as a reduction of these expenses in the period incurred.

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

Transaction Costs
On June 1, 2007, the Emerging Issues Committee of the CICA issued Abstract No. 166 "Accounting Policy Choice for Transaction Costs" ("EIC-166"). This EIC addresses the accounting policy choice of expensing or adding transaction costs related to the acquisition of financial assets and financial liabilities that are classified as other than held for trading. Specifically, it requires that the same accounting policy choice be applied to all similar financial instruments classified as other than held for trading, but that a different accounting policy choice might be made for financial instruments that are not similar. The Company has evaluated the impact of EIC-166 on adoption and determined that no adjustments were required.

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Accounting Policies
On December 1, 2006, the CICA issued the following new accounting standards: Capital Disclosures (Handbook Section 1535), Financial Instruments - Disclosures (Handbook Section 3862), Financial Instruments - Presentation (Handbook Section 3863), and Inventories (Handbook Section 3031). These new standards became effective for the Company on January 1, 2008.

Capital Disclosures
CICA Handbook Section 1535 “Capital Disclosures”, issued in December 2006, establishes standards for disclosures about capital that are effective for fiscal periods beginning on or after October 1, 2007. It requires an entity to disclose its objectives, policies and processes for managing capital and to disclose quantitative data about what it considers to be capital. It also requires an entity to disclose whether it has complied with any externally imposed capital requirements and, if not, the consequences of such non-compliance. The Company has included disclosures recommended by the new Handbook section in Note 15 to these consolidated financial statements.

Financial Instruments
In December 2006, the Canadian Accounting Standards Board (AcSB) issued two new Sections in relation to financial instruments: Section 3862, Financial Instruments - Disclosures, and Section 3863, Financial Instruments - Presentation. The Company adopted both sections, effective January 1, 2008. The Company has included disclosures recommended by the new Handbook section in Note 11 to these consolidated financial statements.

Inventories
In June 2007, the CICA issued section 3031, Inventories to establish standards for the measurement and disclosure of inventories. The standard provides guidance on the determination of cost and requires the allocation of overhead expenses and other costs to inventory. Inventories must be measured at the lower of cost and net realizable value. Consistent use must be made of the method of determining inventory. Reversal of previous write-downs is required when there is a subsequent increase in the value of inventories. The amount of inventories recognized as an expense during the period is disclosed. Except for the new guidance on reversal of write downs the Company’s practice for valuing inventory in prior periods was substantially in accordance with this new standard. The Company has adopted this change in accounting policy and the adoption of this standard did not have a material impact on the Company’s consolidated financial statements.

Future Accounting Changes

Rate Regulated Operations
Effective January 1, 2009, the temporary exemption from CICA Handbook Section 1100, “Generally Accepted Accounting Principles”, which permits the recognition and measurement of assets and liabilities arising from rate regulation, will be withdrawn. The change is not expected to have an impact on the Company’s consolidated financial statements.

Goodwill and Intangible Assets
In November 2007, the CICA issued Handbook Section 3064, Goodwill and Intangible Assets, which replaces the existing Handbook Section 3062, Goodwill and Other Intangible Assets and Handbook Section 3450, Research and Development Costs. This standard is effective for annual financial statements relating to fiscal years beginning on or after October 1, 2008, with earlier application encouraged. The standard provides guidance on the recognition, measurement and disclosure requirements for goodwill and intangible assets. The Company is currently assessing the impact of this new accounting standard on its consolidated financial statements.

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3. SIGNIFICANT ACCOUNTING POLICIES (Continued)

Future Accounting Changes (Continued)

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

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

International Financial Reporting Standards (“IFRS”)
In January 2006, the CICA Accounting Standards Board (“ACSB”) adopted a strategic plan for the direction of accounting standards in Canada. As part of that plan, accounting standards in Canada for public companies are expected to converge with IFRS by 2011. The Company continues to monitor and assess the impact of the convergence of Canadian GAAP and IFRS.

EIC 173 - Credit Risk and the Fair Value of Financial Assets and Financial Liabilities
In January 2009, the CICA approved EIC 173 Credit Risk and the Fair Value of Financial Assets and Financial Liabilities. This guidance clarified that an entity's own credit risk and the credit risk of the counterparty should be taken into account in determining the fair value of financial assets and financial liabilities including derivative instruments. This guidance is applicable to fiscal periods ending on or after January 12, 2009. The Company is continually evaluating its counterparties and their credit risks.

4. CASH AND CASH EQUIVALENTS

	2008 $	2007 $
Cash	5,460,904	2,597,876
Cashable guaranteed investment certificate, bearing interest of 1.9%	16,304	-
	5,477,208	2,597,876

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5. INVENTORIES

	2008 $	2007 $
Construction materials	601,571	225,887
Gas appliances, meters, and spare parts	237,418	190,414
	838,989	416,301

The amount of inventory recognized as an expense during the year ended December 31, 2008 was $2,416,634 (2007 - $1,642,973).

6. PLANT AND EQUIPMENT

	2008 Cost $	Accumulated Amortization $	2008 Net $
Pipelines	32,302,722	5,623,911	26,678,811
Land use rights	1,330,454	264,197	1,066,257
Motor vehicles	771,710	145,307	626,403
Furniture and equipment	346,164	54,427	291,737
Computer equipment	82,510	34,824	47,686
	34,833,560	6,122,666	28,710,894
Construction in progress (Note 16)	2,953,124	-	2,953,124
	37,786,684	6,122,666	31,664,018

	2007 Cost $	Accumulated Amortization $	2007 Net $
Pipelines	21,905,033	3,540,250	18,364,783
Land use rights	1,002,843	179,838	823,005
Motor vehicles	279,948	47,925	232,023
Furniture and equipment	223,300	24,149	199,151
Computer equipment	39,358	18,994	20,364
	23,450,482	3,811,156	19,639,326
Construction in progress	1,908,592	-	1,908,592
	25,359,074	3,811,156	21,547,918

As at December 31, 2007 and 2008, the Company has four land use rights certificates covering 92,437M^2 of land. They all have a 50 year term with an expiry date of February 28, 2051. No new land use rights were acquired in 2008.

Included in construction in progress as at December 31, 2008 is capitalized interest of $102,802 (RMB 572,715) incurred during the year ended December 31, 2008 (2007 - $7,590; RMB 56,100).

Continued...

7. SHORT-TERM AND LONG-TERM DEBT

Long-term debt consists of the following

	2008 $	2007 $
a) Term Loan Facility – China Development Bank RMB 35,200,000 (2007 – RMB 47,800,000), advanced from the China Development Bank to Sanya State Assets Management Corporation (an intermediary company controlled by the municipality of Sanya City, see Note 7(b), and loaned to the Company, bearing interest at the floating prescribed rate of the People's Bank of China (5.76% as at December 31, 2008; 2007 – 7.83%) due quarterly, principal repayments commencing February 2008, due November 2012, secured by all pipelines and land use rights of the Company with an estimated net book value as at December 31, 2008 of $27,745,068 (2007 - $19,187,788) and gas distribution rights.	6,318,400	6,467,340
b) Term Loan Facility – Sanya State Assets Management Corporation RMB 42,200,000 (2007 – RMB 42,200,000), representing principal repayments of the term loan facility described in Note 7(a) made by Sanya State Assets Management Corporation on behalf of the Company, unsecured, with no fixed terms of repayment. Interest is calculated at the floating prescribed rate of the People's Bank of China (5.76% per annum as at December 31, 2008; 2007 – 7.83%).	7,574,900	5,709,660
c) Term Loan Facility – Bank of China RMB 10,000,000 (2007 - RMB 10,000,000), bears interest at a rate of 110% of the floating prescribed rate of the People's Bank of China prime lending rate (6.336% as at December 31, 2008; 2007 – 8.415%), interest due monthly with principal repayable in 20 monthly payments of RMB 500,000 ($89,750), commencing April 30, 2011. The interest rate is adjusted semi-annually based on the floating prescribed rate at that time. This loan is secured by gas connection fees.	1,795,000	1,353,000
	15,688,300	13,530,000
Less: current portion	(9,836,600)	(7,549,740)
	5,851,700	5,980,260

Continued...

7. LONG-TERM DEBT (Continued)

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

	RMB	$
2009	54,800,000	9,836,600
2010	12,600,000	2,261,700
2011	9,500,000	1,705,250
2012	10,500,000	1,884,750
	87,400,000	15,688,300

As at December 31, 2008, the Company had accrued interest of $2,337,486 (RMB 13,022,204) (2007 - $1,898,029; RMB 14,028,300) with respect to the loan facilities described in Notes 7(a) and (c). As at December 31, 2008, and 2007, interest of $Nil was charged on the loan facility described in Note 7(b) as at December 31, 2008 and 2007 as a form of government assistance provided to the Company by Sanya State Assets Management Corporation.

The entire balance of the loan described in Note 7(b) has been classified as current due to the fact that no fixed terms of repayment have been established.

As at December 31, 2007, HEL had a short-term note payable to the Company in the amount of $200,000 bearing interest at 1% monthly, due on demand, secured by 13 kilometres of pipeline having an estimated net book value of $1,082,400 as at December 31, 2007. As at December 31, 2007, HEL had accrued interest of $22,130 (RMB 163,562) with respect to this loan. Upon completion of the RTO transaction described in Note 2, this loan was eliminated on consolidation.

8. CAPITAL STOCK

a) Authorized
Unlimited number of common shares

b) Issued
66,025,000 common shares

Transactions during the years ended December 31, 2007 and 2008 are as follows:

	Number of Shares	Amount $
Balance, December 31, 2006	50,000	1,630,001
Issue of shares (i)	50,000	5,800,000
Balance, December 31, 2007	100,000	7,430,001
Adjustments to give effect to RTO transactions (Note 2)		
Adjust number of common shares outstanding to that of the legal parent immediately prior to the RTO	6,900,000	-
Share exchange to effect RTO and conversion of subscription receipts (ii) and convertible debentures (iii)	59,025,000	5,217,527
RTO transaction costs	-	(525,720)
Balance, December 31, 2008	66,025,000	12,121,808

(i) On July 6, 2007, HEL issued 50,000 shares for cash consideration of $5,800,000.

(ii) Immediately prior to the RTO transactions described in Note 2, the legal parent completed a private placement and issued 12,500,000 subscription receipts for gross proceeds of $7,500,000. These subscription receipts were subsequently converted into 12,500,000 common shares for no additional consideration. The legal parent paid cash commission of $600,000 and issued 1,000,000 agents warrants valued at $321,724 (see Note 8(d)). The legal parent also incurred additional costs of $585,000 relating to the private placement.

Continued...

8. CAPITAL STOCK (Continued)

b) Issued (continued)

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

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

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

c) Stock Options and Contributed Surplus

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

On January 22, 2008 prior to the RTO transactions described in Note 2, the Company granted options to directors, officers and consultants of the Company to acquire 3,750,000 common shares of the Company at an exercise price of $0.60 per share on or before January 22, 2013. The options vested immediately. The fair value of the options granted was estimated as $1,057,603 at the date of grant using the Black-Scholes option pricing model with the following assumptions:

Expected dividend yield	0%
Expected volatility	66%
Risk free interest rate	3%
Expected life	60 months

On August 25, 2008 the Company granted options to a consultant of the Company to acquire 50,000 common shares of the Company at an exercise price of $0.60 per share on or before August 28, 2013. The options vested immediately. The fair value of the options granted was estimated as $13,628 at the date of grant using the Black-Scholes option pricing model with the same assumptions above.

A continuity of stock options is as follows:

	Number of Stock Options	Weighted Average Exercise Price	Expiry Date
	#	$	
Balance, December 31, 2006 and 2007	-	-	
Options granted by legal parent prior to RTO (Note 2)	3,750,000	0.60	January 22, 2013
Options granted	50,000	0.60	August 25, 2013
Balance, December 31, 2008 (See Note 8(e))	3,800,000	0.60	

Continued...

8. CAPITAL STOCK (Continued)

c) Stock Options (Continued)

A continuity of contributed surplus is as follows:	Balance $
Balance, December 31, 2006 and 2007	-
Options granted by legal parent prior to RTO (Note 2)	1,057,603
Options granted	13,628
Balance, December 31, 2008	1,071,231

d) Warrants

Pursuant to the private placement mentioned in Note 8(b)(ii) and prior to the RTO described in Note 2, the legal parent granted 1,000,000 warrants to the Agent to acquire 1,000,000 common shares of the Company at an exercise price of $0.60 per share on or before January 29, 2010. The fair value of warrants granted was estimated to be $321,724 at the date of grant using the Black-Scholes option pricing model with the following assumptions:

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

e) Shares and Options Held in Escrow

Pursuant to Escrow Agreements entered into during the year ended December 31, 2008, 36,350,000 common shares of the Company and 1,750,000 options issued to certain officers and directors of the Company were held in escrow and released as follows: one quarter were released on February 4, 2008, the date on which the common shares were listed on a Canadian stock exchange; one third of the remaining securities were released six months following the listing date; one half of the remaining securities will be released twelve months following the listing date; and the remaining securities will be released 18 months following the listing date. As at December 31, 2008, 18,175,000 common shares and 875,000 options remained in escrow.

9. INCOME TAXES

a) Provision for Income Taxes

Major items causing the Company's income tax rate to differ from the federal statutory rate of 34% (2007 - 36%) were as follows:

	2008 $	2007 $
Income before taxes:	1,104,603	307,428
Expected income tax provision based on statutory rate	370,000	50,700
Deductible expenditures	(229,600)	-
Tax assets acquired in RTO (Note 2)	(648,400)	-
Change in expected tax rates	(138,700)	-
Capital loss	(34,400)	-
Change in foreign exchange rates	(105,900)	(39,700)
Utilization / expiration of losses	50,700	-
Other	101,412	76,600
Change in valuation allowance	821,200	(698,200)
Income taxes expense (recovery)	186,312	(610,600)
Current income tax expense	76,460	-
Future income tax expense (recovery)	109,852	(610,600)
	186,312	(610,600)

Continued...

9. INCOME TAXES (Continued)

b) Future Tax Balances

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

	2008 $	2007 $
Future income tax assets:		
Non capital losses	713,500	309,400
Plant and equipment	279,900	276,100
Share issue and transaction costs	441,800	-
Capital losses	34,400	-
Valuation allowance	(821,200)	-
	648,400	585,500

c) Tax Loss Carry Forwards

As at December 31, 2008, the Company has approximately $1,190,000 of non-capital losses, which can be used to reduce taxable income in Canada in future periods that expire on December 31 of the following years:

Year	$
2009	8,000
2013	10,000
2014	11,000
2025	24,000
2026	383,000
2027	28,000
2028	726,000

The Company also has approximately $1,675,000 (RMB 9,332,000) of non-capital losses in China, which can be used to reduce taxable income in China in future periods, of which $610,000 (RMB 3,398,000) expires in 2010, and $1,065,000 (RMB 5,934,000) expires in 2011.

10. RELATED PARTY TRANSACTIONS

(a) Due to related parties

During the year ended December 31, 2007, a significant shareholder, who is also an officer and director of the Company advanced loans in the aggregate amount of RMB 40,000,000 ($7,180,000) (2007 - $5,412,000) to the Company, through wholly owned corporations, in accordance with a Subordination and Forbearance Agreement dated April 27, 2007, Consignment Loan Agreements dated May 23, 2007 and June 26, 2007, and other ancillary documentation.

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

In addition, the Company owed this individual $128,444 for unpaid salary and included the amount in accounts payable. This amount is unsecured, non-interest bearing with no fixed terms of repayment. This transaction was in the normal course of operations and was measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

A corporation controlled by this same individual owed the Company a total of US$62,889 (Cdn$76,599) as at December 31, 2008 (2007 - $Nil) for various expenditures paid by the Company on behalf of this corporation. This amount is unsecured, non-interest bearing with no fixed terms of repayment.

Continued...

10. RELATED PARTY TRANSACTIONS (Continued)

(b) Subscription receipts
Pursuant to the financing described in Note 8(b)(ii), four directors and officers of the Company subscribed for an aggregate of 1,559,000 subscription receipts for gross proceeds of $935,400. The related party subscriptions were on the same terms and conditions as the arm's length subscribers.

11. FINANCIAL INSTRUMENTS

Fair Value

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

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

The fair value of long-term debt described in Note 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.

Financial Risk Factors

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

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

As at December 31, 2008, the Company held foreign currency cash and cash equivalents of RMB 18,046,198 ($3,239,293) (2007 – RMB18,846,489; $2,549,930).

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

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

Continued...

11. FINANCIAL INSTRUMENTS (Continued)

Financial Risk Factors (continued)

(c) Interest Rate Risk

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

As at December 31, 2008, the Company had variable interest rate term loan facilities in the aggregate of $15,688,300 (2007 - $13,530,000) as described in Note 7.

A 1% increase or decrease in the average interest rate for the year ended December 31, 2008 would have had the following impact on the Company's net income.

	Impact on 2008 Net Income
Interest rate +1%	$ 144,000
Interest rate -1%	($144,000)

(d) Credit Risk

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

(e) Liquidity Risk

The Company's approach to managing liquidity risk is to ensure that it will have sufficient liquidity to meet liabilities when due. The contractual maturities of the Company's long term financial liabilities are described in Note 7 and the remaining financial liabilities consisting of accounts payable are expected to be realized within one year. As at December 31, 2008, the Company had a cash and cash equivalents balance of $5,477,208 (2007 - $2,597,876), to settle current liabilities of $17,179,708 (2007 - $12,844,013). The Company has classified the loan from Sanya State Assets Management Corporation as current since no fixed terms of repayment have been established (see Note 7(b)).

(f) Sensitivity Analysis

The Company has designated its cash and cash equivalents as held for trading, which are measured at fair value. Financial instruments included in other assets are classified as loans and receivables, which are measured at amortized cost. Accounts payable and accrued liabilities, short-term loans and long-term debt are classified as other financial liabilities, which are measured at amortized cost. As at December 31, 2008, the carrying and fair value amounts of the Company's financial instruments are approximately the same.

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12. SEGMENTED INFORMATION

For management purposes, the Company is currently organized into two operating divisions: gas connections and piped gas sales. These principal operating activities are the basis on which the Company reports its primary segment information. Expenses and assets of non-operational divisions are allocated to the gas connection and piped gas sales divisions based on their portion of consolidated revenue. Transactions between reportable segments, namely the transfer of certain pipeline assets from the gas connection segment to the piped gas sale segment, have been accounted for based on the carrying values of the assets transferred. The gas connection and piped gas sales operating divisions are based in the PRC.

FOR THE YEAR ENDED DECEMBER 31, 2008

	Gas Connection	Piped Gas Sales	Consolidated
	$	$	$
REVENUE	5,290,950	7,723,286	13,014,236
COST OF SALES	3,347,796	1,877,510	5,225,306
	1,943,154	5,845,776	7,788,930
EXPENSES			
General and administrative	1,390,511	2,498,629	3,889,140
Interest on long-term debt	-	733,414	733,414
Travel and promotion	416,584	776,926	1,193,510
Amortization	29,878	890,200	920,078
Stock based compensation	5,540	8,088	13,628
	1,842,513	4,907,257	6,749,770
Income before the under-noted	100,641	938,519	1,039,160
Interest income	26,606	38,837	65,443
	127,247	977,356	1,104,603
Income tax expenses - current	(76,460)	-	(76,460)
Income tax expense - future	(10,471)	(99,381)	(109,852)
NET INCOME FOR THE YEAR	40,316	877,975	918,291
ACQUISITION OF PLANT AND EQUIPMENT DURING THE YEAR	25,283	4,117,990	4,143,273
AS AT DECEMBER 31, 2008 ASSETS	2,405,294	37,685,641	40,090,935

Substantially all of the Company's assets are located in the PRC. As at December 31, 2008, there was cash of $973,250 (2007 - $Nil) and other current assets of $102,084 (2007 - $Nil) held in Canada.

Continued...

12. SEGMENTED INFORMATION (Continued)

FOR THE YEAR ENDED DECEMBER 31, 2007

	Gas Connection	Piped Gas Sales	Consolidated
	$	$	$
REVENUE	3,805,840	5,434,657	9,240,497
COST OF SALES	2,473,962	1,290,909	3,764,871
	1,331,878	4,143,748	5,475,626
EXPENSES			
General and administrative	965,443	1,583,377	2,548,820
Interest on long term debt	-	972,760	972,760
Travel and promotion	580,608	363,652	944,260
Amortization	23,360	678,998	702,358
	1,569,411	3,598,787	5,168,198
(Loss) income before the under-noted	(237,533)	544,961	307,428
Interest income	-	-	-
	(237,533)	544,961	307,428
Income tax recovery	10,300	600,300	610,600
NET (LOSS) INCOME FOR THE YEAR	(227,233)	1,145,261	918,028
ACQUISITION OF PLANT AND EQUIPMENT DURING THE YEAR	67,675	2,824,673	2,892,348
AS AT DECEMBER 31, 2007 ASSETS	1,675,651	24,249,263	25,924,914

Substantially all of the Company's assets were located in the PRC as at December 31, 2007.

Continued…

13. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

	2008 $	2007 $
Balance, at the beginning of the year	(460,613)	(331,563)
Currency translation adjustment during the year	1,187,833	(129,050)
Balance, at the end of the year	727,220	(460,613)

14. ECONOMIC DEPENDENCE

Currently, one gas field in the South China Sea supplies all of the Company's natural gas. There may be no alternative supply in the short-term. Interruption of this gas field could affect the Company's ability to operate. Currently, the Company has a contract to purchase up to 24 million M^3 gas a year (which represents less than 1% of the field's total capacity) from this supplier until December 31, 2015. In 2007, a supplementary agreement was signed by the Company to purchase a minimum 20 million M^3 gas during the year ended December 31, 2008 and the Company had met this minimum obligation in 2008. From 2009 to 2015, the Company will purchase 24 million M^3 a year. There is no certainty that the Company will be able to purchase gas in excess of this amount from this gas field. The Company is currently exploring other possible sources of natural gas.

15. CAPITAL MANAGEMENT

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

Management reviews its capital management approach on an ongoing basis and believes that this approach, given the relative size of the Company, is reasonable.

There were no changes in the Company's approach to capital management during the year ended December 31, 2008.

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16. COMMITMENTS

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 appropriate 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, 2008 and 2007, CF China had not appropriated RMB to the above statutory reserve funds as CF China has not yet reported retained earnings.

Haitang Bay Pipeline Construction

The Company has signed eight contracts with a sub-contractor and other relevant suppliers to construct pipelines to extend to the Haitang Bay area of Sanya City, for a total contract amount of RMB 20,893,429 ($3,750,371), of which RMB 11,072,870 ($1,987,580) was incurred as at December 31, 2008 and included in construction in progress. The contracts are expected to be completed by August 31, 2009.

Purchase Commitments

See Note 14.

17. SUBSEQUENT EVENT

Subsequent to December 31, 2008, the Company acquired 60% of the equity interest in Hunan CNPC New Energy Investment (“Hunan CNPC NEI”) for cash consideration of RMB 5,000,000 (Cdn$897,500). Hunan CNPC NEI has a contract with Hunan CNPC Pipeline Gas Co. Ltd., an arm’s length corporation, to purchase 11 million M^3 of CNG a year until September 12, 2027. The CNG purchased pursuant to this contract will be used to supply the Company’s CNG commercial vehicle filling stations in Changsha City, upon completion of construction.