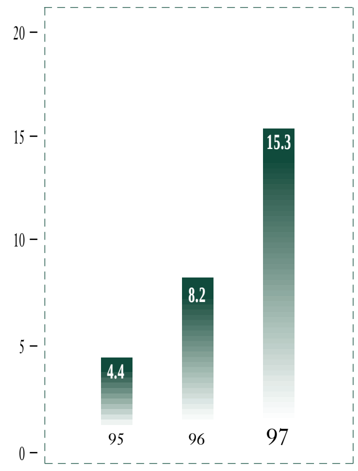
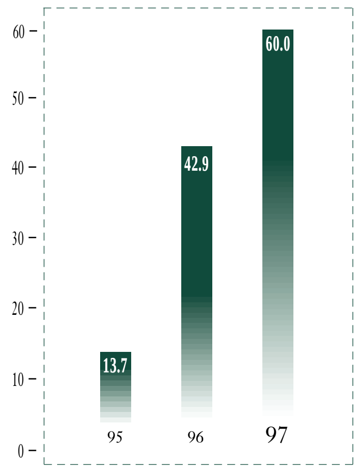
Revenue and Income (in thousands of U.S. dollars)	1997	1996	% change
Revenue	**$ 41,783**	$ 32,428	28.8%
Income from operations	**18,246**	13,933	31.0
Net income attributable to shareholders	**15,297**	8,157	87.5
Financial Position (in thousands of U.S. dollars)			
Working capital	**$ 13,582**	$ 21,305	(36.2)%
Total assets	**72,840**	69,618	4.6
Convertible debenture	**3,000**	3,000	–
Long-term debt	**3,710**	–	–
Non-controlling interests	**–**	20,607	–
Shareholders' equity	**60,012**	42,851	40.0
Per Share Information (in U.S. dollars except for number of shares)			
Basic earnings per Class A and Class B share	**$ 0.23**	$ 0.19	21.1%
Fully diluted earnings per Class A and Class B share	**0.19**	0.14	35.7
Shareholders' equity per Class A and Class B share	**0.82**	0.53	54.7
Class A Subordinate-Voting Shares outstanding			
– weighted average for the year	**59,718,000**	36,666,000	62.9
– at year end	**67,569,000**	37,150,000	81.9
Class B Multiple-Voting Shares outstanding			
– weighted average for the year	**6,000,000**	6,000,000	–
– at year end	**6,000,000**	6,000,000	–
Wood Chip Production (in bone dry metric tonnes)			
Export	**311,300**	346,400	(10.1)%
Domestic PRC market	**849,260**	246,400	244.7
Total	**1,160,560**	592,800	95.8

< NET EARNINGS >
(MILLIONS OF U.S. DOLLARS)



< SHAREHOLDERS' EQUITY >
(MILLIONS OF U.S. DOLLARS)



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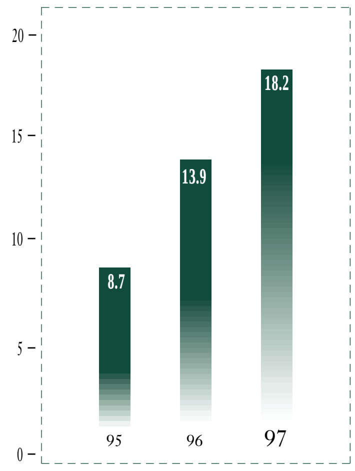
(MILLIONS OF U.S. DOLLARS)



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< REPORT TO SHAREHOLDERS >

< ALLEN T.Y. CHAN >

CHAIRMAN & CHIEF EXECUTIVE OFFICER

Sino-Forest Corporation ("Sino-Forest") has made significant progress and recorded strong growth since the Company began operations just three years ago. Last year, we continued to build on our achievements and we are pleased to report that 1997 was the most successful year in the history of Sino-Forest. Our revenues and profit climbed to record levels. We reached aggressive production goals, despite difficult economic conditions. We accelerated and expanded the phasing-in of the Company's plantation program. And we announced major, new initiatives to increase and broaden our revenue base.

One of the most important goals we reached in 1997 was the shipment of over one million Bone Dry Metric Tonnes (BDMT) of wood chips. We set this target two years ago and our shipments in 1997 represent an increase of 96 percent over 1996, when we shipped almost 600,000 BDMT, and an increase of 245 percent over 1995, when we shipped 336,700 BDMT. And in 1997, we not only reached our goal, we also reached an important milestone. The one million BDMT means that we are well on the way to reaching our near-term goal of producing and sustaining four million BDMT of wood chips a year. This will occur once the 603,000 hectares of plantation lands have been fully phased-in, a target we expect to reach in 2005. (This excludes the additional 200,000 hectares of plantation lands that were negotiated in November 1997 and which are subject to regulatory approvals.)

In 1997, Sino-Forest reported net income of $15.3 million or $0.23 per share, an increase of 87 percent from 1996's net income of $8.2 million or $0.19 per share. The primary reason net income grew was the significant increase in the shipment of wood chips, itself the result of the Company's continuing ability to meet its phasing-in targets for the contracted plantation lands.

Revenue for 1997 also grew significantly, to $41.8 million, or 29 percent more than in 1996. One reason revenue increased was the dynamic growth in the Company's shipments in 1997. A second reason was the Company's decision to begin acting as principal on certain contracts. The Company expects to act as principal rather than agent on most of its shipments over the next three years.

During the year, the Company expanded its plantation lands under contract when it signed new agreements with local forestry bureaus in the provinces of Fujian and Hainan. The agreements will enable Sino-Forest to increase its plantation lands by 100,000 hectares in each province, on similar terms and conditions as the Co-operative Joint Ventures (CJVs) already established in the provinces of Guangxi, Guangdong, and Jiangxi.

Sino-Forest phased-in an additional 43,000 hectares to its plantation program in 1997. The Company has now phased-in a total of 61,000 hectares, or 10 percent of the 603,000 hectares under its management. Our goal is to have the 603,000 hectares fully phased-in by 2005.

Our results are especially gratifying in light of what was a trying and difficult year for most of our Asian export markets. Bankruptcies, currency devaluations and over-extended credit combined to cause severe economic problems for some countries in the region. Fortunately, Sino-Forest does not export to the hardest-hit countries such as Indonesia, Thailand, Malaysia and Philippines. Japan, whose economy continued to underperform in 1997, still commands a significant total of our export wood chips, approximately 42 percent.

Intervention by the International Monetary Fund (IMF) in certain countries mitigated the impact of the economic crisis in the region. At the same time, the IMF advanced a recovery plan and imposed stringent economic measures on these countries. Sino-Forest is confident that the economic outlook in the region will improve during the latter part of 1998, and Asia will come out of this economic crisis stronger.

While exports to Japan as a percentage of total shipments declined, shipments to the People's Republic of China (PRC) increased substantially, to 849,000 BDMT in 1997, compared to 246,000 in 1996. This was a pivotal development, indicating that the Company has captured a large market share in the growing domestic PRC market.

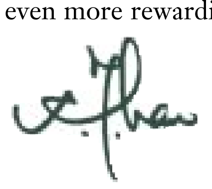
Strong growth in Gross Domestic Product, as well as steady growth in its population and literacy rates, were the main reasons that the PRC established itself as the leading market for Sino-Forest's wood chips. The Company believes that the Chinese economy is dynamic and strong, and that demographic and structural changes will make it even stronger in the years ahead. As a result, the Company believes that demand for wood chips will remain strong going forward and that its shipments to the PRC will grow significantly.

Over the years, Sino-Forest has grown to become a fully integrated producer of wood chips. Going forward, we intend to grow even more, by becoming vertically integrated and diversifying our revenue base. We took our first step last year by establishing Sino-Panel Corporation to pursue certain projects in the wood-based panel and contract supply businesses. We will continue to identify opportunities in the PRC that will provide value-added development for Sino-Forest's plantation base.

At Sino-Forest, we take pride in our research and development. Last year, our efforts were rewarded when a leading international wood products research institute, Forintek Canada, established that Sino-Forest's Italian Poplar wood chips are of premium quality and superior to most others on the market. In its testing, Forintek concluded that Sino-Forest's Italian Poplar has certain qualities that allow OSB (Oriented Strand Board) and MDF (Medium Density Fibreboard) manufacturers to produce boards from fewer chips, and at lower costs. These reports are encouraging and open up new markets and industries for our wood chips. Currently, our wood chips are sold only to pulp and paper manufacturers.

As we look back on 1997, we see a year of significant growth. And as we look ahead to 1998, we are focused more than ever on sustaining and accelerating that growth. Sino-Forest's goal is to become a major forestry company in Asia and in 1998, we are confident that we will take major steps to achieving that goal. We are confident as well that we will continue our strong financial performance and maintain our record of delivering and increasing value for our shareholders.

In closing, we would like to thank our shareholders for their continued support in 1997. We also recognize the key role that each director and employee played in our achievements last year, and we thank each one of you for your contribution. We are confident that 1998 will be even more rewarding for us all.



ALLEN T. Y. CHAN
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
MAY 4, 1998

< K.K. POON >

PRESIDENT

The Asian financial turmoil of last year demonstrated the real strength of China's economy. This year, change of leadership marks a new epoch in China's economic development. Geared with our positional advantage and the support from the Chinese community, Sino-Forest Corporation is poised to create opportunities for more diversified and higher-value utilisation of our plantation resources.

KAI KIT POON
PRESIDENT

MAY 4, 1998

疾风方知草劲，去年的亚洲金融风暴证明了中国的经济实力，而今年领导层的改变则揭开了中国经济发展的新一页。吾等地利人和，正好乘此天时，为嘉汉林木资源创造更多元化、更高价值的利用机会。

志诚

潘家杰

九八.四

IN THE SERIES OF QUESTIONS AND ANSWERS BELOW,
CHAIRMAN ALLEN T.Y. CHAN ELABORATES ON SINO-FOREST'S
ACHIEVEMENTS LAST YEAR AND ITS PLANS AND GOALS FOR THE YEAR AHEAD.

> 1. WHAT WAS SINO-FOREST'S MOST IMPORTANT ACHIEVEMENT IN 1997?

Our most important achievement was that we met, and in fact exceeded, our target of phasing-in the contracted plantation lands to produce over 1,000,000 BDMT (bone dry metric tonnes) of wood chips. Our initial target was to ship 1,000,000 BDMT of wood chips in 1997. I am pleased to say that we actually shipped 1,160,560 BDMT, which is 16 percent over budget and a 96 percent increase over last year. As at December 31, 1997, we had phased-in a total of approximately 61,000 hectares of plantation land, or approximately 10% of the total contracted plantation land. This compares to 6% or 37,600 hectares in 1996. This is a major accomplishment, especially when one considers the large increase in production in 1997 and the different steps in our operation – selecting the land to be phased-in, harvesting, chipping, winning new customers and market share, and replanting. Careful planning and numerous details are involved to ensure that growth is managed effectively.

> 2. WHAT WERE SOME OTHER MILESTONES YOU REACHED IN 1997?

There were three. First, we were able to secure chipping plant capacity to process our timber. Under agreements with chipping plant operators, the Company has until December 31, 1999 to acquire equity interests in these facilities and the right to process up to 1.8 million BDMT of wood chips. This arrangement ensures that we will have the chipping capacity to meet our production targets in 1998 and 1999.

Second, we increased our total contracted plantation land by almost one-third – 200,000 hectares. We signed agreements with the local forestry bureaus in the provinces of Fujian and Hainan to form CJVs on similar terms and conditions as our existing CJVs. Acquiring this contractual plantation land is very important to our longer-term plan of having a CJV in every province in southern China.

Third, we established a new venture, Sino-Panel, to pursue certain projects in the wood-based panel and contract supply businesses. This new venture is part of the Company's strategy of finding value-added uses for our wood fibre in an industry expected to have phenomenal growth over the next decade. Sino-Panel marks a major step in our goal to becoming vertically integrated.

Sino-Forest has come a long way since its inception in 1994 and I believe the Company is now uniquely positioned to capitalize on the many opportunities in the forestry industry in China.

> 3. What are your main goals for 1998?

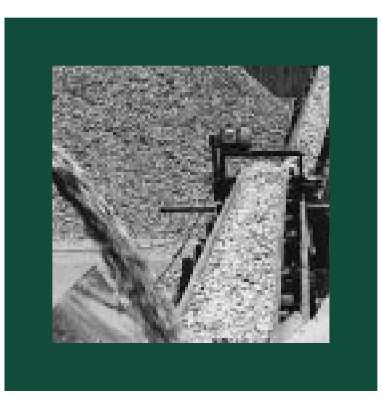
Our most important goal for 1998 is to ensure that our plantation program continues to remain on target and that the logistics are in place to meet the planned yearly increase in production. We also have to continue to find new customers and increase our market share for wood chips both in the PRC and export markets.

Another important goal for 1998 is to ensure that any businesses Sino-Panel establishes in 1998 and 1999 are set up according to plan and budget. These wood-based businesses are very promising and complement our plantation business. Most importantly, these businesses are expected to be very lucrative, and that will have a very positive impact on Sino-Forest's overall performance.

Finally, we will need to implement better logistical and monitoring systems to manage our new businesses and expected growth in 1998.

> 4. The domestic PRC market has become Sino-Forest's largest market in 1997. Why?

We knew from the very beginning that the PRC will be our largest market and it should be. China's economy is growing faster than any other country's, and with a population of 1.3 billion people, it is the largest market in the world for our fibre. China is also the country and market we know best and where we have most of our operations. Other than making sure that we command a significant market share in the PRC, we also want to make sure that we continue to sell our products to export markets. Our goal is to maintain a healthy 20% to 30% of our total shipments for export sales on an ongoing basis.



> 5. What made you decide to go into the particle board and wood product businesses?

As I said earlier, we are committed to finding value-added products for our wood chips. Our plan is to find ways to move Sino-Forest's fibre higher up the supply chain, to higher end, manufactured

products. These value-added products are part of our plan to become vertically integrated and will expand our revenue base and ultimately increase the bottom line.

The demand for particle board in China has been growing rapidly since 1980, when China started its economic reform. The strong growth in particle board consumption is expected to continue over the next decade, primarily driven by the expansion and modernization of the Chinese furniture industry. The particle board industry in China currently is very fragmented, consisting of a large number of small-scale producers using older technology and non-wood fibre. There are approximately 240 particle board mills in China, and only 15 have a capacity of 50,000 m3/annum each, while only two have a capacity of over 50,000 m3/annum each. The largest existing particle board mill is a 100,000 m3/annum mill located in northern China. The particle board mill to be constructed in Gaoyao, in the province of Guangdong in southern China, will have a rated capacity of 100,000 m3/annum with lamination capability. This mill will strongly position Sino-Forest to enter the fast growing particle board industry in China.

> 6. What are the market risks in the PRC?

As China continues its economic reform, we believe the demand for wood chips and wood-based panel products will continue to grow. I am not that concerned about demand for our fibre, but rather I'm more concerned about prices. Prices are lower, but our domestic sales have not been significantly affected, as domestic demand is still strong. The economy in China is fundamentally strong and I believe the economic challenges ahead will be managed soundly by the new Premier of China. Our risk is not so much about the Chinese economy but rather the risk of losing good business opportunities to others if we don't seize these opportunities at the right time.

> 7. You are optimistic about Sino-Forest's prospects. Why?

Despite the economic and currency crises experienced in parts of Asia, I remain very optimistic about our business for the coming year, particularly in China. China has weathered the recent economic storm in Asia very well. It is one of the few countries that did not submit to international pressure to devalue its currency. China is projected to have an average growth rate of over 9 percent per year over the next five years, ranking it number one in forecasted real economic growth compared to 50 of the world's largest economies. I believe the economic reforms which China has initiated will be even more impressive over the next 10 years. We have the operating skills set to manage and grow our businesses in China and we certainly know how to structure a "win win" joint venture with the Chinese, which is an important aspect of our success in the plantation business.

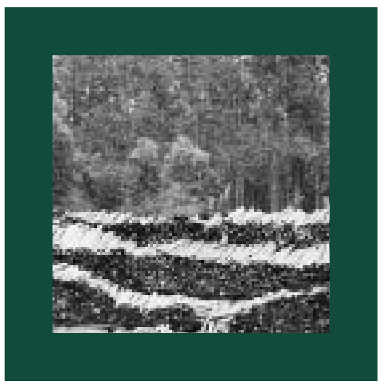
> 8. WHAT ABOUT THE SOFTENING OF THE OTHER ASIAN ECONOMIES IN 1997?

We do not do business in Thailand, Indonesia and other South-East Asian countries that were affected by the recent economic downturn. Exports to South Korea are expected to be weak in 1998. However, our exports to South Korea have never been a very significant percentage of our total export shipments. Exports to Japan and Taiwan represent over 85% of our total export shipments in 1997 and they have remained the biggest markets for our export sales.

> 9. ARE YOU CONSIDERING EXPORTING TO NORTH AMERICA OR TO EUROPE?

We want to be a major player in the forestry industry in Asia and in my view the opportunities in Asia are still better than in North America or Europe. There is no compelling business reason for us to focus on North America or Europe at this point. However, if an opportunity arises and it makes business sense to export to North America or Europe, we will not rule it out.

> 10. WHAT IS THE OUTLOOK FOR WOOD CHIP PRICES IN 1998?



We believe wood chip prices in China, net of VAT, will remain at the 1997 level of $103 per BDMT. For the export market, the average price in 1997, net of VAT, was $98 per BDMT. We believe the pulp market will reach the bottom of the cycle before the end of the third quarter of 1998 and that some improvements in prices can be expected in the latter part of the year.

REVIEW OF OPERATING RESULTS

[ALL AMOUNTS ARE EXPRESSED IN U.S. DOLLARS, UNLESS OTHERWISE INDICATED]

A summary of the results of operations of the Company by segment for the years ended December 31, 1997 and 1996 is as follows:

	Year Ended December 31, 1997			Year Ended December 31, 1996		
[THOUSANDS OF U.S. DOLLARS]	Wood Chips $	Wood-Based & Other $	Total $	Wood Chips $	Wood-Based & Other $	Total $
Revenue						
Sales	21,735	1,800	23,535	23,050	1,175	24,225
Commission income	14,688	3,560	18,248	5,233	2,970	8,203
	36,423	5,360	41,783	28,283	4,145	32,428
Net income	**12,019**	**3,278**	**15,297**	**5,526**	**2,631**	**8,157**

Sino-Forest recorded net income of $15.3 million for the year ended December 31, 1997, an increase of 87% compared to net income of $8.2 million for 1996. Earnings per share on a fully diluted basis increased 36% to $0.19 per share compared to $0.14 per share attained in 1996. Net income for the wood chip operations increased by 117% from $5.5 million in 1996 to $12.0 million in 1997. Net income from other business (primarily lumber trading commission income) increased by approximately 25% to $3.3 million compared to $2.6 million in 1996. The significant increase in earnings on the wood chip operations is attributable to the increase in wood chip shipments in 1997 which is in line with the Company's planned phase-in of the contractual plantation land. Trading in the lumber business has also increased marginally from $3.0 million in 1996 to $3.6 million in 1997. Other sales of $1.8 million in 1997 relate to revenue generated on building materials trading in the fourth quarter of 1997 which is part of the wood-based panel operations to be pursued by Sino-Panel Corporation ("Sino-Panel"), as explained below. Other sales in 1996 relate to miscellaneous sales generated from Leizhou EJV, which had ceased operations in 1997 as explained below.

The average price of wood chips, net of VAT, in 1997 has decreased marginally to $101 per BDMT from $102 per BDMT attained in 1996. Continuing strong demand for wood chips in 1997 in the domestic PRC market helped strengthen the 1997 average price. The average price of wood chips in 1997 in the domestic PRC market was $103 per BDMT compared to $98 per BDMT attained on export sales. With respect to sales in which the Company acted as an agent, the Company earned an average of $15.70 per BDMT in 1997 compared to $13.76 per BDMT earned in 1996.

In 1997, wood chip shipments totaled 1,160,560 BDMT compared to 592,800 BDMT shipped in 1996, an increase of approximately 96%. Of the total wood chips shipped in 1997, 311,300 BDMT were exported to Japan, South Korea and Taiwan and 849,260 BDMT were sold in the domestic PRC market. For the year ended December 31, 1997, the Company acted as principal on 184,400 BDMT and as an agent on 931,160 BDMT. Wood chip shipments from Leizhou EJV in 1997 were 45,000 BDMT compared to the 212,500 BDMT shipped in 1996. The decrease was due to the decision to restructure Leizhou EJV, which was completed in the fourth quarter of 1997 as explained below. As a result of this decision, wood chip orders which could have been shipped by the Leizhou EJV were filled by the Heyuan CJV and the Guangxi CJV partner which together reported a 193% increase in shipments from 380,300 BDMT in 1996 to 1,115,560 BDMT in 1997. Export shipments have decreased approximately 10% from 346,400 BDMT in 1996 to 311,300 BDMT in 1997 as a result of the continuing weak economy in Japan and the economic downturn in Asia. Demand for wood chips in China remains strong and was the reason for the significant increase in shipments from 246,400 BDMT in 1996 to 849,260 BDMT in 1997, an increase of 245%.

A summary of the wood chip shipments from Leizhou EJV and the CJVs for the year ended December 31, 1997 compared to 1996 is set out in the table below:

year ended december 31	Wood Chip Shipments							
	Heyuan CJV		Guangxi CJV		Leizhou EJV		Total	
[thousands of BDMT]	1997	1996	1997	1996	1997	1996	1997	1996
Export	–	–	266.3	133.9	45.0	212.5	311.3	346.4
PRC domestic	184.4	–	664.9	246.4	–	–	849.3	246.4
Total	**184.4**	**–**	**931.2**	**380.3**	**45.0**	**212.5**	**1,160.6**	**592.8**

Wood-Based Panel and Contract Supply

The Company is in the process of establishing wood-based panel manufacturing and contract supply businesses for the sale of value-added wood products in China. These new operations will be carried out through subsidiaries of Sino-Panel, a wholly-owned subsidiary of Sino-Forest incorporated in November 1997. As at December 31, 1997, the Company has incurred $9.4 million with respect to the construction of the particle board mill in the city of Gaoyao, Guangdong Province. The Company is currently in discussion with interested parties with respect to the funding of certain projects of its wood-based operations.

To establish strategic partnerships with key local wood product suppliers and to build a strong distribution network for the wood-based product and contract supply businesses, the Company has acquired a 20% equity interest in Shanghai Jin Xiang Timber Ltd. ("SJXT"), an EJV that was formed in 1997 by the Ministry of Forestry in China. The operation of SJXT is to organize and manage the first and only official market for timber and log trading in eastern China. The investment in SJXT will provide the Company good accessibility to a large base of potential customers and companies in the timber and log businesses in eastern China. The total investment of SJXT is estimated to be $9,662,000 (RMB80 million) of which the Company will be required to contribute approximately $1,932,000 for 20% of the equity interest. As at December 31, 1997, the Company has made capital contributions to SJXT in the amount of $1,037,000.

LEIZHOU EJV

As part of the Company's strategy to operate and manage its plantation business under the preferred CJV structure, the Company entered into an agreement with the Leizhou Forestry Bureau ("LFB"), its partner in the Leizhou EJV, to cease operations and distribute the net assets of the Leizhou EJV according to their respective equity interests. The Company's share of the net assets of the Leizhou EJV, as at the effective date of the partners' withdrawal of their equity interests, October 1, 1997, amounted to $12.4 million. As part of the agreement with the LFB, the LFB agreed to exchange the Company's interest in the net assets of the Leizhou EJV for 730,440 cubic meters of standing timber owned by the LFB. The standing timber is to be provided by the LFB to the Company over a three-year period as required by the Company. The Company is responsible for harvesting and transportation costs. The remaining capital contribution of $4.3 million, which was due to the Leizhou EJV, was also settled as a result of the agreement with the LFB. The Company is in discussions with a potential new partner in the Leizhou region to establish a new CJV on a similar basis to its existing CJVs.

LIQUIDITY AND CAPITAL RESOURCES

Cash generated from operations in 1997 was $20.4 million which, together with the cash released from escrow of $11.0 million and cash on hand of $6.7 million, was sufficient to finance investment in capital assets of $25.5 million which included EJV and CJV plantation costs and other capital expenditures. In 1997, approximately $2.2 million was also spent on deposits for chipping plants, and approximately $1.0 million on an investment in SJXT as explained above.

Included in other capital expenditures were costs of $9.4 million incurred for the purchase of machinery and equipment and other related costs for the construction of the particleboard mills. The Company has arranged a credit facility of $4.5 million from the Finnish Export Credit Ltd. during the year with respect to the purchase of machinery and equipment for the particleboard mills. As at December 31, 1997, $3.7 million had been drawn down under the facility. Interest on the loans is LIBOR plus 0.625%. The loans are repayable in ten equal consecutive semi-annual instalments commencing on June 15, 1999.

As at December 31, 1997, the Company had cash of $5.7 million and approximately $5.0 million available under its credit facility with the Deutsche Bank. As at December 31, 1997, the Company's total debt was $6.7 million, compared with $3.0 million at the 1996 year-end. Subsequent to the year end, the $3.0 million convertible debenture from the Deutsche Bank was converted into equity of the Company in accordance with the terms of the loan agreement. On December 31, 1997, the Company's debt to equity ratio was 0.11:1, compared with 0.07:1 at the end of 1996.

CJVs Capital Contribution Commitments

The Company's subsidiaries are committed to contribute an aggregate of $14,200,000 of capital to the five existing CJVs. As at December 31, 1997, capital contributions of $7,777,000 had been made. The remaining capital contributions of $6,423,000 are 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.

In November 1997, the Company signed agreements with the local forestry bureaus of the Fujian Province and the Hainan Province to increase its plantation lands by 100,000 hectares in each of the provinces, on similar terms and conditions as its existing CJVs. The total capital contributions to be made by the Company's subsidiaries to these two new CJVs will amount to $10,000,000 in total, of which $1,500,000, representing 15% of the total capital contributions, is required to be made within three months of the respective dates of issue of business licenses to these CJVs. As at December 31, 1997, no capital contributions had been made by the Company's subsidiaries as the business licenses of these two new CJVs had not yet been issued.

YEAR 2000 COMPUTER ISSUE

Certain computer programs and microprocessors use two digits to specify the year, rather than four. Any computer programs that have date-sensitive software and microprocessors may recognize a date using "00" as the year 1900 rather than the year 2000. This could cause many computer applications to fail or to create erroneous results unless corrective measures are taken before the year 2000. The Company currently utilizes software and related computer technologies that are largely stand-alone standard software packages. Accordingly, management believes that the Year 2000 Computer Issue will not have a material adverse impact on the Company's operations or financial conditions. However, with the establishment of the wood-based panel and contract supply businesses in 1998, the Company may need to upgrade or implement new computer systems before the year 2000. Any new computer systems that the Company may install will take this computer issue into consideration. The Company is currently assessing whether it will be impacted by computer programs that are employed by its suppliers and customers. Management believes that the nature of the transactions it currently conducts with its suppliers and customers, are not heavily dependent on computer programs and accordingly, should not have a material adverse impact on the Company's operations.

OUTLOOK

The demand for wood chips in the domestic PRC market is expected to remain strong as a result of the continued economic growth in China. Over the next five years, China is expected to have an average growth rate of over 9%. According to a recent economic outlook report issued by the RT Global Investment Group, part of the Royal Trust, China is ranked number one in forecasted real economic growth over the next five years compared to 50 of the world's largest economies. Paper and board consumption in China will continue to increase mainly due to population growth, increasing literacy rates and the conversion of non-wood pulp to traditional wood pulp. Supply of wood chips in China over the next decade is expected to lag behind the projected strong growth in demand for wood chips. With its continued acceleration of the planned phase-in of its plantation lands, Sino-Forest will be well positioned to fill this expected increase in demand for wood chips in China. With respect to the sale of wood chips in the export market, the Company believes that the pulp market will reach the bottom of the cycle before the end of the third quarter of 1998. Some improvements in prices from Japan are expected in the latter part of the year.

The consolidated financial statements contained in this Annual Report have been prepared by management in accordance with generally accepted accounting principles. The financial information contained elsewhere in the Annual Report is consistent with the consolidated financial statements.

Management maintains systems of internal accounting and administrative controls to provide reasonable assurance as to the reliability of the financial records and the safeguarding of the Company's assets.

The Audit Committee, which is mainly comprised of outside directors, meets periodically with management to discuss the adequacy of the system of internal controls and the integrity of the Company's financial reporting.

The consolidated financial statements have been reviewed by the Audit Committee prior to submission to the Board of Directors. The consolidated financial statements have also been audited by Ernst & Young, who have full access to the Audit Committee with and without the presence of management to discuss the scope of their audit, the adequacy of the system of internal controls and the adequacy of financial reporting.

ALLEN T. Y. CHAN
CHAIRMAN AND
CHIEF EXECUTIVE OFFICER

KEE Y. WONG, F.C.A.
EXECUTIVE VICE PRESIDENT AND
CHIEF FINANCIAL OFFICER

MAY 4, 1998

To the Shareholders of
Sino-Forest Corporation

We have audited the consolidated balance sheets of Sino-Forest Corporation as at December 31, 1997 and 1996, 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, 1997 and 1996, 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.

Ernst & Young
CHARTERED ACCOUNTANTS

TORONTO, CANADA
MAY 4, 1998

[Expressed in thousands of U.S. dollars] As at December 31	1997 $	1996 $
ASSETS		
Current		
Cash	**5,683**	6,718
Cash held in escrow *[note 9]*	**–**	11,042
Accounts receivable *[note 2]*	**4,037**	3,218
Other receivables and prepaid expenses	**2,337**	2,233
Due from PRC CJV partners *[note 6]*	**7,634**	–
Inventories	**9**	1,254
Total current assets	**19,700**	24,465
Capital assets, net *[note 4]*	**48,320**	23,564
Deposits *[note 5]*	**2,250**	–
Jiangxi Investments *[note 3(c)]*	**1,500**	2,044
SJXT Investment *[note 3(b)]*	**1,037**	–
Goodwill, net	**33**	34
Due from LFB *[note 3(a)]*	**–**	14,992
Due from PRC CJV partners *[note 6]*	**–**	4,519
	72,840	69,618
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Accounts payable and accrued liabilities *[note 7(b)]*	**4,134**	1,298
Income taxes payable	**1,984**	1,862
Total current liabilities	**6,118**	3,160
Convertible debenture *[note 7(a)]*	**3,000**	3,000
Long-term debt *[note 8]*	**3,710**	–
Total liabilities	**12,828**	6,160
Non-controlling interests *[note 3(a)]*	**–**	20,607
Commitments *[notes 3 and 14]*		
Shareholders' equity		
Share capital *[note 9]*	**29,302**	6,874
Special warrants *[note 9]*	**–**	20,197
Retained earnings	**30,818**	15,521
Cumulative translation adjustment	**(108)**	259
Total shareholders' equity	**60,012**	42,851
	72,840	69,618

See accompanying notes

On behalf of the Board:

Allen T. Y. Chan
Director

William Rosenfeld
Director

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

[Expressed in thousands of U.S. dollars, except for earnings per share information] Years ended December 31	1997 $	1996 $
Revenue	**41,783**	32,428
Costs and expenses		
Cost of sales	**17,401**	13,976
Selling, general and administration	**5,068**	3,434
Depreciation, amortization and depletion	**717**	673
Research and development	**351**	412
	23,537	18,495
Income from operations	**18,246**	13,933
Equity in losses of Jiangxi Investments	**(418)**	(433)
Net interest income (expense) *[note 8]*	**64**	(53)
Other income (expense)	**(140)**	49
Income before income taxes	**17,752**	13,496
Provision for income taxes - current *[note 10]*	**1,849**	1,855
Income before non-controlling interests	**15,903**	11,641
Non-controlling interests	**606**	3,484
Net income for the year	**15,297**	8,157
Retained earnings, beginning of year	**15,521**	7,364
Retained earnings, end of year	**30,818**	15,521
Earnings per shares *[notes 7(a) and 11]*		
Basic	**0.23**	0.19
Fully diluted	**0.19**	0.14

See accompanying notes

[Expressed in thousands of U.S. dollars] Years ended December 31	1997 $	1996 $
OPERATING ACTIVITIES		
Net income for the year	**15,297**	8,157
Add items not affecting cash		
Depreciation, amortization and depletion	**717**	673
Non-controlling interests	**606**	3,484
Equity in losses of Jiangxi Investments	**418**	433
	17,038	12,747
Net change in non-cash working capital balances	**3,406**	(316)
Cash provided by operating activities	**20,444**	12,431
FINANCING ACTIVITIES		
Issuance of share capital, net	**22,428**	723
Issuance (conversion) of special warrants, net	**(20,197)**	20,197
Issuance of long-term debt	**3,710**	–
Issuance of convertible debentures	–	3,000
Cash provided by financing activities	**5,941**	23,920
INVESTING ACTIVITIES		
Investment in capital assets	**(25,472)**	(14,249)
Distribution of non-controlling interest in Leizhou EJV	**(21,213)**	–
Decrease (increase) in amount due from LFB	**14,992**	(983)
Increase in amount due from PRC CJV partners	**(3,115)**	(3,856)
Cash released from (held in) escrow	**11,042**	(11,042)
Deposits	**(2,250)**	–
Investment in SJXT	**(1,037)**	–
Cash used in investing activities	**(27,053)**	(30,130)
Effect of exchange rate changes on cash	**(367)**	174
Net increase (decrease) in cash during the year	**(1,035)**	6,395
Cash, beginning of year	**6,718**	323
Cash, end of year	**5,683**	6,718

See accompanying notes

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 had a minority interest. All significant inter-company accounts and transactions have been eliminated on consolidation.

The Company's investments in 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 equity joint ventures ["EJVs"] which are controlled by the Company are accounted for on the consolidation basis. Investments in 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 acquisition costs for young trees, 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 including interest capitalized on assets under construction. 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 the sale 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.

Income Taxes

The Company follows the deferral method of accounting for income taxes. Under this method, timing differences between accounting and taxable income result in deferred income taxes.

2. ACCOUNTS RECEIVABLE

The Company reviews its outstanding accounts receivable and records an allowance for doubtful accounts when accounts are determined to be uncollectible. At December 31, 1997 and 1996, no allowance had been recorded by the Company. Accounts receivable at the year end included $2.9 million due from one customer [1996 - $3.0 million]. The fair value of accounts receivable approximates their carrying value.

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

The Company's principal forest products activities in the PRC consist of tree plantation and wood chip operations and forestry chemical operations. The Company is in the process of establishing wood-based panel manufacturing and contract supply businesses for the sale of value-added wood products in China. These operations will be carried out through subsidiaries of Sino-Panel Corporation ["Sino-Panel"], a wholly-owned subsidiary of the Company incorporated in November, 1997.

[a] Tree plantation and wood chip operations

PRC CJVs

In 1995, the Company, through wholly-owned subsidiaries of Sino-Wood Partners, Limited ["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 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. 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. As at December 31, 1997, the initial capital contributions of $2,130,000 had been made in total by Sino-Wood's subsidiaries to the PRC CJVs. Costs incurred for planting, maintenance and harvesting of the PRC CJVs' tree plantations to December 31, 1997 amounted to $5,647,000. Accordingly, the remaining capital contribution required with respect to these five PRC CJVs as at December 31, 1997 is $6,423,000.

The major components of the Company's interests in these five PRC CJVs are as follows:

	1997 $	1996 $
CONSOLIDATED BALANCE SHEETS		
Current assets	**1,376**	1,917
Long-term assets	**10,740**	2,134
Current liabilities	**(616)**	(50)
Long-term liabilities	**–**	–
CONSOLIDATED STATEMENTS OF INCOME		
Revenue	**16,138**	–
Costs and expenses	**12,428**	–
Net income	**3,710**	–
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION		
Cash flow from operating activities	**3,422**	(700)
Cash flow from financing activities	**4,290**	4,001
Cash flow from investing activities	**(8,606)**	(2,134)

In November 1997, the Company signed agreements with the local forestry bureaus of the Fujian Province and the Hainan Province to increase its plantation lands by 100,000 hectares in each of the provinces on similar terms and conditions as its existing PRC CJVs. The total capital contributions to be made by the Company's subsidiaries to these two new PRC CJVs will amount to $10,000,000 of which $1,500,000, representing 15% of the total capital contributions, is required to be made within three months of the respective dates of issue of business licenses to these PRC CJVs. As at December 31, 1997, no capital contributions had been made by the Company's subsidiaries as the business licenses of these two new PRC CJVs had not yet been issued.

LEIZHOU EJV

The Company held until October 1, 1997, a 53% equity interest in the Leizhou EJV which carried on tree plantation activities and had wood chip production facilities. In the fourth quarter of 1997, Sino-Wood agreed with the Leizhou Forestry Bureau [the "LFB"], its partner in the Leizhou EJV, to cease operations and the LFB voluntarily withdrew its entire interest in the Leizhou EJV effective as of October 1, 1997. As a result of this agreement, the net assets of the Leizhou EJV were distributed to the respective partners in proportion approximately to their respective interests, and the amount due from LFB previously accounted for as a long-term asset was settled. The agreement relating to this transaction was formally executed in April, 1998.

A summary of the net assets distributed is as follows:

	$
Net assets distributed	
Capital assets	**18,012**
Due from LFB	**16,755**
Current assets	**815**
	35,582
Income taxes payable	**(1,727)**
Current liabilities	**(212)**
Non-controlling interests	**(21,213)**
Sino-Wood's interest in the net assets	**12,430**

As part of the agreement with the LFB, the LFB agreed to exchange Sino-Wood's interest in the net assets for 730,440 cubic meters of standing timber owned by the LFB. The standing timber is to be provided by the LFB to Sino-Wood over a three-year period as required by Sino-Wood. Sino-Wood is responsible for harvesting and transportation costs. The Company has recorded its interest in the standing timber as timber holdings.

As a result of this withdrawal of the LFB's interest in the Leizhou EJV, the consolidated financial statements of the Company for the year ended December 31, 1997 include the results of the Leizhou EJV to September 30, 1997.

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[B] Wood-based panel and contract supply

The Company is in the process of establishing entities or investments to pursue wood-based panel and contract supply businesses. As at December 31, 1997, the Company had purchased machinery and equipment and incurred costs of approximately $9,384,000 related to the establishment and construction of facilities for wood-based panel manufacturing.

The Company has acquired a 20% equity interest in Shanghai Jin Xiang Timber Ltd. ["SJXT"]. SJXT is a startup entity that will primarily organize trading of timber and logs in the PRC market. The total investment of SJXT is estimated to be $9,662,000 [Chinese renminbi 80 million] of which the Company will be required to contribute approximately $1,932,000 representing 20% of the registered capital. As at December 31, 1997, the Company has made contributions in the amount of $1,037,000 to SJXT.

[C] 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 interests 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, require 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.

4. CAPITAL ASSETS

Capital assets consist of the following:

	1997		1996	
	Cost $	Accumulated depreciation, amortization and depletion $	Cost $	Accumulated depreciation, amortization and depletion $
Timber holdings	**38,355**	**–**	17,367	1,635
Machinery and equipment	**9,384**	**–**	751	242
Office furniture and equipment	**491**	**95**	349	33
Vehicles	**211**	**26**	37	7
Land use rights and buildings	**–**	**–**	7,782	805
	48,441	**121**	26,286	2,722
Less accumulated depreciation, amortization and depletion	**(121)**		(2,722)	
Net book value	**48,320**		23,564	

Machinery and equipment amounting to $9,384,000 [1996 – Nil] is not being depreciated as the production facilities are under construction.

5. DEPOSITS

The Company has entered into agreements with chipping plant operators to acquire equity interests in the facilities. Under the terms of the agreements, the Company has provided a deposit of $2,250,000 which will be applied against the Company's future investment. The Company has a period of two years to December 31, 1999 to complete its investment negotiations.

6. DUE FROM PRC CJV PARTNERS

The amount due from PRC CJV partners relates primarily to commission income and accounts receivable related to wood chips trading and sales during the year and for the reimbursement of office expenses. The amounts are unsecured, non-interest bearing and have no fixed terms of repayment. The carrying value of the amounts due from PRC CJV partners approximates their fair value.

7. DEUTSCHE BANK

[A] 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 into Class A Subordinate-Voting Shares of Sino-Forest based upon specified terms.

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, 1997, the interest rate on the loan was 7.84%. 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 $235,000 [1996 - $219,000].

Subsequent to the year end, Deutsche Bank A.G. of Hong Kong elected to convert the $3,000,000 debenture into 5,994,228 Class A Subordinate-Voting Shares of the Company, in accordance with the terms of the convertible loan agreement. The effect of this transaction results in proforma earnings per share of $0.21.

[B] Credit Facility

Sino-Forest Resources Inc., a wholly-owned subsidiary of the Company, has established a revolving line of credit facility of $6,000,000 with the Deutsche Bank A.G. of Hong Kong. The credit facility bears interest at the prevailing prime rate in Hong Kong and is repayable on demand. Sino-Forest and Sino-Wood have provided guarantees in the amount of $6,000,000 each in connection with this facility. As at December 31, 1997, the Company had utilized the credit facility for letters of credit in the amount of approximately $1,090,000 which are included in accounts payable and accrued liabilities.

8. LONG-TERM DEBT

In November 1997, Sino-Wood entered into two loan agreements with the Finnish Export Credit Ltd. for credit facilities in the amount of $4,505,000 to purchase certain equipment and machinery in connection with the construction of two particleboard mills in China. As at December 31, 1997, $3,710,000 has been disbursed under the facilities. The balance of $795,000 will be disbursed upon the issuance of Certificates of Acceptance after installation of the equipment and machinery. The loans are repayable in ten equal consecutive semi-annual instalments commencing June 15, 1999. Sino-Wood may repay the loans at any time. The loans bear interest at LIBOR plus 0.625% payable semi-annually. As at December 31, 1997, the interest on the long-term debt was approximately 6.6%. Sino-Forest has provided guarantees in respect of the loans.

Interest expense for the year amounted to approximately $19,000 [1996 – Nil].

9. SHARE CAPITAL

Share capital consists of the following:

	1997 $	1996 $
AUTHORIZED Unlimited Class A Subordinate-Voting Shares 6,000,000 Class B Multiple-Voting Shares Unlimited Preference Shares, issuable in series		
ISSUED		
67,569,000 (including 4,204,000 issued under share purchase loans) Class A Subordinate-Voting Shares [1996 – 37,150,000]	**29,302**	6,874
6,000,000 Class B Multiple-Voting Shares [1996 – 6,000,000]	**–**	–
	29,302	6,874

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, 1997 is Cdn. $61,082,578 [1996 - Cdn. $21,944,838].

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 is entitled to one vote per share, whereas each holder of Class B Multiple-Voting Shares is 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 may 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 is 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 Shares, the registered holder executed a Coattail Agreement under which the holder will agree not to effect a transfer of any Class B Multiple-Voting Shares 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 will have the rights and other features fixed by the Board of Directors of the Company. The Preference Shares of each series will 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.

Changes in issued share capital

On October 2, 1996, the Company issued 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. 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. The Cdn. $15,000,000 of cash held in escrow was released to the Company in February 1997.

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. As at December 31, 1997, 1,651,000 of these compensation options were exercised for total proceeds of approximately $1,712,000.

During 1997, options to purchase 4,768,000 [1996 – 1,650,000] Class A Subordinate-Voting Shares were exercised under the terms of the Company's stock option plan [the "Plan"]. The Company made interest free loans during the year totalling $4,380,000 to certain officers, pursuant to the terms of the Plan to acquire 4,204,000 Class A Subordinate-Voting Shares. The average price of the shares acquired subject to share purchase loans was $1.04. In accordance with the terms of the Plan, the shares acquired are pledged to the Company and the indebtedness is repayable upon the sale of the pledged shares. The Company has recorded the share purchase loans as a reduction in share capital. As at December 31, 1997, $4,380,000 remained outstanding under these loans. Gross proceeds on the 564,000 [1996 – 1,650,000] options exercised in 1997 and not subject to share purchase loans was approximately $519,000 [1996 - $723,000].

Stock options

The Company has reserved 10,000,000 Class A Subordinate-Voting Shares for issuance under its stock option plan.

As at December 31, 1997, 1,444,000 options to purchase Class A Subordinate-Voting Shares of the Company at prices ranging from Cdn. $0.55 per share to Cdn. $2.79 per share were outstanding to certain officers and directors of the Company and an employee of Sino-Wood. 200,000 of these options expire in 1999, 1,019,000 options expire in 2001, with the remaining 225,000 options expiring in 2002.

10. INCOME TAXES

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

	1997 $	1996 $
Income before income taxes	**17,752**	13,496
Expected statutory rate	**44.6%**	44.6%
Expected income tax provision	**7,917**	6,019
Increase (decrease) in income taxes resulting from		
Unrecognized income tax losses	**2,161**	1,143
Income tax at different rates in foreign jurisdictions	**(8,230)**	(5,305)
Other	**1**	(2)
	1,849	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.

Hong Kong profits tax has been provided at the rate of 16.5% on the estimated assessable profits arising in Hong Kong during the year. Taxes on profits assessable elsewhere have been calculated at the rate of taxation prevailing in the countries in which the Company operates.

The Company has income tax losses of approximately $1,357,000 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 $172,000 of these tax losses will expire in 2001, $253,000 in 2002, $219,000 in 2003 and the remainder will expire in 2004.

11. 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, 1997	**65,718,000**	81,631,000
December 31, 1996	**42,666,000**	58,462,000

12. RELATED PARTY TRANSACTIONS

[A] Corporate management services were provided during the year by two companies in which directors of Sino-Wood have an interest. These services were provided at an aggregate cost of approximately $1,405,000 [1996 - $886,000].

[B] During the year, commission income earned from Guangxi Forestry Development Centre amounted to approximately $14,688,000 [1996 - $5,233,000].

[C] During the year, the Company, through one of its CJVs, entered into an agreement with its Heyuan CJV partner (the "Partner") pursuant to which the Company purchased timber from the Partner and contracted the Partner to process the timber purchased. As part of the agreement, the Partner agreed to act as the Company's agent to sell the wood chips in the PRC. The net income derived from the above transactions was allocated 85% to the Company and 15% to the Partner. During the year, purchases and chipping of timber under this arrangement totalled $14,617,000 and sales of wood chips amounted to $18,982,000.

The Company has accounted for these transactions on the proportionate consolidation basis.

13. SEGMENTED INFORMATION

	1997			1996		
	Wood Chips $	Wood-Based & Other $	Total $	Wood Chips $	Wood-Based & Other $	Total $
BY INDUSTRY SEGMENT						
REVENUE						
Sales	**21,735**	**1,800**	**23,535**	23,050	1,175	24,225
Commission income	**14,688**	**3,560**	**18,248**	5,233	2,970	8,203
	36,423	**5,360**	**41,783**	28,283	4,145	32,428
Income from operations	**14,631**	**3,615**	**18,246**	10,865	3,068	13,933
Identifiable assets	**55,292**	**17,548**	**72,840**	64,730	4,888	69,618
Depreciation, amortization and depletion	**717**	**–**	**717**	673	–	673
Investment in capital assets	**16,088**	**9,384**	**25,472**	14,249	–	14,249

BY GEOGRAPHIC SEGMENT

28

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 $8,861,000 [1996 - $23,050,000].

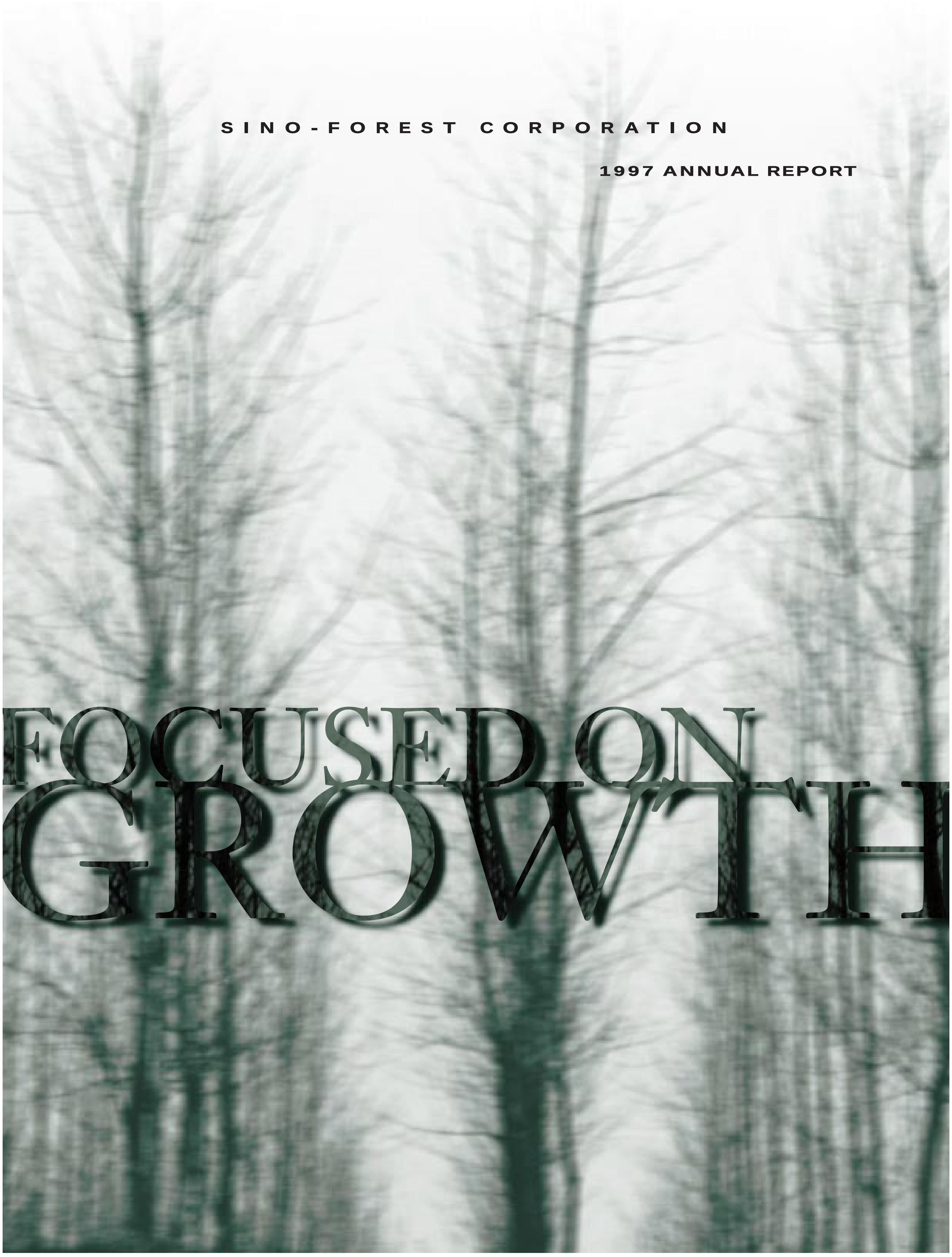
14. LEASE COMMITMENT

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

	$
1998	219
1999	203
	422

15. COMPARATIVE FINANCIAL STATEMENTS

The comparative financial statements have been reclassified from statements previously presented to conform to the presentation of the December 31, 1997 financial statements.



SINO-FOREST CORPORATION

1997 ANNUAL REPORT

FOCUSED ON GROWTH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