



# Sino-Forest Corporation



ANNUAL REPORT 1996



## Corporate Profile

SINO-FOREST CORPORATION IS THE FIRST, AND CONTINUES TO BE THE ONLY, FOREIGN-OWNED PRODUCER AND EXPORTER OF WOOD CHIPS IN THE PEOPLE'S REPUBLIC OF CHINA (THE "PRC"). THE COMPANY WILL HAVE, WHEN FULLY PHASED-IN, 623,000 HECTARES OF TREE PLANTATION LANDS UNDER ITS MANAGEMENT AND OPERATION, PRODUCING AN EXPECTED SUSTAINABLE ANNUAL YIELD OF APPROXIMATELY 4 MILLION BONE DRY METRIC TONNES ("BDMT") OF WOOD CHIP FIBRE FROM ITS EUCALYPTUS, ASPEN AND PINE TREES.

THE COMPANY'S PLANTATION LANDS ARE ALL LOCATED IN SOUTHERN CHINA WHERE THE HOT, HUMID, TROPICAL AND SUB-TROPICAL WEATHER AND SOIL CONDITIONS PROVIDE FOR SHORT CYCLES (FROM PLANTING TO HARVESTING) OF FIVE YEARS FOR EUCALYPTUS AND ASPEN AND TWELVE YEARS FOR PINE TREES.

THE COMPANY EMPLOYS APPROXIMATELY 400 PEOPLE AND ADDITIONAL PEOPLE ARE INDIRECTLY EMPLOYED THROUGH ITS JOINT VENTURE PARTNERS TO PROVIDE CERTAIN PLANTATION SERVICES TO THE COMPANY.

THE COMPANY'S WOOD CHIPS ARE CURRENTLY SOLD IN THE EXPORT MARKET, PRIMARILY TO JAPAN, SOUTH KOREA AND TAIWAN, AND IN THE DOMESTIC PRC MARKET. THE COMPANY HAS EXECUTIVE OFFICES LOCATED IN HONG KONG AND TORONTO. THE COMPANY ALSO HAS OFFICES IN EACH OF THE PROVINCES OF THE PRC WHERE IT CONDUCTS OPERATIONS.

SINO-FOREST IS LISTED ON THE TORONTO STOCK EXCHANGE UNDER THE SYMBOL TRE.A.



# Financial Highlights

REVENUE AND INCOME [IN THOUSANDS OF U.S. DOLLARS]	1996	1995	% Change
Revenue	\$32,428	\$27,423	18.3%
Income from operations	13,933	8,742	59.4
Net income attributable to shareholders	8,157	4,354	87.3

FINANCIAL POSITION [IN THOUSANDS OF U.S. DOLLARS]			
Working capital	21,305	3,613	489.7%
Total assets	69,618	31,549	120.7
Convertible debenture	3,000	—	—
Non-controlling interests	20,607	17,026	21.0
Shareholders' equity	42,851	13,689	213.0

PER COMMON SHARE [IN U.S. DOLLARS]			
Basic earnings per Class A and Class B share	\$0.19	\$0.12	58.3%
Fully diluted earnings per Class A and Class B share	\$0.14	\$0.12	16.7
Shareholders' equity (excluding special warrants) per Class A and Class B share	\$0.53	\$0.33	60.6
Class A Subordinate-Voting Shares outstanding			
– weighted average for the year	36,666,301	34,053,425	7.7
– at year end	37,150,000	35,500,000	4.6
Class B Multiple-Voting Shares outstanding			
– weighted average for the year	6,000,000	1,841,096	225.9
– at year end	6,000,000	6,000,000	—

WOOD CHIP PRODUCTION [IN BONE DRY METRIC TONNES]			
Export	346,400	290,500	19.2%
Domestic PRC market	246,400	46,200	433.3
Total	592,800	336,700	76.1

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## Report to Shareholders

1996 was a record year for Sino-Forest Corporation ("Sino-Forest") from a production as well as a financial perspective. Wood chip shipments for the year totalled approximately 592,800 BDMT, an increase of 76.1% compared to 1995 shipments of 336,700 BDMT. It was also the year in which Sino-Forest successfully undertook its largest equity financing in North America, a Cdn.\$30 million special warrants offering, completed in October

1996. With the proceeds of the offering, the Company's production will grow significantly over the next few years as a result of the acceleration of the planned annual phase-in of the tree plantation lands. Production of wood chips is expected to increase by over 50% in each of 1997 and 1998. Additional chipping plants will be acquired in 1997 and 1998, increasing plant capacity to well over 2 million BDMT. Similarly, the capacity of port facilities will also be expanded to over 2 million BDMT by the end of 1998. It is expected that these expansions will result in capital expenditures in aggregate of approximately U.S.\$13.5 million.

Sino-Forest reported net income of U.S.\$8.2 million or U.S.\$0.19 per share, compared with net income of U.S.\$4.4 million or U.S.\$0.12 per share in 1995. The increase in earnings of 87.3% compared to 1995 is primarily attributable to the increase in wood chip and lumber trading as explained in more detail under "Management's Discussion and Analysis of Financial Condition and Results of Operations".



Wood chip production in the Leizhou EJV in 1995 accounted for approximately 60.6% of total production. In 1996, wood chip production in the Leizhou EJV accounted for approximately 35.8% of total production. As we continue to ramp up the phase-in of our CJV plantations over the next few years, the Leizhou EJV's production of wood chips will be less and less significant to the total production level. In 1996,

the Leizhou EJV produced 212,500 BDMT of wood chips compared to 204,200 in 1995. The remaining production in 1996 of 380,300 BDMT was from our Guangxi CJV. The Guangxi CJV produced 132,500 BDMT of wood chips in 1995. It is expected that in the second quarter of 1997, Sino-Forest will be assuming the sales function of our Guangxi CJV rather than earning commission income in acting as an agent. This change in the sales arrangement will provide the Company with a higher sales margin. The Guangxi CJV will continue to represent the majority of our planned production in 1997. Depending on market conditions, we expect to commence sales of aspen wood chips produced from our Jiangxi CJV toward the end of 1997.

As for the forestry chemical and board operations in Jiangxi, our joint venture partners have agreed that in exchange for eliminating the need to contribute the remaining capital of U.S.\$2,187,000, our equity interest in each of the five Jiangxi EJVs will be reduced accordingly. We are pleased

with the outcome of these negotiations which is in line with our strategic decision to focus on the plantation and wood chip businesses. Our primary goal remains the same, to become a major Asian forestry company by accelerating the phase-in of our contractual plantation lands, and in doing so, maximizing the overall financial return to our shareholders.

On the research and development front, we have established a forestry advisory committee which is comprised of professional foresters and experts from the PRC in eucalyptus, aspen and pine trees. These professional foresters are closely associated with the provincial and municipal forestry bureaus and provide industry and plantation operations advice to the Company on a regular basis. In addition to research performed at our own research facilities, we engage prominent forestry institutes in the PRC to carry out research and development on certain selected projects. We continue to look for ways to increase fibre yield, and reduce the growth cycle (increase growth rate) for eucalyptus and aspen trees, thereby reducing the costs of our timber holdings and establishing ourselves as a low cost producer of wood chips in the PRC.

In November 1996, we moved into a new Hong Kong office which will provide us with the necessary space to accommodate the increase in personnel hired as a result of the planned expansion. We also set up a Canadian office in 1997 where our Senior Vice President, Corporate Development and Chief Financial Officer is based. The Canadian office will provide our shareholders and potential investors in North America with better accessibility to management and the Company.

The outlook in Asia for 1997

remains very positive. The economy in most of Asia is expected to remain strong in 1997. Contrary to the widely held view that there would be instability when the British return Hong Kong to the PRC in just a little less than two months, people in the region in general are in fact rather optimistic about the change. We believe the "changeover" will not impact our business negatively and that we are positioned to grow significantly well into the next millennium.

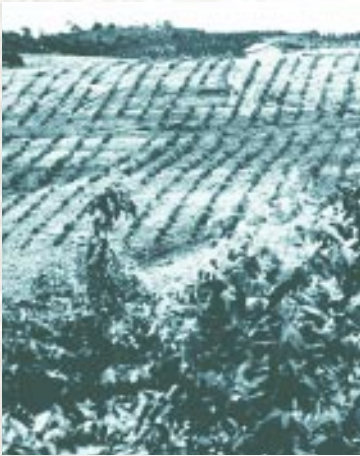
On behalf of the entire management team, I would like to take this opportunity to express our appreciation for the efforts and contributions of our employees, joint venture partners, and advisors to the Company. We would also like to thank our shareholders for their continued support during 1996.



Allen T.Y. Chan  
Chairman and Chief Executive Officer

May 9, 1997

## President's Message



Over the past year, in addition to active implementation of our plantation programme, we have also put in a lot of effort to establish better control systems and procedures, to invest in research projects, and to train and develop our people. Our objective is to continuously improve the utilization of natural, human and financial resources so as to achieve a higher return. This is the way we have chosen to actualize the principle of sustainable forestry management.

Kai Kit Poon  
President

May 9, 1997

過去一年，除了積極推行營林計劃之外，我們亦致力於制度的建立、制度的監管、科研和投資和人才的培訓。務求不斷改善天然資源、人力資源和金融資源的運用，爭取更大的效益，以及更高的回報。這其實踐永續性營林的原則。

總裁

潘家偉

九四廿



## The Year in Review

The key success factors for the Company can be summarized as:

- (a) nurturing our important relationships in the PRC and leveraging those relationships to create new ones;
- (b) phasing in plantation lands under management to develop the standing timber inventory to support the sales demands and opportunities of the future;
- (c) continuing the growth of our customer base both internationally and domestically; and
- (d) ensuring that we have the financial resources to support the rapid development of our plantations and the growth of our customer base.

The goals we set for ourselves as we moved into 1996 recognized these success factors.

We believe that 1996 can be summarized into three phases – *optimism*; then *constraint*; followed by *renewed optimism*. We started the year with great optimism after having entered into five new co-operative joint ventures [the “CJVs”] which provide us with up to 603,000 hectares of additional plantation lands in three provinces in southern China. In January 1996, we closed a \$3 million financing with the Deutsche Bank A.G. of Hong Kong [the “Deutsche Bank”] which provided the funds to finance the initial capitalization of the five new CJVs and commence the phase-in of plantation lands. These funds were expected to be an initial tranche of a \$16 million facility which the bank intended to syndicate on terms similar to the initial tranche. Unfortunately, the Deutsche Bank was unable to organize the syndication in a time frame consistent with our capital needs.

With the delay in the additional bank financing, we moved into the second phase of the year, a period of constraint. Our plan for the year included the phase-in of plantation lands in Guangxi in the early part of 1996 which unfortunately did not materialize as planned due to the delay in obtaining the second tranche of the proceeds from the Deutsche Bank financing. The original plantation lands that we intended to phase-in in Guangxi contained existing standing timber ready for harvest which we planned to acquire, harvest and sell. In anticipation of the phase-in of these lands, we had been securing customers for the Guangxi harvest. Building on the entrepreneurial spirit of the Company and our strong relationship with our Guangxi joint venture partner, we negotiated with our partner to act as an agent instead of principal on these transactions. The agency arrangement allowed us to develop new sales relationships with customers for the future. In addition, we phased in an aggregate of approximately 13,800 hectares of plantation lands in Guangxi by the end of 1996.

At December 31, 1996, Sino-Forest has phased in a total of approximately 37,600 hectares of plantation lands, or 6% of the plantation lands currently under contract. Details of the plantation lands phased in by each of the entities at December 31, 1996 are as follows:

	Hectares Available	Phased in December 31, 1996
CJVs and EJV		
Guangxi CJV	250,000	13,800
Jiangxi CJV	250,000	2,200
Heyuan CJV	50,000	900
Gaoyao CJV	30,000	700
Huazhou CJV	23,000	-
Leizhou EJV	20,000	20,000
<b>Total</b>	<b>623,000</b>	<b>37,600</b>



*E.grandis x urophylla* seedlings in Sino-Forest's Guangxi nursery centre.



1996 planted eucalyptus trees.

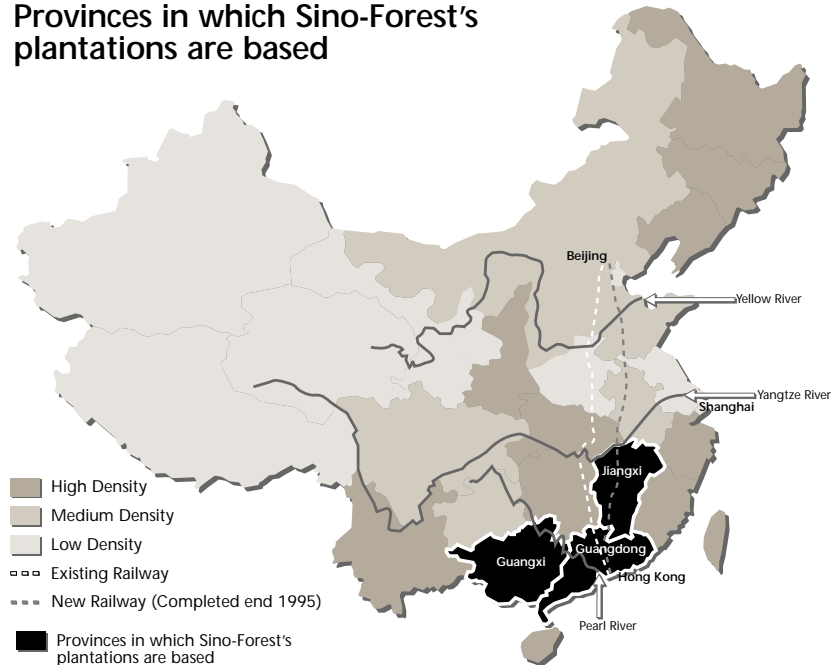


Wood chips produced from eucalyptus trees harvested.



Logs from eucalyptus trees harvested.

### Provinces in which Sino-Forest's plantations are based



The second tranche of the bank syndication was intended to be received in the second quarter of the year. Once the Company recognized that the Deutsche Bank was unable to assemble a syndicate in a time frame which met the Company's needs, other financing options were explored. In early October 1996, the Company closed a new equity financing, which provided gross proceeds of Cdn.\$30 million (approximately U.S.\$22 million). With the closing of the equity financing, we entered a period of renewed optimism. These funds are and will be used to accelerate the phase-in of plantation lands, to acquire and expand chipping facilities, to improve and expand port facilities and for working capital.

Despite the cash constraints experienced in the first nine months of the year, the Company was still able to accomplish many of the goals established for 1996 which were outlined in last year's annual report.

For 1997, we intend to continue building on the key success factors for the Company by nurturing our PRC

relationships, accelerating the phasing in of additional plantation lands, expanding our chipping plant capacity and port facilities to meet the planned increase in production, building and strengthening our work force and developing our customer base. The proceeds of the equity offering in 1996 placed us in a sound financial position to pursue these goals in 1997 and beyond.

The Company expects that it will have an annual sustainable yield of approximately 4 million BDMT of wood chip fibre when all the remaining 623,000 hectares of plantation lands are fully phased in. In addition, the Company plans to expand its plantation and wood chip businesses further by forming new CJVs in other provinces and to increase its plantation base in Guangxi, Jiangxi and Guangdong. Management has already initiated discussion with the appropriate authorities in these provinces and is optimistic that its current plantation base under contract of 623,000 hectares will be increased significantly in 1997.



# Management's Discussion and Analysis of Financial Condition and Results of Operations

(all amounts are in U.S. dollars, unless otherwise indicated)

## Overview

Sino-Forest is the Canadian-based parent company for a group of companies which individually or through joint ventures are engaged in the management and operation of, and investment in, tree plantations in the People's Republic of China [the "PRC" or "China"] and the production of wood chips which are used to make pulp and engineered wood products. Sino-Forest is the first, and continues to be the only, foreign-owned producer and exporter of wood chips in the PRC. The Company's current wood chip shipments are produced from eucalyptus trees grown in partnership with local forestry bureaus or State-owned enterprises in the PRC. The Company also has non-controlling interests in the forestry chemical business in the province of Jiangxi and earns commission income on lumber trading and wood chips trading.

The Company's joint venture tree plantations are all located in southern China where the hot, humid, tropical and sub-tropical weather and soil conditions provide for short cycles (from planting to harvesting) of five years for eucalyptus and aspen trees and twelve years for pine trees. Currently, the Company has, through its various existing agreements with several State-owned forestry bureaus, 623,000 hectares of tree plantation land to be phased in over the next few years. When the tree plantation lands are fully phased in, the Company expects to produce a sustainable annual yield of approximately 4 million BDMT of wood chip fibre.

The table below sets out the provinces in the PRC in which the Company's joint venture plantations are located and the hectareage in each of these provinces when the plantation lands are fully phased in:

Provinces	Hectares
Guangxi	250,000
Jiangxi	250,000
Guangdong	123,000
	<b>623,000</b>

The Company's joint venture in wood chips are currently sold in the export market, primarily to Japan, South Korea and Taiwan, and in the domestic PRC market. Export sales of the Company are all made in U.S. dollars, generally based on the contract prices of Australian wood chips sold in Japan.

With the proceeds of the Company's securities offering completed in October 1996, the Company's production will grow significantly over the next few years as a result of the acceleration of the planned annual phase-in of the tree plantation lands. Given its proximity to the marketplace, especially Japan which imports approximately two-thirds of the world supply of pulpwood fibre, the Company believes it has an advantage as a low cost provider to key markets over its competitors. When all the hectareage of its tree plantations are fully phased in, management believes that the Company will be a significant provider of wood chip fibre to the Asian market.

## Results of Operations

The segmented net revenue and net income for the years ended December 31, 1996 and 1995 are as follows:

	YEAR ENDED DECEMBER 31, 1996			YEAR ENDED DECEMBER 31, 1995		
	WOOD CHIPS \$	OTHER \$	TOTAL \$	WOOD CHIPS \$	OTHER \$	TOTAL \$
	(thousands of U.S. dollars)					
<b>Revenue</b>						
Sales	23,050	1,175	24,225	23,949	1,525	25,474
Commission income	5,233	2,970	8,203	663	1,286	1,949
	28,283	4,145	32,428	24,612	2,811	27,423
Income from operations	10,865	3,068	13,933	7,924	818	8,742
Equity in losses of Jiangxi						
Investments	—	(433)	(433)	—	(262)	(262)
Net interest expense	—	(53)	(53)	—	(6)	(6)
Other income	—	49	49	8	12	20
Income before income taxes	10,865	2,631	13,496	7,932	562	8,494
Provision for income taxes - current	1,855	—	1,855	—	—	—
Income before non-controlling interests	9,010	2,631	11,641	7,932	562	8,494
Non-controlling interests	(3,484)	—	(3,484)	(4,140)	—	(4,140)
Net income for the year	5,526	2,631	8,157	3,792	562	4,354

The Company recorded net income of \$8.2 million for the year ended December 31, 1996, an 87.3% increase compared to net income of \$4.4 million for 1995. Earnings have increased significantly as a result of:

- (i) increased sales of wood chips from 336,700 BDMT in 1995 to 592,800 BDMT in 1996 which included 380,300 BDMT [1995 - 132,500 BDMT] of wood chip shipments in which the Company earned commission income of approximately \$5.2 million as sales agent; and
- (ii) increased commission income from lumber trading from approximately \$1.3 million in 1995 to approximately \$3.0 million in 1996.

As a result of a cash flow constraints caused by the delay in obtaining equity financing in the early part of 1996, the Company was not able to purchase standing timber from its Guangxi joint venture partner. However, the Company was successful in negotiating with its Guangxi joint venture partner on certain sales arrangements with its customers which resulted in the Company earning commission income of approximately \$5.2 million on sales which it would otherwise have made directly to its customers. With the proceeds from the offering of 24,000,000 special warrants for gross proceeds of Cdn. \$30 million completed in October 1996, future chip shipments from the Guangxi joint venture partner will be sold by the Company acting as principal rather than on an agency basis. This should provide the Company with a higher margin in the future.

Sales in the Leizhou EJV remained relatively constant over 1995. Sales were \$23 million in 1996 consisting of approximately 212,500 BDMT of wood chip shipments compared to 204,200 BDMT in 1995. The average selling price of wood



chips, net of VAT, for the year ended December 31, 1996 was \$102 compared to \$103 attained in 1995.

An analysis of the wood chip shipments for the year ended December 31, 1996 compared to 1995 in thousands of BDMT is provided below:

WOOD CHIP SHIPMENTS YEAR ENDED DECEMBER 31 (thousands of BDMT)						
MARKET	LEIZHOU EJV		GUANGXI CJV		TOTAL	
	1996	1995	1996	1995	1996	1995
Export	212.5	204.2	133.9	86.3	346.4	290.5
PRC		—	246.4	46.2	246.4	46.2
<b>Total</b>	<b>212.5</b>	<b>204.2</b>	<b>380.3</b>	<b>132.5</b>	<b>592.8</b>	<b>336.7</b>

Export shipments [including the Guangxi CJV] for the year ended December 31, 1996 represented 58.4% of total shipments compared to 86.3% in 1995. The Company's export shipments are primarily to Japan, South Korea and Taiwan, with Japan representing approximately 64% of the total export shipments. Demand for wood chips in the export market in 1996 and the early part of 1997 has not been very strong due to high worldwide inventory levels. However, demand in the PRC market has remained very strong as reflected in our increased shipments to this market in 1996. Prices of wood chips in the PRC market are also marginally higher than prices attained in the export market. It is expected that the demand in the export market will be stronger in the second half of 1997.

Non-wood chip income represents primarily the commission income earned on lumber trading on behalf of other companies in Hong Kong and the PRC, sales of fertilizer to our joint venture partners and miscellaneous sales in the Leizhou EJV. Non-wood chip income for 1995 includes the results of the Jiangxi EJVs to the dates when effective control was transferred to the Jiangxi EJVs' joint venture partners. After those dates, the Company's share of losses in the Jiangxi EJVs was equity accounted for and shown as a separate line after income from operations.

### Liquidity and Capital Resources

Sino-Forest's balance sheet and earnings have improved for the third consecutive year. In 1996 shareholders' equity increased by a total of \$29.2 million due to \$8.2 million in earnings and approximately \$21.0 million in additional share capital and special warrants. The result is that cash increased by \$17.4 million to \$17.8 million at December 31, 1996. Approximately \$11.0 million of cash was held in escrow pursuant to the special warrant indenture dated October 2, 1996 and was released from escrow in January 1997.

The capitalization of Sino-Forest at December 31, 1996 is comprised of \$3.0 million in the form of a convertible loan with the Deutsche Bank, \$20.6 million of non-controlling interests and \$42.9 million of shareholders' equity. The ratio of total debt to capitalization at December 31, 1996 is low at approximately 4.7%.

Cash from operations amounted to \$12.5 million compared with \$7.7 million in the previous year. This significant improvement resulted primarily from the higher earnings attained in 1996. Funds used in investing activities, net of investment in capital assets and cash held in escrow, amounted to \$4.9 million compared to \$9.8 million in 1995. Investment in capital assets increased from

\$0.5 million to \$14.2 million which is largely attributable to the capitalization of planting costs to timber holdings. Cash provided by financing activities of \$23.9 million represented primarily the proceeds from the special warrants equity offering, the issuance of the convertible debenture to Deutsche Bank and the proceeds received from the exercise of stock options during the year.

The Company estimates that capital spending, excluding capitalization of planting costs to timber holdings, in 1997 will be approximately \$8 million.

### ***Capital Contribution Commitments***

In accordance with the contractual obligations set out in the various joint venture agreements and memoranda as modified with the agreement of its joint venture partners, the Company is required to contribute additional cash as described below:

#### ***The Leizhou EJV***

Under the Leizhou EJV joint venture agreement, the Company's wholly-owned subsidiary, Sino-Wood Partners, Limited ["Sino-Wood"] is committed to provide \$5,300,000 in capital to acquire its 53% equity interest in the Leizhou EJV. An initial capital contribution of \$1,000,000 was made in 1994 with the balance due January 1996. During 1996, Sino-Wood's EJV partner, the Leizhou Forestry Bureau ["LFB"] agreed to extend payment of the balance of the capital contribution to December 1996. No capital contribution was made in December 1996 as Sino-Wood has agreed with the LFB to settle its capital contribution to the Leizhou EJV concurrent with the settlement of amounts due to the Leizhou EJV by the LFB.

#### ***The Jiangxi EJVs***

Pursuant to memoranda of understanding signed between May 14, 1995 and June 28, 1995 [the "MOU Dates"] by Sino-Wood and each of its joint venture partners, the joint venture partners agreed that Sino-Wood would reduce its equity interests in each of the Jiangxi Investments from 55% to 30%. The parties also agreed in the memoranda of understanding to amend the joint venture agreements to change the composition of the board representation in line with the proposed change in equity interests and to reduce the requirement for further capital contribution commitments from \$14,045,000 to \$2,187,000.

Subsequent to the submission to the FERT, Sino-Wood has conducted discussions with its Jiangxi Investments' joint venture partners and the FERT to further restructure its Jiangxi Investments. Amendments to the memoranda of understanding will eliminate the requirement to make the capital contribution of \$2,187,000 by Sino-Wood to the Jiangxi Investments. The equity interest of Sino-Wood in the Jiangxi Investments will be reduced accordingly to reflect the amendments to the memoranda of understanding.

Based on discussions by Sino-Wood with the FERT and on the execution of memoranda of understanding with its Jiangxi Investment partners, the Company does not anticipate any problems obtaining the approval required to implement the changes stated above.



### ***The CJVs***

Sino-Wood's subsidiaries are committed to contribute \$14,200,000 of capital in total to the five PRC CJVs, of which \$2,130,000 was required to be made within three months from the respective dates of issue of business licenses to the PRC CJVs. As at December 31, 1996 capital contributions of \$1,945,000 have been made in total to the PRC CJVs. An amount of \$185,000 that was due in January 1996 has been withheld pending the satisfactory performance of one of the PRC CJV partners. The remaining capital contribution of \$12,070,000 is to be contributed as costs are incurred for planting, maintenance and harvesting of the tree plantations. The timing and amount of the remaining capital contributions is dependent on the phase-in of land for the tree plantations.

The Company believes that the cash on hand at December 31, 1996 and the cash flow to be generated from operations will provide the Company with adequate cash resources to meet its capital contribution commitments, fund its growth strategy and accelerate the planned phase-in of its 623,000 hectares of tree plantation lands.

### **Outlook**

With the successful completion of the Cdn.\$30 million equity offering in October 1996, the Company is well positioned and has the cash resources to accelerate the phase-in of its plantation development plan over the next few years. The Company expects that it will have, when fully phased-in, 623,000 hectares of plantations under its management, producing a sustainable annual yield of approximately 4 million BDMT of wood chip fibre. The Company is also currently in negotiations with the appropriate authorities in the PRC to expand its plantation and wood chip businesses further in Guangxi, Jiangxi and Guangdong and by forming new CJVs in other provinces. If these negotiations are successful, management expects to increase its plantation lands, available to be phased in, significantly.

The demand for wood chips in the Asian market is expected to improve in the next few years as a result of the expected continued impressive economic growth in China and the rest of the Asian region. Paper and board consumption in China and the rest of Asia is expected to increase as a result of population growth, increasing literacy rates, and the conversion of non-wood pulps to traditional wood pulp. According to *The International Woodchip and Pulplog Trade: Supply and Demand Trends and the Outlook for 1996*, wheat, rice, straw, reed bargasse and bamboo are the staple fibres used in papermaking and pulp made from wood fibre represented about 12% of the total raw material used in the industry. Major cost, environmental and quality problems have arisen from the high use of non-wood fibre pulps. Chinese paper industry sources estimate that woodpulp will provide 18% of the fibre produced by the year 2000. This would require 20 million cubic meters of pulpwood, almost three times the current usage.

# Management Responsibility for Financial Reporting

The accompanying consolidated financial statements of Sino-Forest Corporation and all the information in this annual report are the responsibility of management and have been approved by the Board of Directors.

The consolidated financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada. When alternative accounting methods exist, management has chosen those it deems most appropriate in the circumstances. Financial statements are not precise since they include certain amounts based on estimates and judgment. Management has determined such amounts on a reasonable basis in order to ensure that the consolidated financial statements are prepared fairly, in all material respects. Management has prepared the financial information presented elsewhere in the annual report and has ensured that it is consistent with that in the consolidated financial statements.

Sino-Forest Corporation maintains systems of internal accounting and administrative controls to provide reasonable assurance as to the reliability of the financial records and the safeguarding of its assets.

The Board of Directors is respon-

sible for ensuring that management fulfills its responsibilities for financial reporting and is ultimately responsible for reviewing and approving the consolidated financial statements. The Board carries out this responsibility principally through the Audit Committee which is appointed by the Board.

The Committee meets periodically with management and the external auditors to discuss internal controls over the financial reporting process, auditing matters and financial reporting issues, to satisfy itself that each party is properly discharging its responsibilities, and to review the consolidated financial statements and the external auditors' report. The Committee reports its findings to the Board for consideration when approving the consolidated financial statements for issuance to the shareholders. The Committee also considers, for review by the Board and approval by the shareholders, the engagement or re-appointment of the external auditors.

Consolidated financial statements have been audited by Ernst & Young, the external auditors, in accordance with generally accepted auditing standards on behalf of the shareholders. Ernst & Young has full and free access to the Audit Committee.



Allen T.Y. Chan  
Chairman and  
Chief Executive Officer



Kee Y. Wong  
Senior Vice President,  
Corporate Development and  
Chief Financial Officer

May 7, 1997



# Auditors' Report

To the Shareholders of  
**Sino-Forest Corporation**

We have audited the consolidated balance sheets of Sino-Forest Corporation as at December 31, 1996 and 1995 and the consolidated statements of income and retained earnings and changes in financial position 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 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, 1996 and 1995 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles.

Toronto, Canada,  
May 7, 1997.

Ernst & Young  
Chartered Accountants

# Consolidated Balance Sheets

As at December 31

[Expressed in thousands of United States dollars]

	1996	1995
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 6,718	\$ 323
Cash held in escrow <i>[note 8]</i>	11,042	—
Accounts receivable <i>[note 2]</i>	3,218	2,607
Other receivables and prepaid expenses	2,233	1,317
Inventories	1,254	200
<b>Total current assets</b>	<b>24,465</b>	<b>4,447</b>
Capital assets, net <i>[note 4]</i>	23,564	9,988
Due from PRC parties <i>[note 5]</i>	19,637	14,737
Jiangxi Investments <i>[note 3(b)]</i>	1,918	2,342
Goodwill, net	34	35
	<b>69,618</b>	<b>31,549</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>Current</b>		
Accounts payable and accrued liabilities	681	655
Income taxes payable	1,862	—
Other payables	617	179
<b>Total current liabilities</b>	<b>3,160</b>	<b>834</b>
Convertible debenture <i>[note 6]</i>	3,000	—
<b>Total liabilities</b>	<b>6,160</b>	<b>834</b>
Non-controlling interests	20,607	17,026
<b>Shareholders' equity</b>		
Share capital <i>[note 7]</i>	6,874	6,151
Special warrants <i>[note 8]</i>	20,197	—
Retained earnings	15,521	7,364
Cumulative translation adjustment	259	174
<b>Total shareholders' equity</b>	<b>42,851</b>	<b>13,689</b>
	<b>69,618</b>	<b>31,549</b>

See accompanying notes.

On behalf of the Board:



Allen T.Y. Chan  
Director



John Thompson  
Director

# Consolidated Statements of Income and Retained Earnings

Years Ended December 31

[Expressed in thousands of United States dollars, except for earnings per share information]

	1996	1995
<b>Revenue</b>	\$ 32,428	\$ 27,423
<b>Costs and expenses</b>		
Cost of sales	13,976	15,191
Selling, general and administration	3,434	2,697
Depreciation, amortization and depletion	673	793
Research and development	412	—
	18,495	18,681
Income from operations	13,933	8,742
Equity in losses of Jiangxi Investments	(433)	(262)
Net interest expense [note 6]	(53)	(6)
Other income	49	20
Income before income taxes	13,496	8,494
Provision for income taxes – current [note 9]	1,855	—
Income before non-controlling interests	11,641	8,494
Non-controlling interests	3,484	4,140
<b>Net income for the year</b>	<b>8,157</b>	<b>4,354</b>
<b>Retained earnings, beginning of year</b>	<b>7,364</b>	<b>3,010</b>
<b>Retained earnings, end of year</b>	<b>15,521</b>	<b>7,364</b>
<b>Earnings per share [note 10]</b>		
Basic	\$0.19	\$0.12
Fully diluted	\$0.14	\$0.12

See accompanying notes.



# Consolidated Statements of Changes in Financial Position

Years Ended December 31

[Expressed in thousands of United States dollars]

	1996	1995
<b>OPERATING ACTIVITIES</b>		
Net income for the year	\$ 8,157	\$ 4,354
Add items not affecting cash		
Non-controlling interests	3,484	4,140
Depreciation, amortization and depletion	673	793
Equity in losses of Jiangxi Investments	433	262
	12,747	9,549
Net change in non-cash working capital balances	(255)	(1,822)
<b>Cash provided by operating activities</b>	<b>12,492</b>	<b>7,727</b>
<b>FINANCING ACTIVITIES</b>		
Issuance of special warrants, net	20,197	—
Issuance of convertible debenture	3,000	—
Issuance of share capital, net	723	830
<b>Cash provided by financing activities</b>	<b>23,920</b>	<b>830</b>
<b>INVESTING ACTIVITIES</b>		
Investment in capital assets	(14,249)	(547)
Cash held in escrow	(11,042)	—
Increase in amount due from PRC parties	(4,900)	(9,104)
Decrease in cash on reduction of equity interest in Jiangxi Investments [note 3(b)]	—	(675)
<b>Cash used in investing activities</b>	<b>(30,191)</b>	<b>(10,326)</b>
Effect of exchange rate changes on cash	174	125
<b>Net increase (decrease) in cash during the year</b>	<b>6,395</b>	<b>(1,644)</b>
Cash, beginning of year	323	1,967
<b>Cash, end of year</b>	<b>6,718</b>	<b>323</b>

See accompanying notes.

# Notes to Consolidated Financial Statements

December 31, 1996

[Tabular figures expressed in thousands of United States dollars,  
unless otherwise indicated.]

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## 1. SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements of Sino-Forest Corporation ["Sino-Forest" or the "Company"] have been prepared in United States dollars and in accordance with accounting principles generally accepted in Canada. The significant accounting policies are as follows:

### **Basis of consolidation**

These consolidated financial statements include the accounts of the Company and its subsidiaries, some of which have a minority interest. All significant intercompany accounts and transactions have been eliminated on consolidation.

The Company's investments in the Sino-foreign co-operative joint ventures [each a "PRC CJV", collectively, the "PRC CJVs"] are accounted for on the proportionate consolidation basis. Accordingly, the accounts reflect the Company's pro-rata share of the assets, liabilities, revenue, expenses and cash flows of its PRC CJVs.

The Company's investments in Sino-foreign equity joint ventures ["EJVs"] which are controlled by the Company are accounted for on the consolidation basis. Investments in Sino-foreign EJVs over which the Company exercises significant influence are accounted for under the equity method.

### **Translation of foreign currencies**

Foreign currency transactions and balances, and the financial statements of integrated foreign operations, are translated into United States dollars using the temporal method. Under this method, monetary items are translated at the rate of exchange in effect at the consolidated balance sheet dates. Non-monetary items are translated at the historical exchange rate. Revenue and expense items are translated at the average exchange rates prevailing during the year, except for depreciation, amortization and depletion which are translated at the same exchange rates as the assets to which they relate. Exchange gains and losses are included in income in the current year.

Financial statements of self-sustaining foreign operations are translated into United States dollars using the current rate method. Under this method, assets and liabilities denominated in the foreign currency are translated at the rate of exchange in effect at the consolidated balance sheet dates while revenue and expense items [including depreciation, amortization and depletion] are translated at the average exchange rates prevailing during the year. Exchange gains and losses from the translation of such financial statements are deferred and disclosed as a separate component of shareholders' equity.

### **Inventories**

Raw materials are valued at the lower of average cost of acquisition and replacement cost. Work-in-progress and finished goods are stated at the lower of cost and net realizable value.

### **Goodwill**

Goodwill is amortized over forty years on a straight-line basis.

### **Capital assets**

Timber holdings include planting, maintenance and harvesting costs which are capitalized over a period of 5 to 12 years based on the growth cycle of the type of trees. Timber holdings are depleted when the trees are harvested on the basis of the volume of timber cut.

Other capital assets are recorded at cost. Repairs and maintenance expenditures are charged to income; major betterments and replacements are capitalized. Depreciation and amortization are provided on a straight-line basis to reduce the original cost of capital assets to estimated residual values over the following estimated useful lives:

Land use rights and buildings	30 years
Machinery and equipment	15 years
Office furniture and equipment	10 years
Vehicles	10 years

### **Revenue recognition**

Revenue from sales of products is recognized upon shipment to customers. Commission income from wood chip sales is recognized as revenue when the wood chips are shipped. Other commission income is recognized as revenue when the services are rendered.

### **Research and development costs**

The Company expenses all research costs as incurred. Development costs are expensed in the year incurred unless a development project meets the criteria under generally accepted accounting principles for deferral and amortization. No amounts have been capitalized at this time.

## Notes to Consolidated Financial Statements

### 2. ACCOUNTS RECEIVABLE

The Company reviews its outstanding accounts receivable and records an allowance for doubtful accounts when accounts are determined to be uncollectible. On December 31, 1996 and 1995, no allowance had been recorded by the Company. Accounts receivable at the year end included \$3.0 million due from one customer [1995 - \$1.2 million].

### 3. OPERATIONS IN THE PEOPLE'S REPUBLIC OF CHINA ["PRC"]

The Company's principal activities in the PRC consist of tree plantation and wood chip operations and forestry chemical operations.

#### [a] Tree plantation and wood chip operations

##### *Leizhou EJV*

The Leizhou EJV carries on tree plantation activities and has wood chip production facilities. Leizhou EJV is 53% controlled by Sino-Wood Partners, Limited ["Sino-Wood"], a wholly-owned subsidiary of the Company.

Under the Leizhou EJV joint venture agreement, Sino-Wood is committed to provide \$5,300,000 in capital to acquire its 53% equity interest in the Leizhou EJV. The original agreement calls for an initial capital contribution of \$1,000,000 which was made in 1994 with the balance due in January 1996. During 1996, Sino-Wood's EJV partner, the Leizhou Forestry Bureau [the "LFB"], agreed to extend payment of the balance of the capital contribution to December 1996. No capital contribution was made in December 1996 as Sino-Wood has agreed with the LFB to settle its capital contribution to the Leizhou EJV concurrent with the settlement of amounts due to Leizhou EJV by the LFB referred to in note 5.

##### *PRC CJVs*

In 1995 the Company, through wholly-owned subsidiaries of Sino-Wood, entered into agreements to form five PRC CJVs. Under the terms of the agreements the CJV partners are required to provide the land use rights for up to 603,000 hectares of land for tree plantations. The land use rights are for a period of 50 years and the tree land plantations will be phased-in over a number of years. Sino-Wood's subsidiaries are responsible under the agreements for all planting, maintenance and harvesting costs incurred on the phased-in land. The subsidiaries are entitled under the agreements to 70% of the timber harvested on the phased-in land and the PRC CJV partners are entitled to the balance. The CJV partners retain ownership of the land use rights and therefore no value is assigned for accounting purposes to the CJV land use rights.

Sino-Wood's subsidiaries are committed to contribute an aggregate of \$14,200,000 of capital to the five PRC CJVs, of which \$2,130,000 was required to be made within three months from the respective dates of issue of business licenses to the PRC CJVs. As at December 31, 1996 capital contributions of \$1,945,000 had been made in total to the PRC CJVs. An amount of \$185,000 that was due in January 1996 has been withheld pending the satisfactory performance of one of the PRC CJV partners. The remaining capital contribution of \$12,070,000 is to be contributed as costs are incurred for planting, maintenance and harvesting of the tree plantations. The timing and amount of the remaining capital contributions is dependent on the phase-in of land for the tree plantations.

The major components of the Company's interests in the PRC CJVs for the year ended December 31, 1996 are as follows:

<b>Consolidated balance sheets</b>	
Current assets	\$ 1,917
Long-term assets	2,134
Current liabilities	(50)
Long-term liabilities	—
<b>Consolidated statements of income</b>	
Revenue	—
Costs and expenses	—
Net loss	—
<b>Consolidated statements of changes in financial position</b>	
Cash flow from operating activities	(700)
Cash flow from financing activities	4,001
Cash flow from investing activities	(2,134)



## Notes to Consolidated Financial Statements

As certain of the PRC CJVs only commenced commercial operations in late 1995, the Company's proportionate share of the financial position, operating results and cash flows were not significant for the year ended December 31, 1995.

### [b] Forestry chemical operations

Pursuant to memoranda of understanding signed between May 14, 1995 and June 28, 1995 [the "MOU Dates"] by Sino-Wood and each of its joint venture partners, the joint venture partners agreed that Sino-Wood would reduce its initial equity interest of 55% in each of its five forestry chemical EJVs [collectively, the "Jiangxi Investments"] to 30%. The parties also agreed in the memoranda of understanding to amend the joint venture agreements to change the composition of the board representation in line with the proposed change in equity interests and to reduce the requirement for further capital contribution commitments from \$14,045,000 to \$2,187,000.

According to the laws of the PRC on Joint Ventures using Chinese and Foreign Investment, any amendments to joint venture agreements, including amendments to equity interests, the timing and amounts of capital contributions and board representations, requires approval from the Department of Foreign Economic Relations and Trade of the PRC [the "FERT"]. A formal application to change the equity interests, composition of the board and the timing and amounts of remaining capital contributions was submitted to the FERT for approval on March 29, 1996.

Subsequent to the submission to the FERT, Sino-Wood has conducted discussions with its Jiangxi Investments' joint venture partners and the FERT to further restructure its Jiangxi Investments. Amendments to the memoranda of understanding will eliminate the requirement to make the capital contribution of \$2,187,000 by Sino-Wood to the Jiangxi Investments. The equity interest of Sino-Wood in the Jiangxi Investments will be reduced accordingly to reflect the amendments to the memoranda of understanding.

Based on discussions by Sino-Wood with the FERT and on the execution of memoranda of understanding with its Jiangxi Investments' joint venture partners, the Company does not anticipate any problems obtaining the approval required to implement the changes stated above. Accordingly, the Jiangxi Investments have been accounted for by the equity method as of the MOU Dates when effective control of these Jiangxi Investments was passed to the joint venture partners.

The carrying value of the Jiangxi Investments of \$2,547,000 as at the MOU Dates was transferred to long-term investments and consists of the following:

Cash	\$ 675
Other current assets	4,048
Capital assets, net	6,821
	11,544
Current liabilities	(633)
	10,911
Non-controlling interests	(8,364)
<b>Carrying value of Jiangxi Investments transferred to long-term investments</b>	<b>2,547</b>

## 4. CAPITAL ASSETS

Capital assets consist of the following:

	1996		1995	
	COST	ACCUMULATED DEPRECIATION, AMORTIZATION AND DEPLETION	COST	ACCUMULATED DEPRECIATION, AMORTIZATION AND DEPLETION
Timber holdings	\$17,367	\$ 1,635	\$ 3,506	\$ 1,270
Land use rights and buildings	7,782	805	7,658	545
Machinery and equipment	751	242	674	196
Office furniture and equipment	349	33	192	31
Vehicles	37	7	—	—
	26,286	2,722	12,030	2,042
Less accumulated depreciation, amortization and depletion	2,722		2,042	
<b>Net book value</b>	<b>23,564</b>		<b>9,988</b>	

## Notes to Consolidated Financial Statements

### 5. DUE FROM PRC PARTIES

The amounts due from PRC parties consist of the following:

	1996	1995
Due from Leizhou Forestry Bureau	\$ 14,992	\$ 14,009
Due from Guangxi Forestry Development Centre	4,519	663
Due from Jiangxi Forestry Economic & Technology Development Company ["JFE&TDC"]	126	65
	19,637	14,737

The above PRC parties are the joint venture partners of the Company's subsidiaries and joint ventures in the PRC. The amounts due are unsecured, non-interest bearing and have no fixed terms of repayment. The carrying value of the amounts due from PRC parties approximates their fair value.

The \$14,992,000 due from the LFB represents cash collected from the sale of wood chips on behalf of the Leizhou EJV. As originally agreed to by Sino-Wood, the cash was being retained by the LFB to fund the ongoing plantation costs of the Leizhou EJV incurred by the LFB. Sino-Wood and LFB have agreed that the amount due to the Leizhou EJV, after reduction for plantation costs incurred, will be settled in 1997 concurrent with the settlement of capital contributions due to the Leizhou EJV by Sino-Wood.

The amount due from Guangxi Forestry Development Centre represents commission income earned on wood chips trading during the year. A portion of the amount due will be used in 1997 to cover planting costs on phased-in lands.

### 6. CONVERTIBLE DEBENTURE

On January 15, 1996, Sino-Wood entered into a \$3,000,000 convertible loan agreement with Deutsche Bank A.G. of Hong Kong. The convertible loan agreement provides that from January 15, 1998 until repayment of the loan, the loan is convertible in minimum amounts of \$500,000 into Class A Subordinate-Voting Shares of Sino-Forest at the lower of:

- five times the fully diluted [including the shares issued on conversion] earnings of the Company for the previous fiscal year; or
- at a 40% discount to the average closing prices of the shares on The Toronto Stock Exchange for the five trading days preceding the conversion notice.

However, in no circumstances can the conversion price be less than \$0.4426 per share.

The loan is for a period of 5 years and may be called by the bank after four years. Interest is payable, at the option of Sino-Wood, either quarterly or semi-annually based on the three-month or six-month LIBOR U.S. dollar deposit rate plus 2%. As at December 31, 1996, the interest rate on the loan was 7.87%. The loan is guaranteed by Sino-Forest and is collateralized by a first fixed and floating charge on the assets of the Company. The carrying value of the debenture approximates its fair value.

Interest expense for the year amounted to approximately \$219,000.

### 7. SHARE CAPITAL

Share capital consists of the following:

	1996	1995
<b>Authorized</b>		
Unlimited Class A Subordinate-Voting Shares		
6,000,000 Class B Multiple-Voting Shares		
Unlimited Preference Shares, issuable in series		
<b>Issued</b>		
37,150,000 Class A Subordinate-Voting Shares [1995 - 35,500,000]	\$ 6,874	\$ 6,151
6,000,000 Class B Multiple-Voting Shares	—	—
	6,874	6,151

The legal stated capital of Sino-Forest's Class A Subordinate-Voting Shares differs from the carrying value reflected in these consolidated financial statements. The legal stated capital as at December 31, 1996 is Cdn. \$21,944,838 [1995 - Cdn. \$20,954,838].

## Notes to Consolidated Financial Statements

### Authorized

Except with respect to voting, dividends and the rights of conversion described below, each Class A Subordinate-Voting Share and each Class B Multiple-Voting Share have the same rights and are equal in all respects:

- each holder of Class A Subordinate-Voting Shares will be entitled to one vote per share whereas each holder of Class B Multiple-Voting Shares will be entitled to five votes per share;
- the Class A Subordinate-Voting Shares rank in priority to the Class B Multiple-Voting Shares as to the payment of dividends; however, no dividends shall be declared or paid on the Class B Multiple-Voting Shares in any fiscal year unless in that fiscal year dividends shall have been declared or paid on Class A Subordinate-Voting Shares in an amount per share at least equal to or equivalent to the amount of the dividend per share proposed to be declared or paid on Class B Multiple-Voting Shares;
- each holder of Class B Multiple-Voting Shares shall be entitled at any time and from time to time to have all or any part of the Class B Multiple-Voting Shares held converted into Class A Subordinate-Voting Shares on a share-for-share basis; and
- as a condition of the issue of any Class B Multiple-Voting Share, the registered holder will be required to execute a Coattail Agreement under which the holder will agree not to effect a transfer of any Class B Multiple-Voting Share unless such transfer is made in accordance with the terms thereof and is a Permitted Transfer, as defined in the provisions attaching to the Class B Multiple-Voting Shares.

The Preference Shares may from time to time be issued in one or more series, each series of which shall have the rights and other features fixed by the Board of Directors of the Company. The Preference Shares of each series shall rank equally with the Preference Shares of every other series with respect to priority in payment of dividends and return of capital in the event of the liquidation, dissolution or winding-up of the Company and have a preference over the Class A Subordinate-Voting and the Class B Multiple-Voting Shares.

The holders of Series A Preference Shares shall not be entitled to receive any dividends. Except as otherwise required by the Business Corporations Act (Ontario), the holders of the Series A Preference Shares shall not be entitled to receive notice of or to attend any meetings of shareholders of the Company or to vote at any such meeting.

The Company may at any time after March 31, 1996 redeem the issued Series A Preference Shares at a redemption price of Cdn. \$0.01 per share. Subject to certain conditions, each holder of a Series A Preference Share shall be entitled prior to March 31, 1996 to have all or any part of the Series A Preference Shares held converted into fully paid and non-assessable Class B Multiple-Voting Shares on a share-for-share basis.

### Changes in issued share capital

On September 22, 1995, Sino-Forest issued 2,000,000 Class A Subordinate-Voting Shares in a private placement for total net proceeds of \$830,000.

On April 18, 1996, options to purchase 1,650,000 Class A Subordinate-Voting Shares were exercised under the terms of the Company's stock option plan for total proceeds of \$723,000.

### Stock options

As at December 31, 1996, 6,431,000 options to purchase Class A Subordinate-Voting Shares of the Company at prices ranging from Cdn. \$0.55 per share to Cdn \$1.55 per share were outstanding to certain officers and directors of the Company and employees of Sino-Wood. 500,000 of these options expire in 1999 with the remaining 5,931,000 options expiring in 2001.

On September 30, 1996, the Board of Directors passed a resolution to increase the maximum number of shares which may be issued or reserved for issuance under the Company's stock option plan from 4,200,000 to 10,000,000, subject to the necessary shareholder and regulatory approvals. The exercise of 3,881,000 of the 6,431,000 outstanding options as at September 30, 1996 is subject to receipt of these approvals.

## 8. SPECIAL WARRANTS

The Company issued on October 2, 1996, 24,000,000 special warrants at Cdn. \$1.25 per special warrant for aggregate gross proceeds of Cdn. \$30,000,000. The net proceeds of the special warrants issue were \$20,197,000 after deducting issue costs of approximately \$1,826,000. The Company received half of the gross proceeds on October 2, 1996 and the balance was held in escrow pending the issue of receipts for a final prospectus. On December 31, 1996, the escrowed amounts were invested in government securities with maturities of less than 30 days bearing interest at 2.4% per annum. All receipts for a final prospectus were received in January 1997 and the 24,000,000 special warrants were converted into Class A Subordinate-Voting Shares on a one-for-one basis.

## Notes to Consolidated Financial Statements

The Company granted to certain of the special warrant underwriters brokers' special warrants to acquire non-assignable compensation options. The compensation options entitle the holders thereof to purchase an aggregate of 2,400,000 Class A Subordinate-Voting Shares at an exercise price of Cdn. \$1.44 for each Class A Subordinate-Voting Share at any time on or before October 2, 1998.

### 9. INCOME TAXES

The provision for income tax expense differs from that obtained by applying the statutory rates as a result of the following:

	1996	1995
Income before income taxes	\$ 13,496	\$ 8,494
Expected statutory rate	44.6%	44.3%
Expected income tax provision	6,019	3,763
Increase (decrease) in income taxes resulting from		
Unrecognized income tax losses	1,143	1,097
Income tax at different rates in foreign jurisdictions	(5,305)	(4,859)
Other	(2)	(1)
	1,855	—

The Leizhou EJV, the Jiangxi Investments and the PRC CJVs are governed by the Income Tax Laws of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws [the "Income Tax Laws"]. Pursuant to the Income Tax Laws, Sino-foreign equity and co-operative joint venture enterprises generally are subject to income tax at an effective rate of 33% [30% state income taxes plus 3% local income taxes] on income as reported in their statutory financial statements. The Company's PRC CJVs and the Leizhou EJV are eligible for an exemption from state and local income taxes for two years starting from the first profitable year of operations, followed by a 50% exemption for the next three years. The Leizhou EJV has completed three years of profitable operations.

No assessable profits were earned in or derived from Hong Kong by Sino-Wood during 1996 and 1995.

The Company has income tax losses of approximately \$1,171,000 which can be applied against future years' taxable income in Canada, the benefit of which has not been recorded in these consolidated financial statements. Approximately \$191,000 of these tax losses will expire in 2001, \$359,000 in 2002 and the remainder will expire in 2003.

### 10. EARNINGS PER SHARE

Earnings per share are calculated using the weighted average number of Class A Subordinate-Voting and Class B Multiple-Voting Shares outstanding during each year. The weighted average number of Class A Subordinate-Voting and Class B Multiple-Voting Shares outstanding were as follows:

	Weighted average	
	Basic	Fully diluted
December 31, 1996	42,666,301	58,461,760
December 31, 1995	35,894,521	36,594,521

### 11. RELATED PARTY TRANSACTIONS

- [a] Corporate management services and office facilities were provided during the year by two companies [1995 – one company] in which directors of Sino-Wood have an interest. These services were provided at an aggregate cost of approximately \$886,000 [1995 – \$487,000].
- [b] GTL Securities Inc. ["GTL"] participated as agent in assisting the Company in the raising of capital. A director of the Company is also a principal of GTL. Commissions paid to GTL amounted to approximately \$360,000 [1995 – \$26,000]. In addition GTL received 960,000 of the brokers' special warrants referred to in note 8.

GTL also provided the Company with investor relations and related consulting services during the year at a cost of approximately \$44,000 [1995 – \$44,000].



## Notes to Consolidated Financial Statements

### 12. SEGMENTED INFORMATION

	1996			1995		
	Wood chips	Other	Total	Wood chips	Other	Total
<b>BY INDUSTRY SEGMENT</b>						
<b>Revenue</b>						
Sales	23,050	1,175	24,225	23,949	1,525	25,474
Commission income	5,233	2,970	8,203	663	1,286	1,949
	<b>28,283</b>	<b>4,145</b>	<b>32,428</b>	<b>24,612</b>	<b>2,811</b>	<b>27,423</b>
Income from operations	10,865	3,068	13,933	7,924	818	8,742
Identifiable assets	64,730	4,888	69,618	26,369	5,180	31,549
Depreciation, amortization and depletion	673	—	673	619	174	793
Investment in capital assets	14,249	—	14,249	542	5	547

#### BY GEOGRAPHIC SEGMENT

The Company conducts substantially all of its operations in one geographic area, East Asia. During the year, export sales from the PRC amounted to approximately \$23,050,000 [1995 - \$22,878,000].

### 13. LEASE COMMITMENT

The Company's future annual commitment under operating leases is as follows:

<b>1997</b>	<b>163,000</b>
<b>1998</b>	<b>163,000</b>
<b>1999</b>	<b>135,000</b>
	<b>461,000</b>

### 14. COMPARATIVE FINANCIAL STATEMENTS

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the December 31, 1996 financial statements.

## Directors and Officers

### Directors

Allen T.Y. Chan<sup>(1)</sup>  
Chairman and Chief Executive Officer

K.K. Poon  
President

Kee Y. Wong, F.C.A.  
Senior Vice President,  
Corporate Development and  
Chief Financial Officer

Edmund Mak<sup>(1)</sup>  
Real Estate Marketing Executive,  
Royal LePage Real Estate Ltd.

John Thompson<sup>(1)</sup>  
Principal of Gornitzki, Thompson  
& Little

John (Jack) Lawrence<sup>(2)</sup>  
Chairman of Lawrence & Company

William Rosenfeld, Q.C.<sup>(2)</sup>  
Partner of Goodman Phillips &  
Vineberg

(1) Member of the Audit Committee

(2) Nominated to join the Board at the upcoming AGM.

### Officers

Allen T.Y. Chan  
Chairman and Chief Executive Officer

K.K. Poon  
President

Leslie Chan  
Executive Vice President

Kee Y. Wong, F.C.A.  
Senior Vice President, Corporate  
Development and Chief Financial  
Officer

Lawrence Hon  
Senior Vice President, Operations

## Corporate and Shareholder Information

### Auditors

Ernst & Young  
Ernst & Young Tower  
P.O. Box 251  
Toronto Dominion Centre  
Toronto, Ontario M5K 1J7

### Legal Counsel

Aird & Berlis  
BCE Place  
Suite 1800, Box 754  
181 Bay Street  
Toronto, Ontario M5J 2T9

### Common Shares

The Class A Subordinate-Voting Shares  
of the Company are listed on  
The Toronto Stock Exchange.

Stock Symbol: TRE.A

Registrar and Transfer Agent  
The R-M Trust Company  
393 University Avenue  
5th Floor  
Toronto, Ontario M5G 1E6

### Annual Shareholders' Meeting

Library Room  
Royal York Hotel  
100 Front Street West  
Toronto, Ontario M5J 1E3  
4:00 pm on Monday, 16th June, 1997

### Annual Report

Copies of this report are available from  
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