



**SINO-FOREST CORPORATION**

Annual Information Form  
in respect of the year ended  
December 31, 2008

March 31, 2009

## TABLE OF CONTENTS

	Page
THE CORPORATION .....	1
CORPORATE STRUCTURE.....	1
GENERAL DEVELOPMENT OF THE BUSINESS .....	3
Overview .....	3
Strategic Business Units.....	3
Wood Fibre Operations.....	3
Plantation Fibre .....	3
Other Fibre .....	3
Manufacturing and Other Operations.....	3
Historical Milestones .....	4
DESCRIPTION OF THE BUSINESS.....	5
Vision and Strategy.....	5
Our Wood Fibre Operations.....	5
Overview .....	5
Tree Plantations and Plantation Business Models.....	6
Purchased Tree Plantation Model .....	6
Planted Tree Plantation Model.....	7
Integrated Tree Plantation Model.....	7
Wood Logs.....	10
Imported Wood Products .....	10
Our Manufacturing and Other Operations .....	11
Overview .....	11
Particleboard Operation .....	11
Engineered Wood Flooring.....	11
Oriented Strand Board.....	11
Sawn Timber Facility.....	12
Finger-Joint Board .....	12
Our Greenery and Nursery Operations.....	12
Other Information.....	12
Sales and Marketing.....	12
Suppliers.....	13
Transportation .....	13
Customers.....	13

**TABLE OF CONTENTS**  
(continued)

	<b>Page</b>
Competition.....	14
Environmental Matters.....	14
Research and Development.....	16
Other Tree Plantation Contractual Arrangements.....	17
Investment in Greenheart and Omnicorp.....	18
Insurance.....	18
Employees.....	19
GOVERNMENT REGULATION.....	19
PLANTATION INDUSTRY.....	19
Development of the Plantation Industry.....	19
Permits and Approvals Necessary for the Operation of our Plantation Business.....	20
Plantation Rights Certificates for Our Planted Tree Plantations.....	21
Plantation Rights Certificates for Our Purchased Tree Plantations.....	21
Timber Logging Permits and Logging Quotas.....	21
Timber Transportation Permit.....	21
MANUFACTURING.....	22
Engaging in the Timber Business.....	22
Regulations that Apply Nationwide.....	22
Eleventh Five-Year Plan.....	22
RISK FACTORS.....	23
Risks Related to Our Business.....	23
Risks Related to the PRC.....	35
DIVIDEND RECORD AND POLICY.....	40
DESCRIPTION OF CAPITAL STRUCTURE.....	40
Share Capital.....	40
Ratings.....	40
MARKET FOR SECURITIES.....	42
Trading Price and Volume.....	42
Prior Sales.....	42
DIRECTORS AND EXECUTIVE OFFICERS.....	42
Prior Principal Occupations.....	44
INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS.....	45
CONFLICTS OF INTEREST.....	46

**TABLE OF CONTENTS**  
(continued)

	<b>Page</b>
TRANSFER AGENT AND REGISTRAR.....	46
MATERIAL CONTRACTS .....	46
INTERESTS OF EXPERTS .....	47
AUDIT COMMITTEE .....	47
Audit Committee’s Charter .....	47
Composition of Audit Committee .....	47
Relevant Education and Experience.....	47
Reliance on Certain Exemptions.....	48
Audit Committee Oversight .....	48
Pre-Approval Policies and Procedures.....	48
External Auditor Service Fees (By Category).....	48
ADDITIONAL INFORMATION.....	48
AUDIT COMMITTEE CHARTER.....	A-1

## **FORWARD-LOOKING STATEMENTS**

This Annual Information Form, and the documents incorporated herein by reference, contain forward-looking statements which reflect management's expectations regarding Sino-Forest Corporation's ("Sino-Forest") future growth, results of operations, performance, business prospects and opportunities. Words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or similar expressions, are forward-looking statements within the meaning of applicable securities laws. Forward-looking statements include, without limitation, the information concerning possible or assumed future results of operations of Sino-Forest set out under "Description of the Business". These statements are not historical facts but instead represent only Sino-Forest's expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve assumptions, risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. In addition to the factors Sino-Forest currently believes to be material which are identified under "Risk Factors," other factors not currently viewed as material could cause actual results to differ materially from those described in the forward-looking statements. Although Sino-Forest has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be anticipated, estimated or intended. Accordingly, readers should not place any undue reliance on forward-looking statements. Sino-Forest does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report.

## CERTAIN DEFINITIONS, CONVENTIONS AND CURRENCY PRESENTATION

We have prepared this Annual Information Form using a number of conventions, which a reader should consider when reading the information contained herein. When we use the terms “we”, “us”, “our” and words of similar import or use the term “Corporation” or “Sino-Forest”, we are referring to Sino-Forest Corporation itself, or to Sino-Forest Corporation and its consolidated subsidiaries, as the context requires.

All references in this Annual Information Form to “U.S. dollars” and “US\$” are to United States dollars; all references to “Canadian dollars” and “Cdn.\$” are to Canadian dollars; all references to “H.K. dollars” and “HK\$” are to Hong Kong dollars; all references to “RMB” or “Renminbi” are to Renminbi, the official currency of the People’s Republic of China, or the PRC; and all references to “€” or “Euro” are to Euros. Solely for the convenience of the reader, this Annual Information Form contains translations of certain H.K. dollar and Renminbi amounts into U.S. dollars. Unless otherwise indicated, all dollar amounts in this Annual Information Form are expressed in U.S. dollars.

All such H.K. dollar translations have been made at the rate of HK\$7.750 to US\$1.00. All such Renminbi translations have been made at the rate of RMB6.835 to US\$1.00. No representation is made that the H.K. dollar or Renminbi amounts stated herein could have been, or could be, converted into U.S. dollars at such rates or at any other rate.

Statistical references to “PRC” and “China” do not include the Hong Kong Special Administrative Region, or Hong Kong, or the Macau Special Administrative Region, or Macau.

Certain references to PRC laws, regulations and policies in this Annual Information Form include the corresponding Chinese translations.

“PRC government” means the central government of the PRC, including all political subdivisions (such as provincial, municipal and other regional or local governmental entities) and instrumentalities thereof.

A hectare is a metric unit of area equal to 10,000 m<sup>2</sup> or approximately 2.471 acres.

“Cooperative joint venture” or “CJV” means a Sino-foreign cooperative joint venture enterprise with limited liability established in the PRC under the relevant PRC laws and regulations which provides, among other things, that the distribution of profit or loss and the control of the joint venture company is entirely based on the joint venture contract and not on the joint venture parties’ contributions to the registered capital of the joint venture.

“Wholly foreign owned enterprise” or “WFOE” means an enterprise established in China in accordance with the relevant PRC laws, with capital provided solely by foreign investors. Such enterprises do not include branches and offices established in China by foreign enterprises and other economic entities.

An “Original Equipment Manufacturer” or “OEM” is a company that builds products or components that are used in products sold by another company.

TOTALS PRESENTED IN THIS ANNUAL INFORMATION FORM MAY NOT TOTAL CORRECTLY DUE TO ROUNDING OF NUMBERS.

## THE CORPORATION

Sino-Forest was formed under the *Business Corporations Act* (Ontario) upon the amalgamation of Mt. Kearsarge Minerals Inc. and 1028412 Ontario Inc. pursuant to articles of amalgamation dated March 14, 1994. The articles of amalgamation were amended by articles of amendment filed on July 20, 1995 and May 20, 1999 to effect certain changes in the provisions attaching to our class A subordinate-voting shares and our class B multiple-voting shares. On June 25, 2002, we filed articles of continuance to continue under the *Canada Business Corporations Act*. On June 22, 2004, we filed articles of amendment whereby our class A subordinate-voting shares were reclassified as common shares (“Common Shares”) and our class B multiple-voting shares were eliminated.

We have offices located in Toronto, Hong Kong and the PRC. Our executive offices are located at 3815-29, 38/F, Sun Hung Kai Centre, 30 Harbour Road, Wanchai, Hong Kong. Our registered office and principal business office is located at 90 Burnhamthorpe Road West, Suite 1208, Mississauga, Ontario, L5B 3C3.

## CORPORATE STRUCTURE

(i) The following is a list of the Corporation’s subsidiaries (which does not include certain immaterial subsidiaries) as at December 31, 2008, indicating the place of incorporation / registration and showing the percentage equity interest beneficially owned (directly or indirectly) by the Corporation:

	<b>Place of Incorporation / Registration</b>	<b>Percentage Equity Interest Held by the Corporation</b>
Sino-Forest Corporation	Canada	100
Sino-Panel Holdings Limited	British Virgin Islands	100
Sino-Global Holdings Inc.	British Virgin Islands	100
Sino-Forest Resources Inc.	British Virgin Islands	100
Sino-Panel (Asia) Inc.	British Virgin Islands	100
Grandeur Winway Limited	British Virgin Islands	100
Sinowin Investments Limited	British Virgin Islands	100
Dynamic Profit Holdings Limited	British Virgin Islands	100
Suri-Wood Inc.	British Virgin Islands	100
Sino-Panel (Guangxi) Limited	British Virgin Islands	100
Sino-Panel (Yunnan) Limited	British Virgin Islands	100
Sino-Panel (North East China) Limited	British Virgin Islands	100
Sino-Panel [Hunan] Limited	British Virgin Islands	100
SFR (China) Inc.	British Virgin Islands	100
Sino-Panel (Gaoyao) Ltd.	British Virgin Islands	100
Sino-Panel (North Sea) Limited	British Virgin Islands	100
Sino-Forest Investments Limited	British Virgin Islands	100
Sino-Wood Partners, Limited	Hong Kong	100
Sino-Plantation Limited	Hong Kong	100
Sino-Wood (Guangxi) Limited	Hong Kong	100
Sino-Wood (Jiangxi) Limited	Hong Kong	100
Sino-Wood (Guangdong) Limited	Hong Kong	100
Sino-Wood (Fujian) Limited	Hong Kong	100

	<b>Place of Incorporation / Registration</b>	<b>Percentage Equity Interest Held by the Corporation</b>
Sino-Panel (China) Investments Limited	PRC	100
Hunan Jiayu Wood Products (Hongjiang) Co., Ltd.	PRC	100
Sino-Maple (Shanghai) Trading Co., Ltd.	PRC	100
Sino-Maple (Shanghai) Co., Ltd.	PRC	100
Sinowin Plantings (Suzhou) Co., Ltd.	PRC	100
Sino-Panel (Guangxi) Development Co., Ltd.	PRC	100
Sino-Panel (Gengma) Co., Ltd.	PRC	100
Heilongjiang Jiamu Panel Co., Ltd.	PRC	100
Shaoyang Jiading Wood Products Co., Ltd.	PRC	100
Jiafeng Wood (Suzhou) Co., Ltd.	PRC	100
Guangdong Jiayao Wood Products Development Co., Ltd.	PRC	100
Sino-Panel (Beihai) Development Co., Ltd.	PRC	100
Sino-Forest (China) Investments Limited	PRC	100
Guangxi Guijia Forestry Co., Ltd.	PRC	100
Gaoyao Jiayao Forestry Development Co., Ltd.	PRC	100
Jiangxi Jiachang Forestry Development Co., Ltd.	PRC	100
Heyuan Jiahe Forestry Development Co., Ltd.	PRC	100
Zhangzhou Jiamin Forestry Development Co., Ltd.	PRC	100
Sino-Forest (Heyuan) Co., Ltd.	PRC	100
Sino-Forest (Guangzhou) Co., Ltd.	PRC	100
Sino-Forest (Guangzhou) Trading Co., Ltd.	PRC	100
Sino-Forest (Suzhou) Trading Co., Ltd.	PRC	100
Sino-Forest (Anhui) Co., Ltd.	PRC	100

(ii) The following is a list of entities in which the Corporation holds a non-controlling equity interest, indicating the place of incorporation / registration and showing the percentage equity interest beneficially owned (directly or indirectly) by the Corporation as at March 31, 2009:

	<b>Place of Incorporation / Registration</b>	<b>Percentage Equity Interest Held by the Corporation</b>
Mandra Forestry Holdings Limited	British Virgin Islands	15
Greenheart Resources Holdings Limited ("Greenheart")	British Virgin Islands	17.26 <sup>(1), (2)</sup>
Omnicorp Limited ("Omnicorp")	Bermuda	20 <sup>(1)</sup>

**Notes:**

(1) Ownership percentage is based on the outstanding ordinary shares as published respectively by Greenheart and Omnicorp.

(2) The equity interest is made up of 5.18% direct investment and 12.08% indirect investment through Omnicorp in Greenheart.



## GENERAL DEVELOPMENT OF THE BUSINESS

### Overview

Sino-Forest Corporation is a leading commercial forest plantation operator in the People's Republic of China ("PRC"). The Canadian corporation began business in 1994 as the first foreign and privately-managed company involved in forestry products in the PRC. Its principal businesses include the ownership and management of forest plantation trees, sale of standing timber, wood logs, and complementary manufacturing of downstream engineered-wood products. Our executive offices are located in Hong Kong and Toronto, Canada and our Common Shares are traded on the Toronto Stock Exchange (the "TSX") under the symbol TRE since 1995.

### Strategic Business Units

Sino-Forest's operations are comprised of two core business segments - **Wood Fibre Operations** is the major revenue contributor, while our **Manufacturing & Other Operations** enable us to add value to our fibre by producing downstream products.

Revenue from Wood Fibre Operations is derived from the following sources:

#### *Plantation Fibre*

- We acquire, cultivate and sell standing timber or harvested logs from our purchased, integrated and planted plantation business models in eight provinces and regions across China.

#### *Other Fibre*

- Wood logs – we source logs from PRC suppliers and sell them in the domestic market; and
- Imported wood products – we source logs, veneer, sawn timber and other wood-based products globally and sell them in the domestic PRC market.

Our Manufacturing & Other Operations include:

- particleboard manufactured in Guangdong Province;
- engineered wood flooring produced in Jiangsu Province, and sold through over 200 stores nationwide in the PRC;
- oriented strand board manufactured in Heilongjiang Province;
- sawn timber produced in Yunnan Province;
- finger-joint board, block board and particleboard produced in Hunan Province; and
- greenery and nursery operations based in Jiangsu Province.

As discussed below under “Our Manufacturing and Other Operations”, we entered into an agreement to sell our particleboard manufacturing equipment in Guangdong Province in the first quarter of 2009. Further, the operational lease of the particleboard production facility in Hunan Province will be terminated in 2009.

### **Historical Milestones**

The following are important recent historical milestones in the development of Sino-Forest’s business:

- 2006
- Secured a syndicated loan facility with several financial institutions for a US\$150 million five-year plus one day term loan.
  - Entered into a master agreement to secure 1.5 million cubic meters annually of long-term wood fibre supply over 12 years in the Inner Mongolia Autonomous Region by managing a programme of secondary forests.
  - Entered into agreements in the third and fourth quarters to acquire a total of 400,000 hectares of Chinese fir and pine over next 14 years in the Hunan Province.
- 2007
- Closed a private placement on April 10, 2007 in which 25.4 million Common Shares were issued to several institutional investors, including Temasek Holdings (Pte) Ltd. and United Capital - Investment Group Limited at Cdn.\$9.15 per share for gross proceeds of approximately US\$200 million. Proceeds of the offering are expected to be used for the acquisition of standing timber in the Yunnan Province, for the acquisition or construction of related processing facilities in the regions and for working capital.
  - Entered into a master agreement on March 23, 2007 to acquire approximately 200,000 hectares of non-state owned commercial standing timber of pine, oak, birch and broadleaved shaw in the Yunnan Province over a 10-year period.
  - Completed a bought deal on June 12, 2007 and raised gross proceeds of approximately Cdn\$201 million by issuing 15.9 million Common Shares at Cdn.\$12.65 per share. The proceeds shall be used primarily for general corporate purposes, including the acquisition of standing timber, for the acquisition or construction of related processing facilities in the plantation regions that have or will have operations, and for working capital in connection with the foregoing.
  - Entered into a master agreement on December 10, 2007 to purchase approximately 150,000 hectares of non-state owned commercial timber of Chinese fir and pine trees in the Guangxi Province over a 5-year period.
- 2008
- Closed an offering for US\$300 million, 5% convertible senior notes to international investors on July 23, 2008. Net proceeds from the offering are expected to be used to acquire commercial plantation forests in the Fujian Province, to lease land and plant with *Jatropha* trees and for general corporate purposes.

The underwriters in connection with the offering exercised an over-allotment option and sold an additional US\$45 million convertible senior notes on August 6, 2008.

- Entered into a master agreement on August 11, 2008 to acquire 200,000 hectares of non-state owned plantation trees of pine, Chinese fir and eucalyptus forest in the Fujian Province over a 10-year period.

On February 6, 2009, the Corporation acquired 55 million ordinary shares in the capital of Omnicorp Limited (“**Omnicorp**”), a Hong Kong listed company, and Omnicorp 4% secured convertible bonds (the “**Omnicorp Convertible Bonds**”) with an aggregate principal amount of approximately US\$21.6 million from various vendors. The aggregate purchase price paid by the Corporation was satisfied by the payment of approximately US\$4.3 million in cash for the Omnicorp ordinary shares and the issuance of approximately 2.7 million Common Shares at a price of Cdn.\$10.00 per share for the Omnicorp Convertible Bonds.

## **DESCRIPTION OF THE BUSINESS**

### **Vision and Strategy**

Our vision is to become the leading commercial forestry plantation operator and preferred supplier of wood fibre to downstream consumers in the wood panel, furniture, construction, interior decoration and pulp and paper industries in the PRC.

Our strategy is to build on our competitive strengths and seize business opportunities in the PRC in order to become a leading plantation developer and wood resource supplier with established operations in or close to PRC regional markets, providing wood fibre to downstream consumers in the wood panel, furniture, construction, interior decoration and pulp and paper industries. The following are the key elements for executing our strategy:

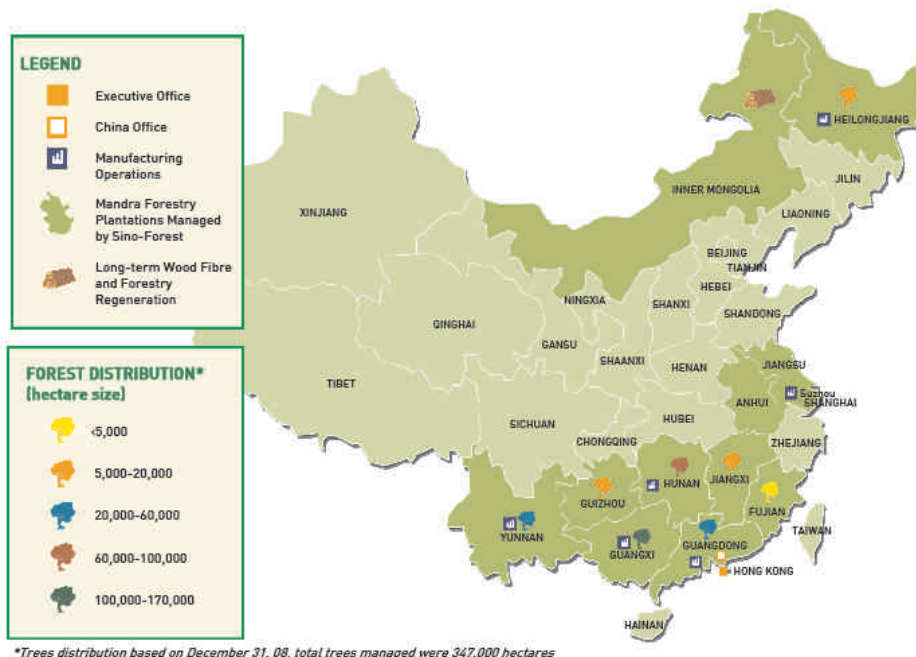
- expand geographically, invest in additional tree plantations to gain access to long-term supplies of wood fibre, and develop regional wood fibre markets in the PRC by providing quality logs and value-added manufacturing products;
- build integrated manufacturing operations to supply value-added, wood-based products to the PRC market and further diversify our revenue streams;
- improve the yields of our tree plantations by continued investment in research and development and application of advanced forestry management techniques;
- practice sustainable and environmentally responsible forestry and manufacturing; and
- strengthen management processes and information systems to support the growth of our multi-faceted businesses.

### **Our Wood Fibre Operations**

#### *Overview*

Our wood fibre operations generate the bulk of our revenue, accounting for 93% of our revenue in the year ended December 31, 2008. These operations essentially consist of acquiring, cultivating, harvesting and selling logs and standing timber from our tree plantations, selling wood logs sourced from PRC suppliers, and selling wood products imported from outside the PRC. Most of the standing timber and logs we sell come from our own tree plantations. All of our tree plantations are located in the southern

and eastern regions of the PRC. The following map highlights the locations of our tree plantations in the PRC as of December 31, 2008:



### ***Tree Plantations and Plantation Business Models***

We operate our plantations using three business models: purchased, planted and integrated.

#### ***Purchased Tree Plantation Model***

In our purchased tree plantation model, we purchase young trees from local forestry entities and subsequently sell the trees as standing timber when they reach maturity. The purchase agreements for the trees also give us the right to lease the plantation land and replant after we harvest the trees. The right to lease the plantation is subject to negotiation of definitive plantation land-use agreement and obtaining and completing the requisite government approval and registration procedures. We refer to plantations managed under our purchased tree plantation model as “purchased tree plantations.”

The purchase price of the trees takes into account a variety of factors such as tree species, yield, age, size, quality and location of the tree plantation. We also consider soil and weather conditions for replanting, log prices and regional market demand. While we normally do not have to conduct extensive plantation management work with respect to the trees growing on our purchased tree plantations, we do take measures to ensure that the trees are protected from pests and disease, and apply fertilizer regularly, where appropriate, depending on the age of the trees.

As of December 31, 2008, our purchased tree plantations represented approximately 286,000 hectares under cultivation. Our purchased tree plantations are primarily located in Guandong, Guangxi, Hunan, Yunnan, Heilongjiang and Guizhou Provinces. They consist of a diversified mix of tree species,

predominantly pine, Chinese fir and eucalyptus. The advantages of purchasing trees include the ability to achieve an expansion of plantation reserves within a shorter time scale than by planting, while at the same time better positioning us to ensure a sizeable harvesting profile.

#### *Planted Tree Plantation Model*

In our planted tree plantation model, we assess the suitability of land where trees have been recently harvested for replanting and conversion into fast-growing high-yielding plantations. If we find the land to be suitable, we seek to lease the land under long term lease agreements. We then replant and cultivate trees using improved silviculture techniques and sell the trees as standing timber. We refer to our planted or re-planted trees as “planted tree plantations.” We choose to plant trees in strategically located areas and operate our commercial plantations using advanced environmentally prudent plantation management practices. We believe our 14-year track record in the PRC using advanced plantation management techniques is a competitive advantage in the country, where the commercial tree plantation industry is comparatively underdeveloped and where there are currently limited large-scale plantations using advanced plantation management practices.

In the fourth quarter of 2007, we completed the conversion of the legal structure of all of our four CJVs to WFOEs in accordance with PRC law. Under the WFOE structure, we will have overall operational control and management rights of our plantation operations. We have leased and will continue to lease land from the original plantation rights holders and pay the land lease rent, which is settled mainly on an annual basis. Terms of land leases are between 30 and 50 years, depending on negotiations in different locations. The conversion is expected to provide us with greater control over plantation management through plantation land leasing rather than harvested timber sharing and allow us to capture higher margins. As of December 31, 2008, our planted tree plantations operated through WFOEs comprised approximately 61,000 hectares. For those plantations originally operated by CJVs, we are still in the process of negotiating with the original plantation land use rights holders to enter into plantation land use agreements and going through the requisite governmental approval and registration procedures. There is no assurance that we will secure all of these plantation land use rights from the farmers and collective organizations. See “Risk Factors — Risks Related to Our Business”.

We started operating our first planted tree plantation on barren land in 1995. Our planted tree plantations now consist primarily of eucalyptus trees in Guangdong, Guangxi and Jiangxi Provinces. As of December 31, 2008, our planted tree plantations represented approximately 61,000 hectares under cultivation.

#### *Integrated Tree Plantation Model*

Pursuant to our integrated tree plantation model, instead of selling trees from purchased or planted tree plantations as standing timber, we either sell the logs or vertically integrate them with our manufacturing facilities to produce value-added wood products and lease the underlying land for replanting. Our integrated tree plantation model is essentially a combination of the purchased tree and planted tree plantation models.

The following table sets forth the location and approximate total hectares of our tree plantations as of December 31, 2008:

## Tree Plantations Under Cultivation

<b>PRC Province</b>	<b>Planted Tree Plantations (in hectares)</b>	<b>Purchased Tree Plantations (in hectares)</b>	<b>Total Hectares (approximate)</b>
Guangdong	39,000	9,000	48,000
Guangxi	11,000	139,000	150,000
Jiangxi	7,000	—	7,000
Hunan	4,000	86,000	90,000
Yunnan	—	39,000	39,000
Heilongjiang	—	6,000	6,000
Guizhou	—	7,000	7,000
<b>Total</b>	<b>61,000</b>	<b>286,000</b>	<b>347,000</b>

As of December 31, 2008, our tree plantations under cultivation represented approximately 347,000 hectares.

### *Access to Future Purchases of Tree Plantations*

Pursuant to our strategy of acquiring plantations inland, where forests are denser and the acquisition of trees and leasing of underlying land tends to be more cost effective, we have entered into long-term master agreements in Hunan, Yunnan, Guangxi and Fujian Provinces, giving us the right to acquire up to approximately 950,000 additional hectares of trees, of which approximately 185,000 hectares have been acquired as of December 31, 2008. A description of our main long-term master agreements is provided below. In addition, despite higher acquisition costs of trees in the Guangxi region in comparison to Hunan and Yunnan, the geographical location and climate of this region are conducive to fast-growing, high-yield species, such as eucalyptus.

#### *Long-term Acquisition Agreements*

##### Hunan

We entered into long-term master agreements in September and December 2006 through Sino-Panel (Asia) Inc. (“Sino-Panel”), one of our wholly-owned subsidiaries, with Hongjiang City Forestry Technology Integrated Development Services Company to acquire approximately 400,000 hectares of plantation trees for between RMB10.4 billion to RMB12.5 billion over 14 years in Hunan Province. As of December 31, 2008, we have acquired approximately 71,000 hectares of plantation trees for US\$299.0 million pursuant to such agreements.

Under the provisions of such master agreements, Sino-Panel has the pre-emptive rights to lease the underlying plantation land for up to 50 years. We intend to annually re-plant approximately the same amount of hectares of trees harvested in the previous year over the 14-year period of the agreements. The terms of the lease are to be negotiated with Hongjiang City Forestry Technology Integrated Development Services Company, the counterparty of the master agreements, upon the authorization of the original plantation rights holders and subject to the requisite governmental approval and plantation rights registration with the local forestry bureau in accordance with PRC laws and regulations.



## Yunnan

Pursuant to a master agreement entered into in March, 2007 by Sino-Panel with Gengma Dai and Wa Tribes Autonomous Region Forestry Company Ltd. (“Gengma Forestry”), established in Lincang City, Yunnan Province, Sino-Panel has the right to acquire approximately 200,000 hectares of non-state owned commercial standing timber in Lincang City and surrounding cities in Yunnan Province for between RMB5.5 billion to RMB10.9 billion over a 10-year period.

Under the provisions of such master agreement, Sino-Panel has the pre-emptive rights to lease the underlying plantation land for up to 50 years. The final terms of the lease are to be further negotiated with Gengma Forestry and the lease is subject to the requisite governmental approval and plantation rights registration with the local forestry bureau in accordance with PRC laws and regulations.

Under the provisions of such master agreement, we have acquired approximately 40,000 hectares of standing timber for US\$232.5 million as of December 31, 2008.

## Guangxi

In December 2007, we entered into a master agreement with Zhanjiang Bo Hu Wood Company Limited (“Bo Hu”) to acquire approximately 150,000 hectares of plantation trees in Guangxi Province through Sino-Panel for between RMB5.7 billion to RMB6.8 billion, over a 5-year period.

Under the provisions of such master agreement, Sino-Panel has pre-emptive rights to lease land at a price not to exceed RMB525 per hectare per annum for 30 years. The land lease can be for up to 50 years from the harvest date as permitted under PRC laws and regulations. The specific terms and conditions of such purchase or lease are determined following the execution of definitive agreements between our PRC subsidiaries (“PRC Subsidiaries”) and Bo Hu upon the authorization of the original plantation rights holders, and subject to compliance with the relevant PRC laws and regulations.

Under the provisions of this master agreement, we have acquired approximately 75,000 hectares of plantation in Guangxi Province for US\$343.5 million as of December 31, 2008.

## Fujian

On August 11, 2008, we entered into a master agreement with Zhangzhou Lu Sheng Forestry Development Company Limited (“Lu Sheng”) to acquire 200,000 hectares of non-state-owned, plantation trees in Fujian Province through Sino-Panel for a price not to exceed RMB350 per cubic meter over a 10-year period. In addition to securing the maximum tree acquisition price, Sino-Panel has pre-emptive rights to lease land at a price not to exceed RMB450 per hectare per annum for 30 years. The permissible land lease term is up to 50 years under PRC laws and regulations after harvesting. The specific terms and conditions of such purchase or lease are to be determined upon the execution of definitive agreements between our PRC subsidiaries and Lu Sheng upon the authorization of the original plantation rights holders, and subject to compliance with the relevant PRC laws and regulations.

Under the provisions of this master agreement, we have not acquired any hectares of plantation trees in Fujian Province as of December 31, 2008.

## ***Plantation Management***

To optimize the yields on our planted tree plantations, we engage in intensive silviculture and a variety of advanced plantation management techniques. Our advanced management practices include

detailed site assessments, site selection and preparation, terracing, use of improved planting materials, density and spacing control, fertilization and tending and monitoring and preventing damage to the trees. We generally engage third parties to perform the day-to-day management of the plantations.

We have developed a sustainable intensive plantation management system to work together with our management practices and environmental policies. This system and our other management practices are designed to produce fast-growing, high-quality sustainable forestry resources, optimize yields, improve resistance to disease, frost and fire, enhance environmental conservation and improve aesthetics. In addition, these practices result in more uniform tree plantations, which increase harvesting efficiency and reduce waste through sawing and peeling.

### ***Plantation Service Providers***

We engage third parties for all of the field operations of our tree plantations. During the course of the year, we typically engage approximately 10 to 20 third-party service providers for our planted tree plantations and our purchased tree plantations. The terms of our contracts with these service providers vary and can range from one or two years to one plantation cycle. The services to be provided by the plantation service providers must comply with our plantation management systems and operation guidelines. For areas with trees planted by us, the service providers perform all preparatory work and planting work such as clearance of plantation land, preparation for plowing or terracing, leveling of land, planting, fertilization and applying pesticides and other cultivation activities. We are generally responsible for providing seedlings and fertilizer and inspecting and supervising the different stages of work of the service providers. For our purchased tree plantations, depending on the age profile of the trees, the service provider is engaged to manage the trees, such as applying fertilizers and pesticides.

### ***Wood Logs***

Wood chips operations were ceased due to a lack of chipping capacity available to us. Therefore, from the third quarter 2007 onwards, the wood chips business has been reclassified to report as discontinued operations. The reportable revenue stream now primarily represents the sale of logs.

We now source logs from PRC suppliers, including pursuant to the Inner Mongolia master agreement referred to below, and sell them in the domestic PRC market. Wood logs sales comprised 1.5% of total revenue in 2008, compared to 0.5% of total revenue in 2007.

### ***Imported Wood Products***

We also engage in trading activities of wood-based products sourced from outside the PRC. These consist primarily of large diameter logs, sawn timber, veneer and other wood-based products sourced from Suriname, Papua New Guinea, Brazil, Vietnam, Russia and New Zealand. In these transactions, we purchase wood-based products that correspond to the requirements of wood dealers and sell directly to these dealers. Our customers in these transactions are primarily wood dealers in the PRC. The overseas suppliers generally ship the wood-based products to ports in the PRC designated by the wood dealers.

The purchase contracts and the sales contracts are generally short-term contracts, with delivery within one to two months from the date of the contracts. The sales are usually denominated in U.S. dollars. Payments are usually settled within 45 to 90 days of delivery.



## **Our Manufacturing and Other Operations**

### ***Overview***

Our manufacturing operations complement our wood fibre operations by maximizing usage and adding value to upstream fibre.

In 2000, we began the process of developing our manufacturing plants to complement our tree plantation operations using small diameter logs to manufacture quality wood-based products that are traditionally made from large-diameter logs. To date, we produce engineered wood flooring, oriented strand board (“OSB”), finger-joint board, block board and other wood-based products in four provinces in the PRC. In addition, we have a greenery and nursery operations based in Jiangsu Province which was established to source, supply and manage landscaping products for property developers and other organizations.

### ***Particleboard Operation***

The particleboard operation in Guangdong Province had a total land area of approximately 122,000 square meters and a total building area of approximately 26,000 square meters, located within the Economic Development Zone of the Pearl River Delta. The plant produced quality particleboard and a melamine-faced chipboard, targeting one of the largest furniture manufacturing markets in the PRC.

We entered into an agreement to sell our particleboard manufacturing equipment in the first quarter of 2009.

### ***Engineered Wood Flooring***

The flooring business was established in 2004. We developed the Sino-Maple brand to market our engineering wood products. Seeing the growth opportunities, in 2006 we decided to build our own engineered flooring facility in Suzhou. The Suzhou operation has a total land area of approximately 156,000 square meters and a total building area of approximately 18,700 square meters. The first phase of the manufacturing facilities was completed in the third quarter of 2006 and is in full commercial operation with an annual capacity of approximately 4.0 million square meters. The second phase was completed in 2007, and the combined capacity is approximately 6.5 million square meters. Sino-Maple flooring products are distributed through more than 200 outlets nationwide, including B&Q’s large do-it-yourself chain stores. Sino-Maple has also participated in numerous international exhibitions promoting its wood flooring products, which are fast becoming a popular substitute for solid and laminated flooring in the PRC due to its environmentally conscious use of forest plantation logs instead of large diameter natural forest logs.

In addition, this facility recently received accreditation from the Forest Stewardship Council (“FSC”) for its flooring products.

### ***Oriented Strand Board***

Our Heilongjiang facility was established in the fourth quarter of 2005 to manufacture OSB and other wood-based products. The facility is located in Heilongjiang Province, close to the Russian border and close to a source of wood supplies. OSB is still a relatively new product in the PRC, although it is widely used in other countries as a building, flooring and packaging material. The plant has an annual capacity of approximately 12,000 cubic meters.

### ***Sawn Timber Facility***

Our Yunnan facility was established in the fourth quarter of 2008, producing sawn timber and flooring material with an estimated annual capacity of 18,000 cubic meters anticipated for full ramp up in 2009.

### ***Finger-Joint Board***

We acquired processing facilities in Hunan Province, producing finger-joint board, block board and particleboard with a total annual capacity of 150,000 cubic meters. We will cease the operational lease agreement of the particleboard production facility in June 2009. Our strategy in Hunan is to maximize the value of our wood fibre through value-added processing.

### ***Our Greenery and Nursery Operations***

According to the PRC State Forestry Administration, there is a lack of forestation in the country, and six major cities, including Beijing, Shanghai and Guangzhou, have been identified among the 10 most polluted in the world. In order to counteract these problems, the PRC government has called for the improvement of air quality and city landscaping through the planting of trees in green belts along city borders, roads and streets, and in parks. Seeing the need to improve the gap between landscape management and supply of tree nursery products, we decided to pursue opportunities in this forest product business segment. With our plantation resources and expertise, we established a greenery and nursery operations in Jiangsu Province to source, supply and manage landscaping products for property developers and other organizations.

### **Other Information**

#### ***Sales and Marketing***

Substantially all of our sales are made in the PRC. In the year ended December 31, 2008, sales to customers in the PRC were US\$895 million and sales to customers located in other countries were US\$6 million. In the years ended December 31, 2006, 2007 and 2008, our domestic sales of wood-based products, wood logs and standing timber accounted for virtually all of our revenue.

One of our marketing strategies is to develop long-term relationships with wood dealers that will engage in sales transactions and trading activities with us year after year. These long-term relationships will enable us to better understand their needs and to take advantage of our competitive strengths, including our market expertise and advanced plantation management practices.

We engage in trading of logs and wood-based products both in the PRC and overseas, generally under short-term contracts. We issue invoices to our authorized intermediaries in the PRC on a quarterly basis. Sales are usually denominated in Renminbi, with payments usually settled within 60 days of delivery.

With respect to trading activities involving the export of wood-based products overseas, the delivery period of wood-based products is usually one to two months from the date of the contract. The sales are denominated in U.S. dollars and are made pursuant to letter of credit arrangements. Payments are usually settled within 45 to 90 days of delivery. In cases where we purchase imported logs for sale in the PRC, we issue letters of credit for the purchase of the logs. The purchases and sales are denominated in U.S. dollars, with payments usually settled within 45 to 90 days of delivery.

With respect to sales of standing timber, we generally grant buyers a credit period of up to nine months from the date of the contract, with sales generally denominated in Renminbi. We generally require a partial payment of approximately 20% of the purchase price within 60 days of the sales contract, payment of 40% of the purchase price within 150 days of the sales contract and the remaining 40% within nine months of the sales contract. Pursuant to the sales contract, the buyer is required to harvest the standing timber within 18 months from the date of the contract. We recognize revenue upon such sale.

Our wood-based product manufacturing plants currently consist primarily of sales of wood-based panel to distributors, which engage in further processing before sale to end-user customers, and sales of flooring products to distributors, property developers and contractors. These sales are generally under short- to medium-term contracts and are denominated in Renminbi. Payments are usually settled within 120 days.

### ***Suppliers***

The supply of wood logs and wood-based products for our trading activities is sourced primarily from local suppliers of logs and wood-based products in the PRC. We also source logs and wood-based products for our trading activities overseas, primarily from Suriname, Papua New Guinea, Brazil, Vietnam, Russia and New Zealand. The credit terms granted by our suppliers of logs and wood-based products generally range from one to three months on open account and by letters of credit.

In the years ended December 31, 2006, 2007 and 2008, our five largest suppliers accounted for approximately 44.2%, 54.8% and 45.5% of our total costs of sales, respectively. The largest supplier accounted for approximately 12.6%, 32.2% and 16.5% of our total costs of sales, respectively, during such periods. See “Risk Factors — Risks Related to Our Business.”

### ***Transportation***

Historically, we have not transported logs and wood-based products to customers ourselves, as we mainly engaged in sales of timber from our planted tree plantations and purchased tree plantations. In these sales transactions, the customer is responsible for harvesting and transporting the logs out of the forested areas.

With respect to our trading activities of logs and wood-based products sourced from overseas, we generally arrange for the shipping of the logs and wood-based products to ports in the PRC for the customers of the products, who arrange for the transportation of the products once they are unloaded at the port. The logs and wood-based products are generally shipped to ports in the southern region of the PRC.

### ***Customers***

Our customers and authorized intermediaries (“AI”) are mostly wood dealers and panel manufacturers. We intend to expand our customer base to include more end-user customers, such as pulp and panel mills, and, with respect to our wood-based product manufacturing plants, large furniture manufacturers.

In the years ended December 31, 2006, 2007 and 2008, our five largest customers (including AIs) accounted for approximately 57.5%, 58.7% and 55.6% of our revenue, respectively. In the same periods, our largest customer (including AIs) accounted for approximately 12.9%, 15.8% and 13.9% of our revenue, respectively. See “Risk Factors — Risks Related to Our Business.”

## ***Competition***

The market for logs and wood-based products in the PRC is highly fragmented, with a large number of small operators of tree plantations. There are also large operators of tree plantations in the PRC. These operators normally operate their own plantations and, in certain cases, replant and utilize these plantations as a source for their downstream operations.

The market for wood-based panels in the PRC is also highly fragmented, with a large number of small manufacturers and no dominant manufacturers. We expect that our principal competitors in the wood-based product manufacturing industry will be large domestic and foreign manufacturers of wood-based panels and engineered floorings. A number of domestic and foreign mills have commenced or announced plans to build wood-based panel mills in the PRC, which are expected to increase competition in the wood-based panels market in the PRC. We may also face competition from imports of wood-based panels. The primary competitive factors in the wood-based panels industry are product quality, level of technology in the manufacturing process, product innovation, product mix, price and logistics.

The markets for forest products in the PRC are highly competitive in terms of price and quality. In addition, wood-based products are subject to increasing competition from a variety of substitutes, including non-wood and engineered wood-based products, as well as import competition from other worldwide suppliers. See “Risk Factors — Risks Related to Our Business.”

## ***Environmental Matters***

Our tree plantation and manufacturing operations are subject to PRC laws and regulations relating to the protection of the environment. We believe that our operations are in substantial compliance with these laws and regulations. There are currently no significant environmental proceedings involving Sino-Forest.

### *Tree Plantations*

We maintain an environmental management system designed to ensure sustainable and responsible resource management. It sets out policies on the social, ecological and environmental aspects of our tree plantation operations and detailed operating procedures on environmental compliance. Some of our plantation operations are managed in accordance with the environmental standards of two of the most recognized international forest certification systems. Besides the environmental requirements of International Organization for Standardization ISO14001, we have also been working since 2000 to integrate Forest Stewardship Council (“FSC”) principles and criteria into our tree plantation management and operations, which cover all recognized environmental and relevant issues such as the control of soil and water erosion, the conservation of biodiversity and natural habitats, the improvement of environmental conditions, the maintenance of production continuity, health and protection of forests, local community development, etc. We obtained an ISO14001 certificate in 2002 for one of our plantation companies in Guangxi Province, and an FSC Forest Management (“FM”) certificate in 2003 for another in Guangdong Province (SW-FM/COC-001146). We aim to expand our success in FSC to all of our plantation forests.

In the past five years, we have gone through stringent third-party annual assessments and re-assessments for our FSC and ISO operations, continuously improving our environmental performance through the recurrence of prescribed operation, monitoring and inspection, technological development and correction of plantation management. Our efforts in addressing all main environmental concerns or issues are well recognized by the independent assessors. For example, we strive to address: (i) soil erosion issues through sound site preparation, forest road construction, planting spacing, harvesting planning, and operation season control; (ii) the maintenance of long-term land productivity through soil erosion control,

fertilizing, understory vegetation conservation, species rotation, etc.; and (iii) natural disasters such as forest fire, disease and pest, freezing and snowing through effective fire prevention and control systems, proper management of genetic diversity, development and deployment of resistant varieties etc. Our practice of identifying and conserving biodiversity and the potentially special habitats nested in our plantation forest ecosystems is also recognized.

Besides our commitment to managing our plantation forests in an environmentally-friendly manner, we are also actively involved in various activities relevant to environmental protection or enhancement. The PRC launched its first China Green Carbon Foundation, spearheaded by the State Forestry Administration, on July 20, 2007 to develop carbon credit trading, forest bio-fuels and renewable energy through large-scale tree plantation in a sustainable manner, which will also mitigate greenhouse gas emissions. We are one of the founding members and the only member from the forestry sector. In 2008, we donated approximately US\$769,000 to the establishment of “Applied Research Centre for Pearl River Delta Environment” at Hong Kong Baptist University. A primary goal of the research centre is to develop a competent team to study the pollution problems and provide solutions for industries in the Pearl River Delta Region.

We believe that, with our commitment to corporate responsibility, we will steadily and effectively improve our sustainable plantation management, from economic, environmental and social perspectives.

### *Manufacturing*

We began manufacturing engineered wood products to complement our tree plantation operations in 2000, and now produce mainly particleboard, OSB, flooring, block board, finger-joint board, veneer and plywood, which generally cause relatively minor environmental problems. Environmental issues may include, but are not limited to, sawdust emissions, air pollution, glue waste, water pollution, toxic chemical content, fire, health & safety and raw material sourcing. We strive to integrate international standards into our wood product manufacturing by updating our management system and operation procedures in a timely manner.

We are committed to fully utilizing certified and legal raw wood material in our manufacturing, which is considered to be a significant way of protecting regional and even global environments from deforestation. So far, we have obtained FSC Chain-of-Custody (“FSC CoC”) certificates (SW-COC-003299; GFA-COC-001561) for our key factories that produce particleboard, OSB, flooring, veneer, etc. We intend on making all of our wood product manufacturing subject to the FSC CoC certification system, which involves regular stringent inspections carried out by accredited and independent third-parties. Wood products with an FSC CoC certificate must be made from FSC-certified raw materials. To date, we are still one of few companies that simultaneously produces FSC FM-certified raw material and FSC CoC-certified wood products in China.

We have acquired advanced facilities and equipment that fully meet the demands of environmental protection, to keep hazardous substance emissions under acceptable levels. We have various procedures in place for controlling environmental issues. Examples of such procedures include the following: (i) sawdust is properly collected and either recycled as product material or used to produce energy in our factories, thus reducing air and water pollution; (ii) polluted water is processed in special facilities for agricultural irrigation; (iii) wood products are always sampled and inspected in a standardized way to control the quality and toxic chemicals such as formaldehyde; and (iv) procedures for preventing and controlling fire and work accidents are implemented to avoid or reduce loss, damage and relevant environmental accidents. All environmental matters associated with our wood product manufacturing are regularly or periodically inspected and assessed by local authorities or relevant parties.

With our wood product manufacturing, some environmental accidents may still occur from daily operation or at old facilities. As with most other labor-intensive companies in China, we often have inexperienced or outsourced workers in our labor force, who may inadvertently cause environmental and safety accidents, even though professional training is always first provided. We strive to implement an integrated training and monitoring system to avoid or minimize accidents. In addition, old inefficient facilities or equipment may emit hazardous chemicals or contaminated materials and as a consequence, timely replacement and effective maintenance of outdated facilities, equipment or their parts are necessary to control environmental accidents in manufacturing operations.

### *Environmental regulation*

As disclosed below under “Risk Factors – Risks Related to the PRC”, our tree plantations and manufacturing plants are subject to certain environmental laws and regulations, particularly with respect to air emissions and discharges of wastewater and other pollutants into land, water and air, and the use, disposal and remediation of hazardous substances and contaminants. We may be required to incur significant expenditures to comply with applicable environmental laws and regulations. Moreover, some or all of the environmental laws and regulations to which we are subject in our tree plantations and manufacturing plants could become more stringent in the future, which could affect our production costs and results of operations. For example, international standards in wood-based products manufacturing currently require that wood panels satisfy specified maximum levels of formaldehyde emissions, as well as providing for other environmental protection measures. Any failure by us to comply with applicable environmental laws and regulations could result in civil or criminal fines or penalties or enforcement actions, including a requirement to install pollution control equipment or other mandated actions. As a result, environmental laws and regulations may adversely affect our business, financial condition and results of operations.

### *Research and Development*

Research and development is an important function of our tree plantation operations. The goal of our research and development efforts is to improve tree plantation yields and the quality of the trees grown on our tree plantations. We have developed a sustainable intensive plantation management system in order to optimize investment efficiency. The system comprises standardized plantation management operation procedures, genetic improvements, cultivation techniques and inspection and monitoring.

We perform research and development on a wide range of activities, including:

- genetic breeding research, including the breeding, selection and testing of planting materials that perform better, in terms of improved yield, quality and resistance to natural stresses (pests, diseases, low temperature and snow);
- vegetative propagation technology, including lab tissue culture and nursery mass-propagation of cuttings;
- site and nutrition management and fertilizer application for different soil types and developing methods to optimize fertilizer application;
- improved silviculture practices, such as control of stand density, spacing and rotation, and genetic diversity control;
- development of sustainable management system of commercial plantation ecosystems, merging timber production, environmental conservation and social care;



- wood properties and processing (such as change of water content and properties and of short-rotation eucalyptus plantation wood) and value-added products; and
- ecological and environmental technology, including the monitoring and evaluation of ecological and environmental conditions in short-rotation eucalyptus plantations.

In performing our research and development activities, from time to time we also collaborate with, and receive assistance from, research and academic institutions in the PRC.

Our research and development division is composed of a team of nine individuals. The research and development division is headed by a research scientist with over 25 years of research and operations experience in forestry and plantation management.

In the years ended December 31, 2006, 2007 and 2008, we spent approximately US\$371,000, US\$412,000 and US\$1,071,000, respectively, on research and development activities.

### ***Other Tree Plantation Contractual Arrangements***

#### *Inner Mongolia Wood Fibre Supply*

On July 31, 2006, we entered into a master agreement with Inner Mongolia Forest and Timber Resources Co., Ltd., an equity joint venture company in the PRC, and Erliahot Lianhe Forestry Bureau in the Inner Mongolia Autonomous Region, to secure a minimum of 1.5 million cubic meters annually of long-term supply of wood fibre over the period of 12 years by managing a program of secondary forests.

We continue to experience delays in the supply of wood logs from the local partner in Inner Mongolia due to the possible increase in export tariff from 25% to 80% planned by the Russian government. Given the proximity of Inner Mongolia to Russia, and the similarity of certain tree species in those regions, the local partner has decided to delay harvesting in anticipation of higher log prices in the future.

#### *Mandra Forestry*

In 2005, we formed an alliance with Mandra Forestry Finance Limited (“Mandra Forestry”) by investing US\$15.0 million in the form of a subordinated loan and acquiring a 15% equity interest, with the goal of gaining access to timber in Anhui Province close to the strategically important Yangtze River Delta. Leveraging on our track record and expertise in plantation operation, we provide plantation management service for an annual management fee of US\$1.0 million and have obtained access to an inventory of Chinese fir and pine trees while earning a margin of 3% on the sales of timber delivered by Mandra Forestry. We currently have, pursuant to and subject to certain conditions set forth in the terms of a shareholders agreement that we entered into with Mandra Forestry, an option to purchase all of the outstanding equity securities of Mandra Forestry from the other shareholders of Mandra Forestry and shares represented by warrants held by certain warrant holders. This option will remain exercisable until May 11, 2010, the fifth anniversary of the shareholders agreement. Upon the expiration of that option, Sino-Forest Investments Limited will have a final purchase option to purchase the outstanding equity securities of Mandra Forestry from May 11, 2010 to May 11, 2012, being the seventh anniversary of the shareholders agreement.

### ***Investment in Greenheart and Omnicorp***

In July 2007, we signed a master sale and purchase agreement with Greenheart Resources Holdings Limited (“Greenheart”), a natural forest concession owner and operator in Suriname, South America to secure 34,285 cubic meters of logs from Suriname for US\$175 per cubic meter up to January 2009. In addition, we invested US\$6.0 million to acquire approximately 13% of the equity interests in Greenheart. In August 2007, Omnicorp Limited (“Omnicorp”), a listed company in Hong Kong, entered into an agreement with the existing shareholders of Greenheart to acquire approximately 60.3% of the equity interests in Greenheart with an option to acquire the remaining equity interests within 18 months after the completion of the sale. The transaction was completed on November 8, 2007 for consideration to us consisting of 7,860,000 Omnicorp ordinary shares, 4% secured convertible bonds at a principal amount of US\$4.0 million issued by Omnicorp which mature on November 9, 2009, and cash in the amount of US\$302,000, resulting in us recognizing a gain of US\$3.4 million as other income. In October 2007, we acquired convertible bonds issued by Omnicorp for US\$1.8 million from other bondholders. The bonds are convertible at HK\$2.00 of face value per Omnicorp ordinary share.

On February 6, 2009, we acquired 55 million Omnicorp ordinary shares and 4% secured convertible bonds with an aggregate principal amount of approximately US\$21.6 million. The aggregate purchase price paid by us was satisfied by the payment of approximately US\$4.3 million in cash for the Omnicorp shares and the issuance of approximately 2.7 million Common Shares at a price of Cdn.\$10.00 per share for the Omnicorp 4% secured convertible bonds. The issuance of our Common Shares represented a dilution of approximately 1.4% of our existing outstanding Common Shares. The acquisition was completed in the secondary market from various third parties. As a result of the completion of the transaction, our stake in Omnicorp has increased to approximately 20.0% of Omnicorp’s outstanding shares as well as 89.6% of the outstanding convertible bonds. The convertible bonds held by us are convertible into an additional 106,164,150 Omnicorp ordinary shares at a price of HK\$2.00 per share at any time prior to November 9, 2009, subject to certain terms and restrictions. Assuming the full conversion by us of the acquired convertible bonds, subject to certain terms and conditions of the convertible bonds, we would own approximately 40.2% of Omnicorp’s outstanding shares.

### ***Insurance***

We maintain insurance policies against risks of loss of our tree plantations. These policies cover all our planted tree plantations and the indemnity will be on actual insured value of the hectares of damaged plantation after netting deductible. As for our purchased tree plantations, the coverage of our insurance policy is subject to an annual aggregate loss limit at 15% of the declared value of our total purchased tree plantation after netting deductible, with any accident loss limit of RMB10 million. Accidents and disasters insured for our tree plantations include fire, lightning, explosion, flooding and windstorm. We believe our insurance coverage is consistent with the practice of other PRC tree plantation operators. In addition, we believe the risk of loss from fire and other natural disasters is reduced because our tree plantations are located in different provinces in the PRC and because of our measures to protect against natural disasters. We do not carry business interruption coverage. Significant damage to our tree plantations, whether as a result of fire, flooding or other causes, would have a material adverse effect on our business and results of operations.

We also maintain property all risks and public liability insurance policies for our manufacturing facilities. The occurrence of a significant event to our manufacturing facilities that we are not fully insured or indemnified against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect our business and results of operations.



## ***Employees***

As of December 31, 2008, we had 3,032 full-time employees located in Canada, Hong Kong and the PRC.

We believe that our relationships with our employees are generally good. We have not experienced any significant problems with the recruitment or retention of employees, nor suffered from any material disruption of our business operations as a result of any labor dispute, strike or employee dispute.

## **GOVERNMENT REGULATION**

### **PLANTATION INDUSTRY**

#### **Development of the Plantation Industry**

The PRC government encourages the development of the plantation industry in the PRC. In June 2003, the PRC State Council promulgated The Notice on the Decision to Speed Up the Development of Plantation Industry (Zhong Fa (2003) No. 9) (中共中央國務院關於加快林業發展的決定) dated June 25, 2003. The Key Elements of the Policies in Forestry Industry (林業產業政策要點) was jointly promulgated by the State Forestry Administration, National Development and Reform Commission, Ministry of Finance, Ministry of Commerce, State Administration of Taxation, China Banking Regulatory Commission and China Securities Regulatory Commission on August 10, 2007 for implementing this notice.

The notice records the decisions of the PRC central government to pursue the following main goals:

- to develop the non-state owned plantation industry and to encourage the participation of foreign investors in the plantation industry, either solely or jointly with others;
- to strengthen plantation infrastructure in order to ensure the continued development of the economy of the PRC;
- to expedite and reform the development of the plantation industry;
- to emphasize the importance of the plantation industry in the development and preservation of the ecological environment;
- to increase forest resources and the supply of forest products;
- to promote the infrastructure development of the ecological environment;
- to further improve the system of plantation rights in respect of the plantation land and plantation trees;
- to assist in the processing of transfers, leases, mortgages and pledges and making investments in joint ventures for plantations; and
- to strengthen financial support of the development of the plantation industry by continuing to provide long-term and low interest rate credit facilities and encouraging plantation operators to raise funds from the public.

The Key Elements of the Policies in Forestry Industry describe the following main goals:

- to insist on the consistency of the foreign investment policy, *i.e.*, to favor allocation of foreign investments on areas identified in the Catalog of Foreign-invested Industry Guidance (外商投資產業指導目錄) and the Catalog of Foreign-invested Dominant Industries of the Mid-west Region (中西部地區外商投資優勢產業目錄);
- to encourage and facilitate development and use of critical technologies, equipment and products that favor the upgrade of industrial structure of forestry;
- to gradually establish the Timber Industrial Zone composed of the Southeast Coastal Area, Southern Timberland and Huang-Huai-Hai Plain;
- to encourage the development of non-public-owned forestry, eliminate institutional obstacles to such development and introduce advanced international technologies and management experiences;
- to establish a sound product quality inspection and monitoring system and help forestry corporations obtain the ISO 9000 and ISO 14000 certifications;
- to strictly follow the released tax policy and provide insurance and financial services to companies and individuals in the forestry industry;
- to establish a platform for transactions of plantation land use rights;
- to improve forest harvesting management and facilitate harvesting of artificial commercial plantations, in particular at plantations supplying industrial raw materials, and to strengthen the operators' rights to cultivate the plantations; and
- to create a favorable environment for development of the forestry industry.

On July 14, 2008, the PRC State Council promulgated the Opinions on Comprehensively Promoting the Reform of the Collectively Owned Plantation Right System (中共中央國務院關於全面推進集體林權制度改革的意見) dated June 8, 2008 in order to further liberalize and modernize the forestry industry, develop the productivity of the forestry industry, increase farmers' income and develop the ecological system in the PRC. Such opinions provide that, among others, in accordance with applicable laws and regulations, the farmers with contractual rights over the collectively owned PRC commercial plantations may, without change of the plantation usage, dispose of such rights relating to plantation operations and plantation tree ownership rights through sub-contracts, leases, transfers, mortgages, or as contributions in capital or under cooperative structures.

### **Permits and Approvals Necessary for the Operation of our Plantation Business**

We are required to obtain the following permits and approvals for the operation of our tree plantation business:

- Plantation Rights Certificates in respect of the plantation land use rights and the ownership of our planted trees for our planted tree plantations;
- Plantation Rights Certificates in respect of the ownership of our purchased trees for our purchased tree plantations;
- timber logging permits; and
- timber transportation permits.

### **Plantation Rights Certificates for Our Planted Tree Plantations**

The PRC Forestry Law (中華人民共和國森林法) and the Implementation Regulations of the PRC Forestry Law (中華人民共和國森林法實施條例) implement the system of plantation rights registration and issuance of certificates. Pursuant to the Implementation Regulations, all entities should apply to the forestry bureau of the local PRC government at the county level or above for plantation rights registration and the local PRC government at the county level or above is responsible for issuing the plantation rights certificates. Applicants for plantation rights must submit plantation rights registration applications to the forestry bureau at the county level or above and official certificates should be issued to the applicants whose applications have been reviewed and registered by the forestry bureau.

### **Plantation Rights Certificates for Our Purchased Tree Plantations**

For our purchased tree plantations, we have applied for the relevant Plantation Rights Certificates with the relevant local forestry bureaus. As the relevant locations where we purchased our Purchased Tree Plantations have not fully implemented the new form Plantation Rights Certificate, we are not able to obtain all the corresponding Plantation Rights Certificates for our Purchased Tree Plantations. Instead, we obtained confirmation of our ownership of our Purchased Tree Plantations from the relevant forestry bureaus. Based on the relevant purchase contracts and the approvals issued by the relevant forestry bureaus, we legally own our purchased tree plantations.

### **Timber Logging Permits and Logging Quotas**

The Implementation Regulations stipulate that for foreign invested plantation projects, the logging quota will be allocated separately by the provincial forestry department within the annual logging quota approved by the PRC State Council. The WFOEs with planted tree operations will be able to obtain the logging permits within the timber logging quota allocated by the provincial forestry departments.

The logging quota of our purchased tree plantations have been confirmed by the relevant forestry bureaus where the purchased tree plantations are located.

### **Timber Transportation Permit**

Upon obtaining the timber logging permit and provision of certain supporting documents required by the local forestry bureaus, such as the quarantine certification, there should not be any legal constraints for the WFOEs to obtain timber transportation permits.

## MANUFACTURING

### Engaging in the Timber Business

The Implementation Regulations stipulate that any entity engaged in the timber business (including those processing timber) in forestry areas must obtain approval from the forestry bureau of the local PRC government at the county level or above. Certain PRC provinces impose further requirements for granting permission to engage in the timber business, which means that any entity engaged in the timber operations and processing business within the relevant provinces must also apply for a timber business permit from the forestry bureau of the appropriate jurisdiction.

### Regulations that Apply Nationwide

The Implementation Regulations provide that corporations that engage in the timber business (including those processing timber) in forestry areas must obtain approval from the forestry bureau at the county level or above. Any violation of this regulation will result in confiscation of the timber and any illegal gains and payment of a fine of up to twice the amount of the illegal gain.

The Notice on the Enforcement of Management of Forest Resource Protection issued by the General Office of the PRC State Council (國務院辦公廳關於加強森林資源保護管理工作的通知), implemented on May 16, 1994, provides that entities engaging in the timber business and processing of timber in forestry areas and key forestry counties must obtain assessment and approval from the relevant forestry bureaus, then apply for registration with the relevant Administration for Industry and Commerce by obtaining a business license and complying with the business objectives as stated on the license.

The Administration of Standardization of Forestry Regulations (林業標準化管理辦法), implemented on September 1, 2003, provides that the technical requirements of forestry products, quality of timber saplings, safety, hygiene standards, testing, packaging, storing and transportation practices and inspection methods, must be standardized.

In October 2006, the PRC State Forestry Administration promulgated the Notice for Further Strengthening the Administration and Supervision of the Timber Operation and Processing (關於進一步加強木材經營加工監督管理的通知) and adopted a series of rules for the administration and supervision of the timber processing and operating business.

### Eleventh Five-Year Plan

The Eleventh Five-Year Plan (2006-2010), implemented during the Tenth National People's Congress held in March 2006, stipulated plans to improve "three rural problems" in the agricultural sector in relation to agricultural, rural areas and farmers. Top priority will be given to solving the issues of rural poverty with an aim to narrow the poverty gap between urban and rural dwellers. The Eleventh Five-Year Plan calls for infrastructure improvement, social development in rural areas, and creation of regional markets to promote a "new socialist countryside." On the forestry front, the State Forestry Administration plans to speed up the development of fast-growing, high-yield plantation and forestry integration by creating synergy between upstream tree plantations and downstream pulp mills and manufacturing operations.

## RISK FACTORS

### Risks Related to Our Business

#### *The cyclical nature of the forest products industry and price fluctuations could adversely affect our results of operations*

Our results of operations are, and will continue to be, affected by the cyclical nature of the forest products industry. Market prices and demand for standing timber, wood logs and wood products have been, and in the future are expected to be, subject to cyclical fluctuations, which have a significant effect on our business, results of operations and financial condition. The pricing in the forestry market is affected by the prices of the ultimate wood products produced from logs in the PRC, including furniture, construction materials, interior decoration materials and pulp and paper products. The prices of wood products are also affected by the availability of wood substitutes. The markets for wood products are sensitive to changes in industry capacity and output levels, general timber industry conditions and cyclical changes in the world and PRC economies, any of which can have a significant impact on selling prices of wood products. The demand for wood products is also substantially affected by the level of new construction activity, which is subject to fluctuations that may or may not correspond to overall economic trends. Decreases in the level of construction activity generally reduce demand for wood products. The demand for wood products is also affected by the level of interior decoration activity and the demand for wood chips in the pulp and paper markets. These activities are, in turn, subject to fluctuations due to, among other factors:

- changes in domestic and international economic conditions;
- changes in market prices of commodities;
- governmental regulations and policies;
- interest rates;
- population growth and changing demographics; and
- seasonal weather cycles (such as dry or hot summers, wet or cold winters).

Cyclical changes in the forest products industry, including changes in demand and pricing for our products and the other factors described above, could have a material adverse effect on our business, financial condition and results of operations.

#### *Expanding our tree plantations and our manufacturing operations requires substantial future capital expenditures and we may be unable to obtain adequate financing to fund our capital and other requirements*

Expanding our tree plantations and our manufacturing operations requires intensive capital investment. During the years ended December 31, 2006, 2007 and 2008, we incurred approximately US\$407.2 million, US\$647.0 million and US\$672.5 million, respectively, in capital expenditures to acquire tree plantations. We have also recently expanded our manufacturing operations through investments in an engineered wood flooring plant in Jiangsu, an oriented strand board plant in Heilongjiang, finger-joint board and block board plants in Hunan and sawn timber facility in Yunnan. We have financed our expansion of tree plantations and manufacturing operations primarily from internal cash flows and debt and equity financing and, if we require additional debt or equity financing for future

capital expenditures, we can give no assurance that such financing will be available in the future on attractive terms or at all.

In addition, we have substantial indebtedness currently outstanding, including US\$300 million 9 1/8% guaranteed senior notes due 2011 that we issued in August 2004 (the “2004 Senior Notes”), a US\$150 million loan facility with several financial institutions (the “Syndicated Term Loan”) and US\$345 million 5% convertible senior notes due 2013 that we issued in July and August 2008 (the “2008 Convertible Senior Notes”), the terms of which restrict our ability to raise additional debt financing. Such restrictions could affect our ability to raise financing in the future. If we are not able to obtain financing for expanding our tree plantations and/or manufacturing operations and/or other capital requirements our business, financial condition and results of operations may be materially and adversely affected.

***Our decision and ability to develop and operate future tree plantations is subject to various factors and uncertainties, and no assurance can be given that we will actually develop and operate the amount of tree plantations with respect to which we have certain contractual rights***

Our ability to further expand and develop our tree plantations and successfully implement our tree plantation models depends, among other things, on our ability to purchase trees with respect to which we have certain contractual rights and to lease the underlying plantation land on which the trees are located or to find other suitable plantation land. Under our agreements for most of our tree plantations, we have a right to purchase trees and a pre-emptive right to lease the underlying plantation land for a maximum period of up to 30 to 50 years, subject to negotiation of the definitive land use right transfer agreement, obtaining the requisite governmental approval and completing the requisite registration procedures. Our decision and ability to purchase the trees and exercise our contractual rights with respect to our tree plantations will depend on, among other factors, our business strategy and the availability of future financing, our ability to negotiate a final price, whether the area is desirable for tree plantations and the availability of tree plantations for expansion.

Should we be unable to purchase the trees, exercise our right to acquire the underlying plantation land use rights or obtain and complete the requisite governmental approval and registration procedures, or should we be unable to locate available and suitable plantation land for expansion, our business, financial condition and results of operations could be materially and adversely affected.

***Our integrated tree plantation model has a short operating history and may not be successful***

We commenced set-up and operations of our integrated tree plantation model in the fourth quarter of 2006 which consists of selling trees from our plantations as logs or using the wood fibre for producing value-added wood products at our own manufacturing facilities. Our integrated tree plantation model is in an early business stage and has a short operating history. We may be unable to continue to acquire standing timber under the long-term acquisition agreements due to factors such as (i) risks of disagreement with counterparties and/or original plantation rights holders in the provinces regarding entering into specific agreements for the implementation of our plantation acquisition plan, (ii) the failure of any such counterparty to obtain any requisite consents from the original plantation rights holders, and (iii) risks of the counterparties failing to coordinate with us to obtain the requisite governmental approvals and complete the related registration procedures. In addition, we may not have the ability to allocate proper management resources and attention to the implementation of our integrated tree plantation model as well as coordinate the integration of our tree plantations with our downstream manufacturing activities. Furthermore, although results of operations and gross profit margins generated by sales of logs pursuant to our integrated tree plantation model in the year ended December 31, 2008 exceeded management’s guidance, such results are not necessarily indicative of results that may be achievable in the future. We may be subject to operational and execution risks of integrating our upstream plantation activities to our



downstream manufacturing operations, among other things.

***Our expansion in new regions may pose certain implementation risks***

We commenced operations in Hunan and Yunnan Provinces for the first time in the fourth quarter of 2006 and the first quarter of 2007, respectively. We are exposed to certain risks relating to our ability to successfully operate our plantations in those regions, primarily because we have no operating history in Hunan and Yunnan Provinces, and also because we do not have extensive experience interacting with local governments, business counterparties and original plantation rights holders in these provinces. These risks are aforementioned under the integrated tree plantation model.

***We are subject to risks presented by fluctuations in exchange rates***

We publish our financial statements and incur substantially all of our indebtedness in U.S. dollars, while substantially all of our revenue is denominated in Renminbi.

Since 1994, the conversion of Renminbi into U.S. dollars has been based on rates set by the People's Bank of China, which are set daily based on the previous day's PRC interbank foreign exchange market rate and current exchange rates on the world financial markets. The relative value and rate of exchange of the Renminbi against the U.S. dollar is affected by, among other things, changes in the PRC's political and economic conditions. On July 21, 2005, the PRC government changed its decade-old policy of pegging the value of the Renminbi to the U.S. dollar. Under the new policy, the Renminbi is permitted to fluctuate within a narrow and managed band against a basket of certain foreign currencies. This change in policy has resulted in an appreciation of the Renminbi against the U.S. dollar of more than 17.6% since the July 21, 2005 change in exchange rate policy. The PRC government may decide to adopt an even more flexible currency policy in the future, which could result in a further and more significant appreciation or depreciation of the Renminbi against the U.S. dollar.

Renminbi devaluation and exchange rate fluctuations may adversely affect our results of operations and financial condition and may result in foreign exchange losses because we have substantial foreign currency-denominated indebtedness, expenses and other requirements while most of our revenues are denominated in Renminbi. In addition, we may not be able to increase the Renminbi prices of our domestic sales to offset fully any depreciation of the Renminbi due to political, competitive or social factors. To the extent the Renminbi appreciates against the U.S. dollar or other currencies, it will make it more expensive for us to finance the expansion of our plantations in the PRC through equity or non-Renminbi borrowings.

At December 31, 2008, our total long-term debt was US\$714.5 million, all of which was denominated in U.S. dollars. Except for the U.S. dollar semi-annual interest payments due under the 2004 Senior Notes, we do not currently hedge exchange rate fluctuations between the Renminbi and other currencies.

Any significant fluctuation in the exchange rates between the Renminbi and other currencies, such as the U.S. dollar, Canadian dollar, Euro and H.K. dollar, or in the U.S. dollar against the Renminbi, the Canadian dollar, the Euro or the H.K. dollar, may have an adverse impact on our results of operations and may adversely affect the value, translated or converted into U.S. dollars, Canadian dollars or otherwise, of our revenue and net income.

***The forestry industry is susceptible to weather conditions, timber growth cycles and natural disasters outside of our control***

Our business, financial condition and results of operations depend to a significant extent on our ability to harvest trees or engage in trading activities at adequate levels. The following factors, which are outside of our control, may affect the prices of logs and wood-based products, and our ability to harvest the trees on our tree plantations or engage in our trading activities:

- unfavorable local and global weather conditions, such as prolonged drought, flooding, hailstorms, windstorms, typhoons, frost and winter freezing; and
- the occurrence of natural disasters, such as damage by fire, insect infestation, crop pests, and earthquakes.

In recent years, certain areas of the PRC have been adversely affected by severe flooding. In addition, the southern coastal areas of the PRC suffer a number of typhoons each season, which lasts from June to September and occasionally results in significant damage. Further, there have been several incidences of forest fires in Guangdong Province. Dry weather conditions brought by the El Niño weather pattern in 1998 adversely affected certain areas of the world. In 1996, damage brought about by frost adversely affected the yield of eucalyptus plantations on higher altitude inland plantations in the PRC. In February 2008, snow and freezing rain storms damaged plantations in certain provinces. Similar conditions may well recur in the future. The occurrence of these or other natural disasters may disrupt or reduce the supply of trees available for harvesting in the areas of the PRC where our tree plantations are located, or otherwise disrupt our trading activities, which may adversely affect our business, financial condition and results of operations.

***We may not be able to meet our expectations for the yields of our tree plantations***

The success of our business depends upon the productivity of our tree plantations and our ability to realize yields at estimated levels. We estimate that the current average standing timber yield for our eucalyptus trees ranges from approximately 100 to 150 cubic meters per hectare per six-year cycle. See “Business — Our Wood Fibre Operations — Harvest Yields.” Tree plantation yields depend on a number of factors, many of which may be beyond our control. These include weather, climate and soil conditions, as well as damage by disease, pests and other natural disasters. Our ability to maintain our yields will depend on these factors, and in particular the weather, climate and soil conditions for additional tree plantations that we may obtain in the future.

Our ability to improve or maintain our yields will depend on the factors described above as well as our ability to develop genetic improvements in planting materials, our ability to grow improved eucalyptus trees and our ability to implement improved silvicultural practices as we gain experience in managing eucalyptus tree plantations. As a result, we cannot provide any assurance that we will be able to realize the historical or future yields expected by us. If we cannot achieve yields at expected levels, our business, financial condition and results of operations would be materially and adversely affected.

***We may not be able to effectively manage our tree plantations if we do not hire additional employees and improve our management systems and our internal controls***

As of December 31, 2008, we had 3,032 permanent employees based in Canada, Hong Kong and the PRC to manage our operations. We also engage third parties to perform the day-to-day operations of our tree plantations. However, as we expand the area of our tree plantations, we will have to hire additional management employees, strengthen our management processes and develop a plantation resources



information system in order to effectively manage our tree plantations. There is no assurance that we will be able to recruit qualified management employees, strengthen our management processes or develop such an information system in a timely manner, or at all. We also believe that it is necessary for us to strengthen our internal controls and corporate governance as we continue to build our business. Should we fail to take the measures described in this paragraph, we may not be able to implement our expansion strategy or to manage our growth effectively and our business, financial condition and results of operations could be materially and adversely affected.

***The forest products industry is highly competitive***

The forest products industry is highly competitive in terms of price and quality. Wood products are subject to increasing competition from a variety of substitute products, including non-wood and engineered wood products. Lumber and log markets in the PRC are subject to competition from worldwide suppliers. In our tree plantations and standing timber and wood-based products trading activities, we are subject to increasing competition from other large domestic and foreign-owned tree plantations in the PRC, as well as wood dealers and local forestry companies, all of which provide logs and wood-based products for sale in the PRC. We also compete with a number of overseas forestry companies selling wood logs and wood-based products in the PRC.

Our manufacturing plants face competition from other large domestic and foreign-owned wood panel manufacturers in the PRC, as well as manufacturers in other countries selling into the PRC. In this regard, other manufacturers of wood panels are currently constructing new mills in the PRC that will substantially increase the production capacity of wood panels in the PRC. We may not be able to compete effectively against these and other potential competitors. If we are not able to compete effectively in our different business lines, or if competition significantly increases, our business, financial condition and results of operations could be materially and adversely affected.

***We rely on our relationships with local plantation landowners and/or plantation land use rights holders***

The conversion of the legal structure of all four CJVs into WFOEs was completed in the fourth quarter of 2007 and negotiations with local farmers and collective organizations for entering into new plantation land use agreements are in progress. There can be no assurance that through the WFOEs we will be able to secure all the plantation land use rights we would expect them to secure, or secure such rights on satisfactory terms, from the farmers and collective organizations or that we will be able to enter into any plantation land use agreements with relevant farmers, collective organizations or land use rights holders to maintain the use of the tree plantations originally operated by our former CJVs or to obtain additional tree plantations.

In addition, we rely on our relationships with local plantation landowners and/or plantation land use rights holders to enter into any plantation land use agreements on commercially acceptable terms for our purchased tree plantations. We cannot give any assurance that we will be able to enter into any such agreements on commercially acceptable terms.

***The loss of business from a major customer could reduce our sales and harm our business and prospects***

A few large customers account for a significant percentage of our total revenue. During the years ended December 31, 2006, 2007 and 2008, our top five customers accounted for approximately 57.5%, 58.7% and 55.6%, respectively, of our total revenue. For the same periods, our largest customer accounted for approximately 12.9%, 15.8% and 13.9%, respectively, of our total revenue. These major customers are all wood dealers and our AIs who sell logs and wood-based products to end-user customers of these

products. As a result, we expect that, for the foreseeable future, sales to a limited number of customers will continue to account, alone or in the aggregate, for a significant percentage of our total revenue. Dependence on a limited number of customers exposes us to the risk that a reduction of business volume from any one customer could have a material adverse effect on our business, financial condition and results of operations.

***Disruptions in our supply of raw timber could adversely affect our business, financial condition and results of operations***

A few large suppliers account for a significant percentage of our timber supply. For the years ended December 31, 2006, 2007 and 2008, our five largest timber suppliers accounted for approximately 44.2%, 54.8% and 45.5%, respectively, of our total costs of sales. For the same periods, our largest supplier of timber accounted for approximately 12.6%, 32.2% and 16.5%, respectively, of our total costs of sales. These major suppliers are all wood dealers and our AIs. We have not entered into any long-term supply contract for supply of raw timber. Dependence on a limited number of suppliers exposes us to the risk that any significant interruption in the supply of raw timber could have a material adverse effect on our business, financial condition and results of operations.

***We depend on services provided by third party service providers***

We rely to a significant extent on third party service providers for day-to-day operation of our tree plantations. The operations performed by third party service providers include: site preparation, planting, plantation management, fertilization and harvesting. We occasionally experience seasonal labor shortages in May and September as farmers become fully engaged in the planting and harvesting of rice. If we are unable to obtain services from these third party service providers, at economical rates or at all, or if any of the services they provide are inadequately performed, our business, financial condition and results of operations would be materially adversely affected.

***If we lose any of our key personnel, our operations and business may suffer***

We are heavily dependent upon our senior management in relation to their expertise in the forestry industry and research and development in forest plantation management practices and wood-based products manufacturing production processes, and the relationships cultivated by them with our major customers and others. We have no long-term contracts with any of our senior management. We do not have key person life insurance policies covering any of our employees, including our senior management. The departure, or otherwise loss of service, of any of our senior management could materially and adversely affect our business, financial condition and results of operations.

***We may face difficulties during the transitional stages of our expansion; we may experience difficulties in managing future growth and potential acquisitions***

Our organic growth, as well as growth arising from acquisitions, could place a significant strain on our managerial, operational and financial resources. Our ability to manage our future growth will depend on our ability to continue to implement and improve operational, financial and management information systems on a timely basis and to train, motivate and manage an enlarged workforce and our ability to integrate our existing workforce with that of any businesses that we may acquire. Failure to effectively manage our expansion may lead to increased costs, a decline in sales and reduced profitability.

We may also seek to achieve our growth targets through acquisitions of local businesses providing access to new markets and/or creating synergies with our existing business. We may not be able to identify appropriate targets, complete the acquisitions on satisfactory terms (particularly as to price) or

efficiently integrate the acquired companies or activities and achieve the expected benefits in terms of cost and synergies, which could adversely affect our business, financial condition and results of operations. There can be no assurance that we will be able to achieve our growth objectives.

***Our manufacturing plants are in an early stage of development and have a short operating history. Our manufacturing plants may not be profitable or successful***

Our manufacturing plants are subject to the risks inherent in establishing a new business, including competitive pressures. Our ability to conduct and expand our manufacturing plants will depend upon our ability to, among other things:

- produce and develop high quality wood-based products that will be acceptable to customers;
- recruit and retain technical and management personnel with requisite expertise and experience in the wood-based products manufacturing industry; and
- raise working capital and fund capital expenditures for the expansion of the manufacturing plants.

We have reassessed our manufacturing development plan and in accordance with such plan, we have: (i) completed the second phase expansion of an engineered wood flooring plant in Jiangsu in 2007, with a total production capacity of 6.5 million square meters, (ii) developed an oriented strand board plant in Heilongjiang with a production capacity of 12,000 cubic meters, (iii) developed finger-joint board and block board processing facilities in Hunan Province with a total annual production capacity of 150,000 cubic meters, and (iv) established the Yunnan sawn timber facility with an estimated annual production capacity of 18,000 cubic meters. We can give no assurance that these facilities will operate at their planned operating capacity.

***Our insurance coverage may be insufficient to cover losses***

Consistent with PRC forestry industry practice, we have a policy of obtaining external insurance coverage for key insurable risks relating to our tree plantations and the operation of our manufacturing facilities. As a general matter, most of our insurance policies include a coverage limit that applies either per claim or per claim and per year, in particular for our purchased tree plantations. See “Business — Insurance.”

We insure our planted and purchased tree plantations in various locations in the PRC against certain accident and disaster related losses such as fires, lightning, explosion, flooding and windstorm. We do not, however, insure our plantations against losses from all natural and other disasters, such as pest and disease, and we do not carry business interruption insurance. As a result, our insurance coverage may be insufficient to cover losses that we may incur on our tree plantations. If we were to suffer an uninsured loss or a loss in excess of our insurance coverage to our tree plantations, our business, financial condition and results of operations could be materially and adversely affected. We also maintain property all risk and public liability insurance policies for our manufacturing facilities. We maintain a level of fire insurance in amounts that we consider to be appropriate for such risks. Such insurance is subject to deductibles that we consider reasonable and not excessive given the current insurance market environment. The occurrence of a loss at our manufacturing facilities that we are not fully insured or indemnified against, or the failure of a party to meet its indemnification obligations, could materially and adversely affect our business, financial condition and results of operations.

***Our manufacturing plants are subject to operational risks for which we may not be adequately insured***

The operation of manufacturing plants involves many risks and hazards, including the breakdown, failure or substandard performance of equipment, the improper installation or operation of equipment, labor disturbances, natural disasters, environmental hazards, and industrial accidents. In addition, the costs of repairing or replacing our production equipment and the associated downtime of the affected production line may not be insured, or the level of insurance may not be adequate. The occurrence of material operational problems could have a material adverse effect on our business, financial condition and results of operations.

***We may be liable for income and related taxes to our business and operations, particularly our BVI Subsidiaries, in amounts greater than the amounts we have estimated and for which we have provisioned***

Our principal operating subsidiaries incorporated in the British Virgin Islands (the “BVI Subsidiaries”) are engaged in the sale of standing timber and earning income (“Authorized Sales Activities”) in the PRC through authorized intermediaries (“AI”) that are domestic enterprises of the PRC. In accordance with the PRC laws and regulations relating to PRC enterprise income tax, foreign companies such as the BVI Subsidiaries, deriving income from sources in the PRC are subject to enterprise income tax. This also applied to income and commission revenue that the BVI Subsidiaries received from the sale of wood chips in prior years. The wood chips and commission operations were discontinued in 2007.

Under the terms of the master agreements, relevant sales and purchase contracts and commission agreements (“AI Agreements”) made with the AI, the AI are responsible for remitting relevant PRC taxes that arise from the Authorized Sales Activities. It is a question of fact whether the PRC tax authorities may be successful in establishing that the BVI Subsidiaries are subject to enterprise income tax due to the Authorized Sales Activities. Management has concluded that based upon all available evidence it is appropriate to record in the accounts a reserve for tax benefits representing management’s estimate, based upon cumulative probabilities, of the amount the PRC tax authorities might seek to recover.

Included in accounts payable and accrued liabilities including discontinued operations as at December 31, 2008 is the balance of the tax provision for the tax related contingency amounting to US\$89,909,000 [2007 – US\$80,165,000] provided on the profits of the Authorized Sales Activities earned by the BVI Subsidiaries in the current and in the three previous years.

The provision for income taxes and tax related liabilities and whether tax filings are required is subject to a number of different factors, estimates and judgment made by management. A change in the facts and these estimates and judgment could have a material impact on the Company’s tax expense. We have operations in various countries (mainly in the PRC, Canada and Hong Kong) that have different tax laws and rates and are subject to audit by all relevant tax authorities. The effective tax rate may change from year to year based on the mix of income among the different tax jurisdictions in which we operate, changes in tax laws in these jurisdictions, and changes in tax treaties between various tax jurisdictions in which we operate. It is possible that profits already taxed by one tax jurisdiction could be taxed by another tax jurisdiction or multiple jurisdictions. Should the PRC tax authorities recover income tax, business tax and value-added tax directly from the BVI Subsidiaries, they might do so together with related tax surcharges and tax penalties on applicable income or profits of the Authorized Sales Activities from the BVI Subsidiaries for up to a period from three to five years in practice. Under prevailing PRC tax rules, the tax surcharge is calculated at 0.05% per day on the tax amount overdue while the tax penalties can range from 50% to 500% of taxes underpaid. Under the Hong Kong tax regulations,

assessments are open for up to six years in practice and tax penalties can be up to treble amount of the tax underpaid.

Significant estimates and judgment are applied by management to determine the appropriate amount of tax related liabilities and contingencies for tax related liabilities to be recognized and disclosed in the financial statements respectively. Changes in the amount of the estimates could materially increase or decrease the provision for tax related liabilities and the extent of disclosures of contingencies for tax related liabilities in a period.

***Increases in the export tax on logs in Russia may result in decreased demand for logs imported from Russia***

The Russian government significantly increased the export tariffs on logs from 6.5% in early 2007 to 20% and 25% in July 2007 and April 2008, respectively, with a further planned increase to 80% in January 2009 according to RISI, Inc., an information provider for the global forestry industry (“RISI”). These increases primarily had an impact on our revenue from sales of imported wood products, which decreased by 7.3% in the year ended December 31, 2008 compared to the year ended December 31, 2007. Although taxes levied will be passed on to our customers, we do anticipate that demand for logs we import from Russia will continue to decrease as a result of increased prices, which could have a material adverse effect on our results of operations.

The Russian government announced in November 2008 that it would delay the log export tariff increase proposed for January 1, 2009 by nine to twelve months.

***We will be obliged to adopt new accounting standards under IFRS for the years beginning on or after January 1, 2011, which could materially impact our financial statements***

We prepare our financial statements in accordance with Canadian GAAP. All companies that are Canadian reporting issuers will have to use the International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board for their financial reporting for the years beginning on or after January 1, 2011. As such issuers are required to produce comparative consolidated financial statements, the transition to IFRS will have to be reflected in their balance sheets as at January 1, 2010, in order to provide comparable balance sheet, income statement and statement of cash flows data for financial years 2011 and 2010. Applying these standards to our financial statements may have a considerable impact on a number of important areas. The preparation of our financial statements in accordance with IFRS could result in significantly different results from those obtained from financial statements prepared in accordance with Canadian GAAP. In particular, the valuation of our assets, especially our plantations, may be substantially affected by the application of IFRS to our financial statements. We are in the process of completing a detailed IFRS diagnostic analysis to assess the full impact of these new standards on our financial statements.

***Our tree plantations and wood-based products trading activities are subject to extensive PRC laws and regulations***

We are subject to regulation under a variety of PRC national and local laws and regulations, including, among others, the PRC Forestry Law (中華人民共和國森林法) and its Implementation Regulations (中華人民共和國森林法實施條例), the Forest Tree and Forestry Land Ownership and Use Rights Registration Administrative Measures (林木和林地權屬登記管理辦法), the Environmental Protection Law of the PRC (中華人民共和國環境保護法) and the Administrative Measures on Foreign



Investment Forestation of Guangdong Province (廣東省外商投資造林管理辦法). Violations of any of the wide range of PRC laws and regulations that we may be subject to, including PRC environmental policies and programs that apply to our tree plantations, could result in civil and criminal penalties, including the revocation of licenses required for our business. We engage in the following activities that are subject to regulation:

- tree plantation activities, including planting, plantation use and maintenance, logging and transportation of logs;
- marketing, sale and trading of standing timber, logs and wood-based products; and
- timber processing and manufacturing and sale of wood panels.

For further details on these regulations and risks relating to them, see below under “Risks Related to the PRC.”

***Our subsidiaries are subject to restrictions on the payment of dividends and the repayment of inter-company loans or advances to us and our subsidiaries***

As a holding company, we depend upon the receipt of dividends and the repayment of intercompany loans or advances from our subsidiaries and affiliates, including our PRC Subsidiaries, to satisfy our debt obligations. The ability of our direct and indirect subsidiaries to pay dividends and repay intercompany loans or advances to their shareholders (including us) is subject to, among other things, distributable earnings, cash flow conditions, restrictions contained in the articles of association of our subsidiaries, applicable laws and restrictions contained in debt instruments of such subsidiaries. Covenants in the debt instruments of certain direct and indirect subsidiaries of ours limit their ability to pay dividends. In addition, if any of our subsidiaries raises capital by issuing equity securities to third parties, dividends declared and paid with respect to such shares may not be available to us to make payments on the debt obligations. These restrictions could reduce the amounts that we receive from our subsidiaries, which could restrict our ability to meet our payment under the debt obligations. Our ability to utilize cash resources we have from our subsidiaries to finance the needs of other subsidiaries, to a significant extent, is subject to the same restrictions.

In addition, PRC regulations permit payment of dividends only out of accumulated profits as determined in accordance with PRC accounting standards and regulations. Our subsidiaries in the PRC are also required to set aside a portion of their after-tax profits according to PRC accounting standards and regulations to fund certain reserve funds that are not distributable as cash dividends. Furthermore, under prevailing PRC income tax laws, there is a 10% withholding tax imposed on dividend payments received by foreign investors in our PRC Subsidiaries. If the foreign investor is a Hong Kong resident, such withholding tax rate may be lowered to 5% pursuant to a double tax treaty between Hong Kong and the PRC.

In practice, our PRC Subsidiaries may declare dividends once a year at the end of each financial year. We currently conduct substantially all of our operations in the PRC through our WFOEs. Under their articles of association adopted in accordance with PRC regulations, the WFOEs are only allowed to declare dividends once a year although such dividends may be distributed multiple times each year. As a result of such limitations, there could be timing limitations on payments from our PRC Subsidiaries to meet our payment under the debt obligations and there could be restrictions on payments required to pay off the debt obligations at maturity or upon conversion or for repurchase or redemption.

Furthermore, in practice, the market interest rate that our PRC Subsidiaries can pay with respect to offshore loans generally may not exceed comparable interest rates in the international finance markets. Our PRC Subsidiaries are also required to pay a 10% (or 7% if the interest is paid to a Hong Kong resident) withholding tax as well as a 5% business tax on our behalf on the interest paid under any shareholders' loans. Prior to payment of interest and principal on such shareholder loan, the PRC Subsidiaries must present evidence of payment of the required withholding tax on the interest payable under any such shareholder loan and evidence of registration with State Administration for Foreign Exchange ("SAFE"), as well as any other documents that SAFE or its local branch may require.

As a result of the foregoing, there can be no assurance that we will have sufficient cash flow from dividends or payments on inter-company loans or advances from our subsidiaries to satisfy our debt obligations or make dividend payments on our Common Shares.

***Our ability to pay dividends to our shareholders is subject to restrictive covenants under the indenture relating to the 2004 Senior Notes and the Syndicated Term Loan***

On August 17, 2004, we issued the 2004 Senior Notes. The indenture pertaining to the 2004 Senior Notes contains restrictive covenants limiting our ability and the ability of our subsidiaries to make certain restricted payments, including dividends. Such covenants in the indenture relating to the 2004 Senior Notes prevent us and our subsidiaries from making dividend payments, except under certain circumstances, unless our restricted payments under the indenture (including such dividends) shall not exceed a certain threshold based on financial aggregates such as our consolidated net income, net cash proceeds from asset sales or issuance or sale of equity securities, and net reductions in our consolidated investments due, among other things, to specific payments by us or certain of our subsidiaries. Similar restrictions on payment of dividends are contained in our Syndicated Term Loan dated as of February 24, 2006. No assurance can be given that we will be able to make dividend payments on our Common Shares under these covenants should we ever decide to do so in the future.

***We have substantial indebtedness and may incur substantial additional indebtedness in the future, which adversely affects our financial health and our ability to generate sufficient cash to satisfy our outstanding and future debt obligations***

We have a substantial amount of indebtedness. As of December 31, 2008, our total short and long term debt was approximately US\$787.6 million.

Our substantial indebtedness could have important consequences. For example, it could:

- limit our ability to satisfy our obligations under existing debt;
- limit our ability to make dividends or other distributions to our shareholders;
- increase our vulnerability to adverse general economic and industry conditions;
- require us to dedicate a substantial portion of our cash flow from operations to servicing and repaying our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for or reacting to changes in our businesses and the forestry industry in which we operate;
- place us at a competitive disadvantage compared to our competitors that have less debt;

- limit, along with the financial and other restrictive covenants of our indebtedness, among other things, our ability to borrow additional funds; and
- increase the cost of additional financing.

In particular, the Syndicated Term Loan and the indenture relating to our 2004 Senior Notes include restrictive covenants limiting our ability to incur additional debt. Such debt covenants in the indenture relating to the 2004 Senior Notes and the Syndicated Term Loan proscribe us from incurring new debt, except under certain circumstances, unless we meet a specified financial ratio. Further, the indenture governing our 2008 Convertible Senior Notes provides, in certain cases, restrictions against some of our subsidiaries providing additional guarantees.

In the future, we may from time to time incur substantial additional indebtedness. If we or our subsidiaries incur additional debt, the risks that we face as a result of our already substantial indebtedness and leverage could intensify.

Our ability to generate sufficient cash to satisfy our outstanding and future debt obligations will depend upon our future operating performance, which will be affected by prevailing economic conditions and financial, business and other factors, many of which are beyond our control. We anticipate that our operating cash flow should be sufficient to meet our anticipated operating expenses and to service our debt obligations as they become due. However, we may not generate sufficient cash flow for these purposes. If we are unable to service our indebtedness, we will be forced to adopt an alternative strategy that may include actions such as reducing or delaying capital expenditures, selling assets, restructuring or refinancing our indebtedness, or seeking equity capital. These strategies may not be instituted on satisfactory terms, if at all.

In addition, certain of our financing arrangements impose operating and financial restrictions on our business. These provisions require us to, among other things, maintain a debt to equity ratio, a capital asset coverage ratio, an EBITA to interest expense ratio, a current ratio, and a debt to timber holdings ratio, above certain specified levels. Our ability to meet our financial ratios may be affected by events beyond our control. We cannot assure that we will be able to meet these ratios. These provisions may negatively affect our ability to react to changes in market conditions, take advantage of business opportunities we believe to be desirable, obtain future financing, fund needed capital expenditures, significantly increase research and development expenditures, or withstand a continuing or future downturn in our business. Any of these could materially and adversely affect our ability to satisfy our debt obligations.

***If we are unable to comply with the restrictions and covenants in our debt agreements, there could be a default under the terms of these agreements, which could cause payment of our debt to be accelerated***

If we are unable to comply with the restrictions and covenants in our current or future debt and other agreements, there could be a default under the terms of these agreements. In the event of a default under these agreements, the holders of the debt could terminate their commitments to lend to us, accelerate the debt and declare all amounts borrowed due and payable or terminate the agreements, as the case may be. Furthermore, some of our debt agreements contain cross-acceleration or cross-default provisions. As a result, our default under one debt agreement may cause the acceleration of debt, or result in a default under our other debt agreements. If any of these events occur, we cannot assure that our assets and cash flow would be sufficient to repay in full all of our indebtedness, or that we would be able to find alternative financing. Even if we could obtain alternative financing, we cannot assure that it would be on terms that are favorable or acceptable to us.



## **Risks Related to the PRC**

### ***PRC economic, political and social conditions as well as government policies could adversely affect our business***

All of our tree plantations are located in the PRC. The PRC economy differs from the economies of most developed countries in many respects, including structure, government involvement, level of development, economic growth rate, government control of foreign exchange, allocation of resources and balance of payment position.

The PRC economy has been transitioning from a planned economy to a more market-oriented economy. For the past two decades the PRC government has implemented economic reform measures emphasizing utilization of market forces in the development of the PRC economy. Some of these measures will benefit the overall PRC economy, but may have a negative effect on us.

Our business, financial condition and results of operations may be adversely affected by:

- changes in PRC political, economic and social conditions;
- changes in policies of the PRC government, including changes in policies affecting the forestry industry and downstream industries;
- changes in laws and regulations or the interpretation of laws and regulations;
- measures which may be introduced to control inflation or deflation;
- changes in the rate or method of taxation;
- imposition of additional restrictions on currency conversion and remittances abroad; and
- reduction in tariff protection and other import restrictions.

In addition, the level of demand in the PRC for forestry products depends heavily on economic growth. According to the National Bureau of Statistics of China, between 1994 and 2007, the PRC's GDP, based on current prices, increased from approximately RMB482 billion to approximately RMB25.0 trillion. The annual per capita GDP, based on current prices, also rose during this period, from RMB4,044 to RMB18,934. This growth, however, has been uneven both geographically and among various sectors of the economy. From time to time, the central government of the PRC has taken corrective measures and actions to stabilize the country's economy and any possible social unrest, and has implemented various measures in strengthening and improving macroeconomic regulation. We cannot assure that such growth will be sustained in the future.

More recently, the global financial system has experienced significant difficulties and disruptions since the second half of 2007, leading to reduced liquidity, greater volatility, widening credit spreads and a lack of price transparency in the United States and global credit and financial markets. The difficulties in global credit and financial markets have also resulted in widening global economic downturn. There are indications that the current financial crisis and economic downturn may persist or worsen. The slowdown experienced in the economies of the United States, the European Union and certain Asian countries with which the PRC has significant trade relationships may adversely affect economic growth in the PRC. There are indications that economic growth in the PRC has already started to slow significantly

with GDP growth for the PRC declining from 13 % in 2007 to 9 % in 2008. In particular, demand may decrease or slow for wood fibre and wood products from our downstream customers in the PRC real estate, construction and interior decoration industries, as well as overseas demand for exports of Chinese-made wood furniture. Such a decrease and/or slowdown in demand for wood and wood products could in turn put downward pressure on log prices in the PRC.

While various governments, including that of the PRC, have announced efforts to increase liquidity in the financial markets and stimulus packages to slow or reverse the economic downturn, there can be no assurance that these measures will be successful. If the PRC economy continues to grow at a slower rate, or experiences a recession, and growth in demand for forestry products also continues to slow down or decrease, our business, financial condition and results of operations would be adversely affected.

### ***Our operations are subject to the uncertainty of the PRC legal system***

The PRC legal system is based on written statutes. Prior court decisions may be cited for reference but have limited precedential value. Since 1979, the PRC government has been developing a comprehensive system of commercial laws, and considerable progress has been made in introducing laws and regulations dealing with economic matters such as foreign investment, corporate organization and governance, commerce, taxation and trade. However, as these laws and regulations are relatively new, interpretation of many laws, regulations and rules has not always been uniform, and enforcement of these laws and regulations involve significant uncertainties, which may limit or otherwise adversely affect legal protections available to us. Moreover, the PRC legal system is based in part on government policies and internal rules (some of which are not published on a timely basis or at all) that may have a retroactive effect. As a result, we may not be aware of any violation by us of these policies or rules until some time after such violation. In addition, litigation in the PRC may be protracted and may result in substantial costs and diversion of resources and management attention. We cannot predict the effect of future developments in the PRC legal system, including the promulgation of new laws, changes to existing laws or the interpretation or enforcement thereof, or the pre-emption of local regulations by national laws.

Furthermore, the administration of PRC laws and regulations may be subject to a certain degree of discretion by the executive authorities. This has resulted in the outcome of dispute resolutions not being as consistent or predictable compared to more developed jurisdictions. In addition, it may be difficult to obtain a swift and equitable enforcement of laws in the PRC, or the enforcement of judgments by a court of another jurisdiction.

At present, the legal framework for the tree plantation industry in the PRC is at an early stage of development. For example, the laws and regulations relating to the ownership, licensing and rights over forestry areas are not well developed. Because these laws and regulations may not be comprehensive, and because of the limited volume of published cases and judicial interpretations and the non-binding nature of prior court decisions, the interpretation and enforcement of these laws, regulations and legal requirements involve some uncertainty. Such uncertainty may make it difficult for us to enforce our plantation land use rights and other rights. As the PRC legal system develops together with the PRC forestry industry, we cannot be certain that changes in such laws and regulations, or in their interpretation or enforcement, will not have a material adverse effect on our business, financial condition and results of operations.

The reform of the collectively owned plantation rights system has been ongoing in the PRC in recent years in order to enhance the rural land contract relationship and ensure that farmers have proper legal plantation rights. Farmers are currently permitted to transfer their plantation rights to third parties pursuant to existing PRC laws and regulations. We cannot assure that the PRC government will not promulgate new rules and regulations that may be more detailed and complex than existing ones for

regulating the transfer of plantation rights. Such rules may restrict or delay the acquisition of any new plantation rights from original plantation rights holders. Moreover, we cannot assure that the enforcement of such rules and regulations will not have a material adverse effect on our business, financial condition and results of operations.

***Restrictions on foreign currency exchange may limit our ability to obtain foreign currency or to utilize our revenue effectively***

We receive most of our revenues in Renminbi. As a result, any restrictions on currency exchange may limit our ability to use revenue generated in Renminbi to:

- purchase timber imported from other countries;
- fund other business activities outside the PRC, such as the purchase of equipment for our manufacturing plants;
- service and repay our indebtedness, including but not limited to the 2004 Senior Notes and the 2008 Convertible Senior Notes; and
- pay out dividends to our shareholders.

Our subsidiary companies in the PRC do not require prior approval from SAFE before undertaking current account foreign exchange transactions. Current account transactions refer to those international revenue and expenditure dealings that occur on a current basis, including revenues and expenditures in trade and labor services, and the declaration of and payment of dividends out of after tax retained earnings. Foreign exchange for current account transactions may be obtained by producing commercial documents evidencing such transactions, provided that the transactions must be processed through banks in the PRC licensed to engage in foreign exchange.

Foreign exchange transactions under the capital account, however, will be subject to the registration requirements and approval of SAFE. Capital account transactions refer to international revenues and expenditures, that, being inflows and outflows of capital, produce increases or reductions in debt and equity, including direct investment, various types of borrowings and investment in securities. In addition, for either current or capital account transactions, our WFOEs must purchase foreign currency from one of the PRC banks licensed to conduct foreign exchange.

We cannot assure that sufficient amounts of foreign currency will always be available to enable us to meet our foreign currency obligations, whether to service or repay indebtedness not denominated in Renminbi, including the 2004 Senior Notes and the 2008 Convertible Senior Notes, or to remit profits out of the PRC. In addition, our subsidiaries incorporated in the PRC may not be able to obtain sufficient foreign currency to pay dividends to us, repay intercompany loans or to satisfy their other foreign currency requirements. Our capital is subject to PRC foreign currency exchange controls which may limit the ability to repatriate funds. As at December 31, 2008, the Company has retained earnings of US\$770 million in the PRC which may be restricted. Since foreign exchange transactions under the capital account are still subject to limitations and require approval from SAFE, this could affect our subsidiaries' ability to obtain foreign exchange through debt or equity financing, including by means of loans or capital contributions from us. We also cannot provide assurance that the PRC government will not impose further restrictions on the convertibility of the Renminbi.

***Certain PRC regulations governing PRC companies are less developed than those applicable to companies incorporated in more developed countries***

A significant portion of our investments are in the form of WFOEs established in the PRC, which are subject to PRC laws and regulations applicable to foreign investment companies, and other applicable laws and regulations in the PRC. These laws and regulations may not afford investors the same legal protections available to them in the United States, Canada or elsewhere, and may be less developed than those applicable to companies incorporated in the United States, Canada and other developed countries or regions.

***Operational licenses and permits***

Currently, PRC laws and regulations require tree plantation companies to obtain licenses and permits to operate tree plantations, harvest logs on the tree plantations and transport the logs out of the forest areas. The tree plantation companies must apply to the relevant Administration for Industry and Commerce of the PRC for the business license, and must apply to the local forestry bureaus for the logging permits and transportation permits for plantations that are to be harvested. We currently have the relevant business licenses for our subsidiary companies in the PRC to engage in forestry activities and have received the requisite logging permits and transportation permits for our completed logging and transportation activities. In this regard, the PRC State Council reviews and approves the annual logging quota (年采伐限額) every five years. This annual logging quota is allocated by the local forestry bureaus within their administrative regions. For foreign invested plantations, the logging quota is allocated separately by the provincial forestry department within the annual logging quota approved by the PRC State Council. There is no assurance that we will continue to maintain the business licenses and obtain the relevant permits for our future logging and transportation activities, or that the PRC government will not enact laws and regulations that would add requirements for tree plantation companies to conduct these activities in the PRC.

Further, PRC laws and regulations require manufacturers to obtain licenses and permits to operate timber manufacturing plants. The timber manufacturing companies must apply to the relevant Administration for Industry and Commerce of the PRC for a business license, and those established in the forestry areas must apply for the Timber Operation (Processing) Permit required by the relevant forestry regulatory authorities in the PRC. We currently have the requisite business licenses for our subsidiary companies in the PRC to engage in timber manufacturing activities. However, there is no assurance that we will continue to maintain the business licenses for our manufacturing plants, or that the PRC government will not pass laws and regulations that would place additional requirements on companies conducting these activities in the PRC.

***Environmental regulations***

Laws and regulations protecting the environment have generally become stricter in the PRC in recent years and could become more stringent in the future. On December 26, 1989, the Standing Committee of the National People's Congress of the PRC adopted the Environmental Protection Law of the PRC (中華人民共和國環境保護法). This law contains, and future legislation with respect to protection of the environment, whether relating to forests, protected animal species, or water conservation, could contain, restrictions on tree planting, timber harvesting, and other forest practices. Our tree plantations and manufacturing plants will also be subject to environmental laws and regulations, particularly with respect to air emissions and discharges of wastewater and other pollutants into land, water and air, and the use, disposal and remediation of hazardous substances and contaminants. We may be required to incur significant expenditures to comply with applicable environmental laws and

regulations. Moreover, some or all of the environmental laws and regulations to which we are subject in our tree plantations and manufacturing plants could become more stringent in the future, which could affect our production costs and results of operations. For example, international standards in wood-based products manufacturing currently require that wood panels satisfy specified maximum levels of formaldehyde emissions, as well as providing for other environmental protection measures. Any failure by us to comply with applicable environmental laws and regulations could result in civil or criminal fines or penalties or enforcement actions, including a requirement to install pollution control equipment or other mandated actions. As a result, environmental laws and regulations may adversely affect our business, financial condition and results of operations.

### ***Implementation and Issuance of new form Plantation Rights Certificate***

Since 2000, the PRC has been improving its system of registering plantation land ownership, plantation land use rights and plantation ownership and use rights and of issuing certificates to the persons having such plantation rights (the “Plantation Rights Certificates”). In April 2000, the PRC State Forestry Administration issued a notice, which provided that a new form of Plantation Rights Certificate was to be used from the date of the notice. The PRC government is in the process of gradually implementing the issuance of the new form of certificates on a nationwide scale. However, the registration and issuance of the new form plantation rights certificates by the PRC State Forestry Administration have not been fully implemented in a timely manner in certain parts of the PRC. We have obtained the plantation rights certificates or requisite approvals for acquiring the relevant plantation rights for most of the purchased tree plantations and planted tree plantations currently under our management, and we are in the process of applying for the plantation rights certificates for those plantations for which we have not obtained such certificates.

We can give no assurance when the official Plantation Rights Certificates will be issued by the relevant local PRC governments to all the purchased tree plantations and planted tree plantations acquired and under our management and cultivation. Until official new form Plantation Rights Certificates are issued, there can be no assurance that our rights to our tree plantations will not be subject to dispute or challenge. If such certificates are not issued, or are not issued in a timely manner, or if our rights to any of our tree plantation lands are subject to dispute or challenge, our business, financial condition and results of operations could be materially adversely affected.

### ***Agricultural Taxes and Other Related Forestry Fees***

Prior to February 2006, agricultural taxes on forestry companies were levied by the PRC government and generally amounted to approximately 8% of the selling prices or government standardized prices, depending upon the entity and the province in which it operates. The agricultural taxes and other forestry-related fees are levied at the time trees are harvested or sold. In certain provinces where our tree plantations are located, the agricultural taxes have been exempted or reduced. On February 17, 2006, the agricultural taxes were abolished by the PRC State Council. The forestry-related fees include reforestation and maintenance fees, which are generally charged at 10% to 20% of sales, but the fees actually charged vary from place to place. There is also a forest protection fee of RMB5 per cubic meter of wood harvested. No assurance can be given that other forestry-related tax will not be levied and such forestry-related fees will not be increased in the future. According to a notice issued by the Ministry of Finance, the National Development and Reform Commission and the State Forestry Administration on August 4, 2003, the forestry protection fee has been cancelled. However, the cancellation of the forestry protection fee has not yet been fully implemented in the provinces where our tree plantations are located.

## DIVIDEND RECORD AND POLICY

We have not declared any dividends on our Common Shares. Currently, we intend to retain our future earnings, if any, to fund the development and growth of our business, and do not anticipate paying any cash dividends on our Common Shares in the near future. As a result, shareholders will have to rely on capital appreciation, if any, to earn a return on investment in our Common Shares in the foreseeable future. The restrictive covenants under the indenture relating to the 2004 Senior Notes and the Syndicated Loan Facility prohibit the Corporation from declaring and paying dividends unless certain conditions are met.

## DESCRIPTION OF CAPITAL STRUCTURE

### Share Capital

Our authorized share capital consists of an unlimited number of Common Shares and an unlimited number of preference shares issuable in series. Each holder of Common Shares is entitled to one vote at meetings of our shareholders other than meetings of the holders of another class of shares. Each holder of Common Shares is also entitled to receive dividends if, as and when declared by our board of directors. Holders of Common Shares are entitled to participate in any distribution of our net assets upon liquidation, dissolution or winding-up on an equal basis per share. There are no pre-emptive, redemption, retraction, purchase or conversion rights attaching to the Common Shares.

### Ratings

In August 2004, we issued US\$300,000,000 principal amount of 9 1/8% guaranteed senior notes (the “2004 Senior Notes”) with a maturity date of August 17, 2011 and in July and August 2008, we issued US\$345,000,000 principal amount of 5% convertible senior notes (the “2008 Convertible Senior Notes”) with a maturity date of August 1, 2013.

The following table highlights our credit ratings and assigned outlooks with Moody’s Investor Services, Inc. (“Moody’s”), Standard & Poor’s Rating Services (“S&P”) and Fitch Ratings Ltd. (“Fitch Ratings”) as of December 31, 2008, 2007 and 2006:

	December 31,		
	2008	2007	2006
<b>Moody’s</b>			
Outlook	Stable	Stable	Stable
Corporate Family rating	Ba2	Ba2	Ba2
2004 Senior Notes	Ba2	Ba2	Ba2
2008 Convertible Senior Notes	Ba2	N/A	N/A
<b>Standard &amp; Poor’s</b>			
Outlook	Stable	Stable	Stable
Corporate Family rating	BB	BB	BB-
2004 Senior Notes	BB	BB	BB-
2008 Convertible Senior Notes	BB	N/A	N/A
<b>Fitch Ratings</b>			
Outlook	Stable	N/A	N/A
Corporate Family rating	BB	N/A	N/A
2004 Senior Notes	N/A	N/A	N/A
2008 Convertible Senior Notes	N/A	N/A	N/A



Moody's credit ratings are on a long-term debt rating scale that ranges from Aaa to C, which represents the range from highest to lowest quality of such securities rated. According to the Moody's rating system, obligations rated 'Ba' are judged to have speculative elements and are subject to substantial credit risk. They are considered medium-grade and as such may possess certain speculative characteristics. Moody's applies numerical modifiers, 1, 2 and 3 in each generic rating classification from AA through CAA in its corporate bond rating system. The modifier 1 indicates that the issue ranks in the higher end of its generic rating category, the modifier 2 indicates a mid-range ranking and the modifier 3 indicates that the issue ranks in the lower end of its generic rating category.

Standard & Poor's credit ratings are on a long-term debt rating scale that ranges from AAA to D, which represents the range from highest to lowest quality of such securities rated. According to the S&P's rating system, an obligation rated 'BB' is less vulnerable to non-payment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation. The rates from AA to CCC may be modified by the addition of a + or - sign to show relative standing with the major rating categories.

Fitch's rating categories are on a relative rank order scale, from AAA, AA, A, BBB, BB... to D. There are modifiers "+" or "-" which may be appended to a rating to denote relative status within major rating categories (e.g. BB+, BB, BB-), except for the AAA category as well as CCC and below categories.

According to Fitch's rating system, an obligation rated 'BB' category indicates that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade and are one category below the minimum investment grade category of BBB.

An Outlook indicates the direction a rating is likely to move over a one to two-year period. Thus, by assigning a Stable Outlook indicating that the rating is not likely to move over a one- to two-year period. However, if circumstances change and warrant a rating action, ratings for which outlooks are 'stable' could be upgraded or downgraded.

A rating is not a recommendation to buy, hold or sell securities and may be subject to revision, suspension or withdrawal at any time. No assurances can be given that a rating will remain for any given period of time or that a rating will not be lowered or withdrawn entirely by the relevant rating agency if in its judgment circumstances in the future so warrant. We have no obligation to inform holders of the 2004 Senior Notes and the 2008 Convertible Senior Notes of any such revision, downgrade or withdrawal. A suspension, reduction or withdrawal at any time of the rating assigned to the 2004 Senior Notes and the 2008 Convertible Senior Notes may adversely affect the market price of the 2004 Senior Notes and the 2008 Convertible Senior Notes.



## MARKET FOR SECURITIES

### Trading Price and Volume

Our Common Shares are listed on the TSX and trade under the stock symbol “TRE”. The following table sets forth, for the periods indicated, the reported high and low prices and the average volume of trading of our Common Shares on the TSX:

Calendar Period	High (Cdn\$)	Low (Cdn\$)	Average Daily Volume
January 2008	22.23	15.11	1,099,292
February 2008	20.93	18.39	846,102
March 2008	20.33	14.01	1,455,115
April 2008	18.30	14.90	1,072,473
May 2008	21.20	15.10	1,121,848
June 2008	21.23	17.02	909,673
July 2008	18.72	14.38	910,723
August 2008	20.00	14.81	621,207
September 2008	20.03	12.90	878,820
October 2008	14.00	8.35	1,432,363
November 2008	11.25	5.25	1,731,362
December 2008	10.60	6.15	934,325

### Prior Sales

On July 23, 2008, we issued US\$300 million of 5% convertible senior notes (the “**2008 Convertible Senior Notes**”). The 2008 Convertible Senior Notes are convertible into Common Shares at a conversion price of US\$20.29 per share, equivalent to a conversion rate of 49.2974 shares per US\$1,000 principal amount of 2008 Convertible Senior Notes, subject to customary adjustments. On August 6, 2008, we issued an additional US\$45 million of Convertible Senior Notes pursuant to the exercise of the over-allotment option granted to the underwriters in connection with the offering. The 2008 Convertible Senior Notes mature on August 1, 2013 if they have not been converted prior to such date.

## DIRECTORS AND EXECUTIVE OFFICERS

The table presented below provides the names of our current directors and executive officers, the offices held by them and the date of their first appointment, as of March 31, 2009:

Name and Place of Residence	Position(s) Held	Principal Occupation	Director Since <sup>(1)</sup>
Allen T.Y. Chan Hong Kong	Chairman, Chief Executive Officer and Director	Officer of the Corporation	1994
Kai Kit Poon Hong Kong	President and Director	Officer of the Corporation	1994
David J. Horsley Ontario, Canada	Senior Vice President and Chief Financial Officer	Officer of the Corporation	-

<b>Name and Place of Residence</b>	<b>Position(s) Held</b>	<b>Principal Occupation</b>	<b>Director Since<sup>(1)</sup></b>
Chen Hua China	Senior Vice President, China Operations and Finance	Officer of the Corporation	-
Alfred Hung Hong Kong	Vice President, Corporate Planning and Banking	Officer of the Corporation	-
James M.E. Hyde <sup>(2)(3)(4)</sup> Ontario, Canada	Director	Consultant	2004
Albert Ip Hong Kong	Senior Vice President, Development and Operations, North East and South West China	Officer of the Corporation	-
Richard M. Kimel Ontario, Canada	Corporate Secretary	Partner, Aird & Berlis LLP Barristers & Solicitors	-
Edmund Mak <sup>(2)(4)</sup> British Columbia, Canada	Director	Associate broker, Royal Pacific Realty Corporation, a real estate agency	1994
Thomas M. Maradin Ontario, Canada	Vice President, Risk Management	Officer of the Corporation	-
Zhao Wei Mao China	Senior Vice President, China Plantation	Officer of the Corporation	-
Judson Martin <sup>(2)(3)(4)</sup> Ontario, Canada	Director	Consultant	2006
Simon Murray <sup>(3)</sup> Hong Kong	Director	Chairman, General Enterprises Management Services (International) Limited, a private equity fund management company	1999
George Ho Hong Kong	Vice President, Finance, China Vice President, Finance & Chief Financial Officer, Sino Panel (Asia) Inc.	Officer of the Corporation	-
Peter D. H. Wang China	Director	General Manager, Hong Kong Resource Power Development Limited, a company importing machinery equipments into China.	2007
Gary H. Chan Hong Kong	Assistant Vice President, Tax & Special Projects	Officer of the Corporation	-
Eric H. Chan Hong Kong	Financial Controller, Hong Kong	Officer of the Corporation	-

**Notes:**

- (1) All of our directors serve until the next annual meeting of shareholders or until such director's successor is duly elected or appointed.
- (2) Member of the Audit Committee.
- (3) Member of the Compensation and Nominating Committee.
- (4) Member of the Corporate Governance Committee.

## **Prior Principal Occupations**

Each of the foregoing persons has held the position shown as his principal occupation for the last five years except as follows:

Prior to joining our company in October 2005, David Horsley was Senior Vice President and Chief Financial Officer of Cygnal Technologies Corporation, a TSX-listed company. Prior to joining Cygnal Technologies Corporation in September 2003, Mr. Horsley spent an 11-year career with Canadian General Capital Limited, a private equity investment vehicle owned by two major Canadian pension funds, where, most recently, he served as Senior Vice President and Corporate Secretary.

From December 2006 to November 2008, Mr. James Hyde was the Executive Vice President and Chief Financial Officer of Resolve Business Outsourcing Income Fund, a progressive business process outsourcing firm. From April to December 2006, Mr. Hyde was a Consultant to A.O. Smith Corporation. Mr. Hyde was also the Vice President, Finance and Chief Financial Officer of GSW Inc., a manufacturer and distributor of consumer durable products, from October 2002 until April 2006 when GSW Inc. was acquired by A.O. Smith Corporation. Prior to October 2002, Mr. Hyde was with Ernst & Young LLP (an accounting and auditing firm) for 24 years, including 12 years as a Partner.

Mr. Edmund Mak was an associate broker of Re/Max Select Properties from January 1999 to October 2008.

Mr. Judson Martin was the Senior Executive Vice President and Chief Financial Officer of Alliance Atlantis Communications Inc. (“Alliance Atlantis”) from March 2003 to June 2005 and was the Executive Vice President and Chief Financial Officer from May 1999 to November 2002. Mr. Martin was a member of the Board of Directors of Motion Picture Distribution Inc. and an Executive Officer of Movie Distribution Income Fund and Movie Distribution Holding Trust, controlled subsidiaries of Alliance Atlantis, since their launch in October 2003 to June 2005, and also served as the Chief Financial Officer until September 2004. From November 2002 until January 2003, Mr. Martin was the President and Chief Executive Officer of TGS North American REIT. From July 1995 to September 1997, Mr. Martin was the Senior Executive Vice-President and Chief Financial Officer and a Director of MDC Communications Corporation. From October 1982 to July 1995, Mr. Martin was employed by certain subsidiaries of Brascan Corporation, including Trizec Corporation Ltd. as Vice President and Treasurer, Brookfield Development Corporation as Executive Vice President and Chief Financial Officer and Trilon Securities Corporation as President and Chief Executive Officer. Mr. Martin is the Chairman of Skypower Wind Energy Fund LP and serves as Chair of its audit committee. Mr. Martin is also a trustee of Somerset Entertainment Income Fund and serves on its audit committee, and also as Chair of its compensation nominating and corporate governance committee.

Prior to joining our company in September 2005, Thomas Maradin was a senior consultant to several multinational companies from January 1, 2001 until September 1, 2005, where his responsibilities included strategic planning, system implementations, restructuring of business units, financial reporting and internal control and regulatory compliance; he spent a 15-year career with Ernst & Young LLP, where, most recently he served as Principal managing a professional services practice.

Mr. Peter Wang also serves as the Senior Commercial Consultant of Zijin Copper, a subsidiary of Zijin Mining Group, a Hong Kong listed company, and China Far East International Trading Company, one of China’s top 5 import and export companies. Mr. Wang has over 30 years’ experience in Sino-foreign projects and business affairs, predominantly related to petrochemical and mining industries, as well as wood-based panel industries. He was involved in a number of pioneering projects when China first opened up its foreign policies back in the late 1970s. He was a member of the Formulation Committee of Chinese-Foreign Contract, Guangdong Province and was also a member of the delegation

team travelling with China Premier Wen Jiabao to India in 2005 to execute contracts and projects related to highway and power stations, and to expand China-Indian bilateral trade and economic cooperative ties.

Prior to joining our company in October 2007, George Ho was a Senior Manager at BDO McCabe Lo Limited, Certified Public Accountants, an international accounting and audit firm from October 2006 to October 2007. Mr. Ho also served as the Chief Financial Officer, China Operations of a NASDAQ listed merchant bank from January 2004 until September 2006, managing a portfolio of investments in China including joint ventures with PRC hospitals, wind energy development, commodities trading and various Merger & Acquisition activities including a potential merger with a major State-owned equipment manufacturing enterprise. Before January 2004, Mr. Ho spent 10 years providing professional services in a Canadian accounting and audit firm and most recently served in the capacity as a principal. The firm is involved in the audit of publicly listed companies on the TSX and TSX Venture Exchange as well as those listed on NASDAQ and quoted on the OTC board.

Prior to joining our company in January 2009, Gary Chan was the Tax Manager at CHC Helicopter Corporation, a multinational corporation that operates in over 30 countries worldwide. Prior to joining CHC Helicopter Corporation, Mr. Chan spent more than 3 years with HSBC Bank Canada, where, most recently, he served as the Senior Manager, Taxation. Prior to joining HSBC Bank Canada in 2004, Mr. Chan spent 2 years working in various cities of China for a Chinese pulp and paper manufacturer as an internal management consultant.

Prior to joining our company, Mr. Eric Chan spent 5 years providing professional services at Ernst & Young, Hong Kong.

## **Shareholdings**

As of March 31, 2009, our directors and executive officers as a group beneficially owned, or controlled or directed, directly or indirectly 6,842,744 Common Shares, representing approximately 3.68% of the issued and outstanding Common Shares.

## **INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS**

None of our directors or executive officers, or persons or companies that beneficially own, or control or direct, directly or indirectly, more than 10% of our outstanding Common Shares, or any associate or affiliate of any of the foregoing, has any material interest, direct or indirect, in any transactions in which we have participated during the three financial years ending December 31, 2008 which has materially affected or is reasonably expected to materially affect the Corporation.

On February 6, 2009, the Corporation acquired 55 million ordinary shares in the capital of Omnicorp Limited (“**Omnicorp**”), a Hong Kong listed company, and Omnicorp 4% secured convertible bonds (the “**Omnicorp Convertible Bonds**”) with an aggregate principal amount of approximately US\$21.6 million from various vendors. The aggregate purchase price paid by the Corporation was satisfied by the payment of approximately US\$4.3 million in cash for the Omnicorp shares and the issuance of approximately 2.7 million Common Shares at a price of Cdn.\$10.00 per share for the Omnicorp Convertible Bonds. The acquisition was completed in the secondary market from various third parties, as well as from Simon Murray a director of the Corporation, and an entity he controls. The value of the Omnicorp shares and Omnicorp Convertible Bonds sold by Mr. Murray and the entity he controls to the Corporation represented approximately 5.5% of the aggregate value of the overall transaction.

## CONFLICTS OF INTEREST

See above under the section entitled “Interest of Management and Others in Material Transactions”.

## TRANSFER AGENT AND REGISTRAR

The transfer agent and registrar for our Common Shares is CIBC Mellon Trust Company of Canada at its principal offices in the city of Toronto, Ontario.

## MATERIAL CONTRACTS

The following are the contracts that are material to the Corporation that were entered into either (i) during the year ended December 31, 2008; or (ii) prior to January 1, 2008 that are still in effect, other than contracts entered into in the ordinary course of business:

1. Trust Indenture dated as of August 17, 2004 between the Corporation, Law Debenture Trust Company of New York, as Trustee, and certain subsidiaries of the Corporation in connection with the issuance of the US\$300,000,000 2004 Senior Notes, as amended by the Second Supplemental Indenture dated February 24, 2006.
2. Subordinated Loan Agreement dated May 11, 2005 among (1) Sino-Forest Investments Limited, an indirect wholly-owned subsidiary of the Corporation, as lender, (2) Mandra Forestry Holdings Limited, as borrower, and (3) JP Morgan Chase Bank N.A., as trustee, to finance the borrower in an aggregate amount of US\$15,000,000 for the purposes of acquisition of forestry assets in Anhui Province.
3. Share Subscription Agreement dated May 11, 2005 between Sino-Forest Investments Limited and Mandra Forestry Holdings Limited pursuant to which Sino-Forest Investments Limited purchased and subscribed for 15% of the outstanding shares of Mandra Forestry Holdings Limited.
4. Term Loan Facility dated February 24, 2006 between the Corporation and a syndication including Barclays Capital, Bayerische Hypo-und Vereinsbank AG, Hong Kong Branch, CITIC Ka Wah Bank Limited, Export Development Canada, and Hang Seng Bank Limited in connection with a US\$150,000,000 5-year and one day syndicated term loan facility. The facility carries an interest margin of between 0.80% and 1.50% over LIBOR per annum, depending on the Corporation's ratio of consolidated total debt to consolidated EBITDA.
5. Subscription Agreement dated March 23, 2007 between the Corporation and several institutional investors including Aranda Investments Pte. Ltd. and Ellington Investments Pte. Ltd., each an indirectly wholly-owned subsidiary of Temasek Holdings (Pte) Ltd., an Asia investment firm headquartered in Singapore, Golden China Master Fund (managed by Greenworld Asset Management) and United Capital Investment Group Limited, whereby the Corporation sold approximately 25.4 million Common Shares to the institutional investors for gross proceeds of US\$200 million at a price of Cdn.\$9.15 per share.
6. Underwriting Agreement dated May 28, 2007 between the Corporation and a syndicate of underwriters led by Dundee Securities Corporation, and including CIBC World Markets Inc., Merrill Lynch Canada Inc., UBS Securities Canada Inc., Credit Suisse Securities (Canada) Inc., and Haywood Securities Inc. pursuant to which the Corporation issued an aggregate of

15,900,000 Common Shares at a price of Cdn.\$12.65 per share for gross proceeds of approximately Cdn.\$201 million.

7. Purchase Agreement dated July 17, 2008 between the Corporation, Merrill Lynch, Pierce, Fenner & Smith Incorporated and Credit Suisse Securities (USA) LLC in connection with the issuance of the US\$345,000,000 2008 Convertible Senior Notes.
8. Trust Indenture dated as of July 23, 2008 between the Corporation, The Bank of New York Mellon, as Trustee, and certain subsidiaries of the Corporation in connection with the issuance of the US\$345,000,000 2008 Convertible Senior Notes.

The only material contract of the Corporation that has been entered into after the financial year ended December 31, 2008 but prior to March 31, 2009, other than contracts entered into in the ordinary course of business, is the Sale and Purchase Agreement dated February 6, 2009 between the Corporation and certain vendors, whereby the Corporation acquired 55 million ordinary shares of Omnicorp Limited and 4% secured convertible bonds of Omnicorp Limited with an aggregate principal amount of approximately US\$21.6 million.

### **INTERESTS OF EXPERTS**

Pöyry Forest Industry Ltd. (previously named JP Management Consulting (Asia-Pacific) Ltd. or Jaakko Pöyry), an independent forestry consultant, located at 2 Battery Road, #21-01 Maybank Tower, Singapore 049907, is considered an expert in valuing forest assets and prepared reports dated March 15, 2007, March 14, 2008 and April 1, 2009 regarding the description and valuation of Sino-Forest's plantation forest assets in China. To our knowledge, the partners and associates of Pöyry Forest Industry Ltd., as a group, beneficially own, directly and indirectly, less than 1% of our outstanding Common Shares.

The auditors of the Corporation are Ernst & Young LLP, Chartered Accountants. The Corporation's consolidated financial statements as of December 31, 2008 and for the year then ended have been filed under National Instrument 51-102 in reliance on the report of Ernst & Young LLP, Chartered Accountants, given their authority as experts in auditing and accounting. We have been advised that, as of the date hereof, Ernst & Young LLP, Chartered Accountants, is independent in accordance with the rules of professional conduct which govern its professional activities in the Province of Ontario.

### **AUDIT COMMITTEE**

#### **Audit Committee's Charter**

The charter (the "Charter") of our Audit Committee is reproduced as Exhibit "A".

#### **Composition of Audit Committee**

The Audit Committee is comprised of Mr. James Hyde, Mr. Edmund Mak and Mr. Judson Martin. Each member of the Audit Committee is "independent" and "financially literate" (as such terms are defined in National Instrument 52-110 - Audit Committees ("NI 52-110")).

#### **Relevant Education and Experience**

Mr. Hyde is a chartered accountant and has extensive experience in finance and accounting related positions with private and public companies. Mr. Mak is a member of the Certified General Accountants of British Columbia, holds a Masters in Business Administration from the University of Toronto and has



extensive experience in financial management and corporate audit management for various Fortune 500 companies and a TSX listed company. Mr. Martin has obtained extensive experiences in finance and accounting related positions, including being a Chief Financial Officer at Alliance Atlantic, MDC Corporation, Brookfield Development Corporation and Trizec Corporation.

### **Reliance on Certain Exemptions**

At no time since the commencement of our most recently completed financial year have we relied on any exemption described in items 4, 5 and 6 of Form 52-110F1 under NI 52-110.

### **Audit Committee Oversight**

At no time since the commencement of our most recently completed financial year have any recommendations by the Audit Committee respecting the appointment and/or compensation of our external auditors not been adopted by our board of directors.

### **Pre-Approval Policies and Procedures**

The terms of the Charter state that all non-audit services to be provided by our external auditor to us or any of our subsidiaries must be pre-approved by our Audit Committee or by any of its members, if so delegated by the Audit Committee.

### **External Auditor Service Fees (By Category)**

*Audit Fees* - Our external auditors billed us approximately Cdn.\$1,354,000 and Cdn.\$1,150,000 during the financial years ended December 31, 2007 and 2008, respectively, for audit fees.

*Audit-Related Fees* - Our external auditors billed us approximately Cdn.\$127,500 and Cdn.\$413,000 during the financial years ended December 31, 2007 and 2008, respectively for audit-related fees.

*Tax Fees* - Our external auditors billed us approximately Cdn.\$18,000 and Cdn.\$299,000 during the financial years ended December 31, 2007 and 2008, respectively for tax fees.

*All Other Fees* - We did not pay any other fees during the financial years ended December 31, 2007 and 2008, respectively for services other than those reported above.

## **ADDITIONAL INFORMATION**

Additional information relating to the Corporation may be found on SEDAR at [www.sedar.com](http://www.sedar.com).

Additional information relating to the Corporation, including directors' and officers' remuneration and indebtedness, principal holders of our securities and securities authorized for issuance under equity compensation plans, if applicable, is contained in our management information circular for our most recent annual meeting of shareholders.

Additional financial information is provided in our consolidated financial statements and MD&A for our most recently completed year ended December 31, 2008.



## Exhibit “A”

### SINO-FOREST CORPORATION

(the “Corporation”)

### AUDIT COMMITTEE CHARTER

#### STATEMENT OF PURPOSE

The Audit Committee (the “**Committee**”) will assist the Board of Directors of the Corporation (the “**Board**”) in fulfilling its stewardship responsibilities through the oversight of:

- (a) the accounting and financial reporting processes of the Corporation, its subsidiaries and any other business entity controlled in fact by the Corporation (each an “**affiliate**”) and their appropriateness in view of the Corporation’s operations and current GAAP in Canada and other applicable jurisdictions;
- (b) the adequacy and effectiveness of management’s system of internal controls and procedures in the Corporation, its subsidiaries and affiliates;
- (c) the quality and integrity of the Corporation’s, its subsidiaries and affiliates’ financial reporting and disclosure;
- (d) the relationship with the external auditor (the “**Auditor**”), including the audit of the financial statements and any other audit and permitted non-audit services provided by the Auditor; and
- (e) the compliance with laws, regulations and guidelines affecting the Corporation which relate to the duties and functions of the Audit Committee.

#### MEMBERSHIP

1. **Number**

The Board will appoint not fewer than three members to the Committee.

2. **Composition**

All members of the Committee must be members of the Board and “Independent” of management as that term is defined from time to time in relevant securities authorities governing the Corporation. The current independence definition for audit committee members is reproduced in Appendix I.

3. **Qualifications**

All Committee members must be “Financially Literate” as that term is defined in National Instrument 52-110 (and reproduced in Appendix I).

In addition to the foregoing, the composition of the Committee, and qualifications of its members, will comply with such additional requirements as may be imposed by those regulating bodies having jurisdiction over the Corporation.

4. **Training**

Committee members will participate in such training and orientation as may be determined by the Board or the Corporate Governance Committee to be necessary or appropriate in the circumstances.

5. **Chair**

The Board will appoint the chair of the Committee (the “**Committee Chair**”) annually, to be selected from the members of the Committee. If, in any year, the Board does not make an appointment of the Committee Chair, the incumbent Committee Chair will continue in office until that Committee Chair’s successor is appointed. In the Committee Chair’s absence, or if the position is vacant, the Committee may select another member as Committee Chair.

6. **Director Attendance**

All Directors will be entitled to attend Committee meetings. Notice of the time and place of each meeting of the Committee will be given to each Director by telephone not less than 48 hours before the time of the meeting or by written notice (email or otherwise) not less than four days before the day of the meeting, and, subject to the requirements of any applicable law, need not specify the purpose of or the business to be transacted at the meeting. Meetings of the Committee may be held at any time without notice if all the members have waived or are deemed to have waived notice of the meeting.

7. **Removal and Vacancies**

Any member of the Committee may be removed and replaced at any time by the Board and will automatically cease to be a member of the Committee as soon as such member ceases to be a Director. The Board may fill vacancies in the Committee by election from among the members of the Board. If and whenever a vacancy exists on the Committee, the remaining members may exercise all its powers so long as a quorum remains in office.

8. **Tenure**

The Board will appoint members of the Committee annually following the Corporation’s annual general meeting and may make such appointments pursuant to any recommendations (if any) from the Compensation and Nominating Committee. Each member of the Committee will hold office until the following annual general meeting or until his or her term as a member of the Board is terminated or until his or her successor is appointed.

9. **Residency**

At least 66 2/3% of the members of the Committee shall be resident Canadians, provided that the only exchange the Corporation is listed on is the Toronto Stock Exchange (TSX).

10. **Compensation**

Compensation to members of the Committee shall be limited to Directors’ fees, either in the form of cash or equity, and members shall not accept consulting, advisory or other compensatory fees from the Corporation (other than as members of the Board and Board committee members).

## **MEETINGS**

### **1. Notice of Meetings**

- (a) The Committee Chair may call meetings of the Committee periodically and will do so at the request of any member of the Committee, the Auditor, or at the request of any of the Lead Director, Chairman of the Board, Chief Executive Officer (the “CEO”), the Chief Financial Officer (the “CFO”) or any other Director of the Corporation. If any Director of the Corporation requests the Committee Chair to call a meeting of the Committee, that Director may attend such meeting to inform the Committee of a specific matter of concern that Director has, and may participate in such meeting to the extent permitted by the Committee Chair.
- (b) The Auditor will be given notice of every meeting of the Committee and will be permitted to attend and be heard at such meeting on such matters relating to the Auditor’s duties as Auditor.
- (c) The Lead Director (if not a Committee member) will be given notice of every meeting.
- (d) Notice of the time and place of each meeting of the Committee will be given to each member by telephone not less than 48 hours before the time of the meeting or by written notice (email or otherwise) not less than four days before the day of the meeting, and, subject to the requirements of any applicable law, need not specify the purpose of or the business to be transacted at the meeting. Meetings of the Committee may be held at any time without notice if all the members have waived or are deemed to have waived notice of the meeting.

### **2. Times and Places of Meetings**

The Committee will ordinarily meet at least quarterly each fiscal year, and at other times as necessary, at times and places to be determined by the Committee.

### **3. Agenda**

The Committee Chair will, in consultation with management and the Auditor, establish the agenda of the meetings and, where possible, circulate materials in advance to provide sufficient time for study prior to the meeting.

### **4. Quorum**

A quorum at any meeting will be a simple majority.

### **5. Procedure**

The procedure at meetings will be determined by the Committee unless otherwise determined by the by-laws of the Corporation or by a resolution of the Board.

6. **Secretary**

The Secretary of the Corporation will, subject to any contrary direction of the Committee, act as secretary of the Committee.

7. **Minutes of Meetings**

The Committee will keep regular minutes of its proceedings and will report to the Board at each meeting of the Board. Minutes will be circulated to all Directors on a timely basis.

8. **Transaction of Business**

The powers of the Committee may be exercised at a meeting where quorum is present or by resolution in writing signed by all members of the Committee entitled to vote on that resolution at a meeting of the Committee.

9. **Exercise of Power Between Meetings**

Between meetings, the Committee Chair, or any member of the Committee designated for the purpose by the Committee Chair, may exercise any power delegated by the Committee.

**DUTIES AND RESPONSIBILITIES**

1. **Relations With the Auditor**

The Auditor will report directly to the Committee. The Committee shall be directly responsible for overseeing the work of the Auditor engaged for the purpose of preparing or issuing an audit report or performing other audit, review or attest services for the Corporation, and in carrying out such oversight the Committee will:

- (a) recommend to the Board, the appointment, compensation and retention of the Auditor;
- (b) recommend to shareholders the appointment of the Auditor;
- (c) review the Auditor's engagement letter, both for audit and non-audit services;
- (d) review and take action to eliminate all factors that might impair, or be perceived to impair, the independence of the Auditor;
- (e) review the audit plan of the Auditor with management and Auditor so that the Committee, can satisfy itself regarding the appropriate coverage of risks, understand the audit approach, including areas of reliance on internal controls, and understand how changes in the accounting policies of the Corporation might impact the audit approach;
- (f) oversee the work the Auditor performs quarterly (whether review or specified procedures, as determined by the Committee), including resolution of disagreements with the Corporation's management;
- (g) pre-approve all audit, review and attest services;
- (h) approve on an annual basis, the pre-approval policy for audit, audit-related and non audit services that are permitted to be provided by the Auditor and satisfy itself that the

Committee receives regular updates of the services and fees being provided by the Auditor under this framework;

- (i) consider whether any non-audit services performed for the Corporation by the Auditor could detract from the firm's independence in carrying out the audit function. The Committee may pre-approve the appointment of the Auditor for any non-audit services by adopting specific policies and procedures, from time to time, for the engagement of the Auditor for non-audit services;
- (j) review the basis and amount of the Auditor fees in light of the number and nature of reports issued by the Auditor, the quality of the internal controls, the size, complexity and financial condition of the Corporation and the extent of other non-prohibited support provided to the Corporation by the Auditor;
- (k) review all other non-audit fees and services of the Auditor or other accounting firms;
- (l) review post-audit or management letters, containing recommendations of the Auditor and management's response, and oversee their implementation or resolution;
- (m) provide the Auditor with the opportunity to meet with the Committee or the Board without management present, at each quarterly meeting of the Committee, for the purpose of discussing any issues which have arisen during that fiscal quarter or any previous fiscal quarter;
- (n) meet regularly with the Auditor without management present to receive reports of any significant disagreements between management and the Auditor regarding financial reporting, the resolution of any such disagreements and any restrictions imposed by management on the scope and extent of the audit examinations conducted by the Auditor;
- (o) approve the Corporation's hiring of current and former partners and employees of the present and former Auditor;
- (p) satisfy itself that the rotation of the staff of the Auditor is in accordance with applicable laws and professional standards;
- (q) meet with senior management not less than quarterly without the Auditor present for the purpose of discussing, among other things, the performance of the Auditor and any issues that may have arisen during the quarter;
- (r) annually review the expertise, resources and overall performance of the Auditor and, if necessary, recommend to the Board the termination of the Auditor or the rotation of the audit partner in charge. In the case of a recommendation to terminate the Auditor, the Committee will enquire as to the qualifications and independence of the newly proposed Auditor before making its recommendations to the Board;
- (s) at least annually, and in any event before the Auditor issues its report on the annual financial statements, obtain a formal written statement from the Auditor describing all of its relationships with the Corporation and discussing and resolving with the Auditor any relationships that may affect its objectivity and independence;

- (t) have authority to satisfy itself that adequate provisions are made to fund the compensation to be paid to the Auditor;
- (u) review, where there is to be a change of Auditor, all issues related to the change, including the information to be included in the notice of change of auditor called for under National Instrument 51-102 Continuous Disclosure Obligations, as amended from time to time, and the planned steps for an orderly transition; and
- (v) review all reportable events, including disagreements, unresolved issues and consultations, as defined in National Instrument 51-102 Continuous Disclosure Obligations, as amended from time to time, on a routine basis, whether or not there is to be a change of Auditor.

## 2. **Audit and Financial Reporting**

The Committee will be primarily responsible for satisfying itself and on behalf of the Board, that the Corporation (including its subsidiaries) fulfils all of its audit and financial reporting obligations, and will:

- (a) review all financial statements and the related MD&A which require approval by the Board, including, without limitation, interim statements, year end audited statements, statements for use in prospectuses or other offering documents and statements required by regulatory authorities; determine whether the financial statements are complete, accurate and are in accordance with GAAP in all material respects; review all variances between comparative reporting periods; and recommend such financial statements and related MD&A for Board approval;
- (b) review all earnings press releases and other press releases disclosing financial information prior to their dissemination to the public, as well as financial information and written earnings guidance provided to analysts and rating agencies. No written earnings guidance will be provided to analysts unless the Committee has reviewed and approved such guidance. The Committee will also review the use of “pro forma” or “adjusted” non-GAAP information in such press releases and financial information. Such review may consist of a general discussion of the types of information to be disclosed or the types of presentations to be made;
- (c) review all public disclosure documents containing audited or unaudited financial information before release including (without limitation) any: Prospectus, Annual Report and or any other documents extracted or derived from the Corporation’s financial statements filed with regulatory agencies and satisfy itself that all information is consistent with the financial statements and that such document or statement does not contain any untrue statement of any material fact or omit to state a material fact that is required or necessary to make the document or statement not misleading, in light of the circumstances under which it was made;
- (d) review the disclosure in the Annual Information Form regarding details of the Committee’s membership; exemptions relied on, if any; instances of the Board not accepting the Committee’s recommendations, if any; summary of Auditor fees and services provided; and inclusion of the Audit Committee Terms of Reference;



- (e) review the form of the audit report and the scope and quality of the audit work performed;
- (f) review the audit results with the Auditor and management's proposed handling of audit adjustments;
- (g) review and discuss the Auditor's report and the related MD&A for the audited annual financial statements with management and the Auditor;
- (h) review with the Auditor and management any material changes in accounting practices or policies and the financial statement impact thereof, the presentation of the impact of significant risks and uncertainties, and judgments of management that may have a significant effect upon the financial statements;
- (i) review with the Auditor, any disagreements with management over the application of accounting principles, the basis for management's accounting estimates, and the disclosures in the financial statements;
- (j) review the co-operation received by the Auditor from the Corporation's personnel during the audit, any problems encountered by the Auditor and any restrictions on the Auditor's work;
- (k) review with the Auditor and management;
  - (i) critical accounting policies and practices used by the Corporation, including critical accounting estimates, the selection of major accounting policies, reasons why certain policies are not considered critical and how current and future events affect that determination;
  - (ii) all alternative material accounting treatments that have been discussed with management, the ramifications of these alternative treatments and the Auditor's preferred method;
  - (iii) all material written communications between the Auditor and management that would facilitate Auditor and management oversight by the audit committee such as management representation letters, reports on observations and internal control reports, schedules of material adjustments and proposed reclassifications, schedule of unadjusted audit differences and listings of adjustments and reclassifications not recorded, engagement letters and independence letters;
  - (iv) the status of material contingent liabilities and legal matters as reported to the Committee by management;
  - (v) the status of taxation matters of the Corporation; and
  - (vi) any errors or omissions in the current or prior year's financial statements.
- (l) discuss the effect of off-balance-sheet transactions, arrangements, obligations (including contingent liabilities) and other relationships with unconsolidated entities or other persons that may have a material current or future effect on the Corporation's financial

condition, changes in financial condition, results of operations, liquidity, capital expenditures, capital resources, or significant components of revenues and expenses;

- (m) review with the Auditor and management all material related party transactions and the development of policies and procedures related to those transactions;
- (n) review with the Auditor and management, the methods used to account for significant unusual transactions;
- (o) establish and administer a “whistleblower” procedure for the receipt, retention and treatment of complaints regarding accounting, auditing matters, internal accounting controls and employees’ confidential anonymous submission of concerns regarding accounting and auditing matters; and
- (p) consider any other matter which in its judgment should be taken into account in reaching its recommendation to the Board concerning the approval of the financial statements.

### 3. **Risk Management**

The Vice-President of Risk Management will report directly to the CEO (with a dotted reporting line to the CFO and the Committee). The Committee will oversee the guidelines and policies to govern the process by which the Corporation undertakes risk assessment and management, and will:

- (a) establish procedures for the receipt, retention and treatment of complaints received by the Corporation regarding accounting, auditing matters or internal accounting controls, including the confidential and anonymous submission of complaints by employees including reviewing on an annual basis, the Corporation’s Whistleblower Policy;
- (b) review with management and bring to the attention of the Auditor any correspondence with regulators or government agencies, employee complaints or published reports that raise material issues regarding the Corporation’s financial statements or accounting policies;
- (c) review with management, any litigation, claim or other contingency, including tax assessments, that could have a material effect upon the financial position of operating results, and the manner in which these matters have been disclosed in the financial statements;
- (d) identify, assess and monitor the risks inherent in the business of the Corporation and establish and monitor compliance with policies and procedures necessary to address, as much as is reasonably possible, those identified risks;
- (e) in conjunction with management, review on an annual basis all aspects of the Corporation’s risk management program, including insurance coverage, foreign exchange exposures, and investments (including its use of financial risk management instruments), disaster recovery and business continuity plans;
- (f) review with management the presentation and impact of significant risks and uncertainties associated with the business of the Corporation; and

(g) oversee the investigation of alleged fraud, illegal acts and conflicts of interest.

4. **Evaluation of Financial and Accounting Personnel**

The Committee may provide comments to the Compensation and Nominating Committee and the Board, concerning the following:

- (a) a position description for the CFO, which would include the CFO's authority and responsibilities;
- (b) the goals and objectives that are relevant to the CFO's compensation;
- (c) the CFO's performance in meeting his or her goals and objectives;
- (d) the performance of Corporation's financial and accounting personnel; and
- (e) remedial action where necessary.

5. **Relations with Management**

The Committee will coordinate with management on audit and financial matters, and will:

- (a) review decisions of the Corporation's Disclosure Committee in which unanimity was not achieved and in instances where the Disclosure Committee<sup>1</sup> deems appropriate;
- (b) meet privately with senior management at least quarterly to discuss any areas of concern to the Committee or management;
- (c) review with management and assess the results of instances, if any, where management seeks a second opinion on significant accounting or auditing matters;
- (d) where possible, consult on the appointment of and departure of individuals occupying senior financial positions; and
- (e) have the Committee Chair review the expenses incurred by the Chairman of the Board and the CEO.

6. **Authority to Engage Advisers**

The Committee will have the authority to engage and determine the funding for independent counsel and other advisors to assist it in carrying out its duties.

7. **Access to Records**

The Committee will be permitted access to all records and corporate information that it determines to be required in order to perform its duties.

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<sup>1</sup> Provided the Disclosure Policy contemplates other such instances.

8. **Other**

The other duties of the Committee shall include:

- (a) reviewing the Directors and Officers insurance policy prior to its renewal each year and reviewing from time to time the indemnification agreements provided to the Directors and Officers of the Corporation;
- (b) reviewing any inquires, investigations or audits of a financial nature by governmental, regulatory or taxing authorities;
- (c) reviewing annual operating and capital budgets;
- (d) reviewing the funding and administration of the Corporation's compensation and pension plans, if any;
- (e) reviewing and reporting to the Board on difficulties and problems with regulatory agencies which are likely to have a significant financial impact;
- (f) inquiring of management and the Auditor as to any activities that may be or may appear to be illegal or unethical; and
- (g) any other questions or matters referred to it by the Board.

9. **Reporting**

The Committee will regularly report to the Board on:

- (a) the Auditor's independence, engagement and fees;
- (b) the performance of the Auditor and the Committee's recommendations regarding its reappointment or termination;
- (c) the adequacy of the Corporation's internal controls and disclosure controls;
- (d) the Corporation's risk management procedures;
- (e) its recommendations regarding the annual and interim financial statements of the Corporation, including any issues with respect to the quality or integrity of the financial statements;
- (f) its review of the annual and interim MD&A;
- (g) any validated complaints made under and the effectiveness of the Corporation's Whistleblower Policy;
- (h) the Corporation's compliance with legal and regulatory requirements related to financial reporting; and
- (i) all other significant matters it has addressed or reviewed and with respect to such other matters that are within its responsibilities, together with any associated recommendations.

## APPENDIX I DEFINITIONS

“**Financially Literate**” shall mean:

An individual who has the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues expected to be raised by the issuer’s financial statements. A comprehensive knowledge of GAAP and generally accepted auditing standards is not required.

“**Independent**” shall mean:

- (a) a director may not, either directly or indirectly, other than in his or her capacity as a member of the Committee, the Board, or any other Board committee, accept any consulting, advisory or other compensatory fee from the Corporation. Indirect acceptance of compensatory payments includes payments to spouses, minor children or step-children and children or step-children sharing a home with the director as well as payments accepted by an entity in which the Committee member is a partner, member, officer such as a managing director occupying a comparable position or executive officer or occupies a similar position and which provides accounting, consulting, legal, investment banking or, financial advisory services to the issuer;
- (b) a director may not be an “**affiliated person**” of the Corporation or any subsidiary of the Corporation. A director, who is also an employee of an affiliate, an executive officer of an affiliate or a general partner or managing member of an affiliate would be deemed to be an affiliate. An “**affiliate of**” or person “**affiliated**” with a specified person is defined as “a person that directly or indirectly through one or more intermediaries, controls or is controlled by, or is under common control with, the person specified”. “**Control**” means “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise”. A person is deemed not to control the issuer if the person is not an executive officer, or a shareholder of more than 10% of any class of voting equity securities of the issuer. Notwithstanding the foregoing, there is an exception to the affiliate prohibition for overlapping board relationships. If a member sits on the Board of the Corporation and on the board of an affiliate of the Corporation, the member is exempt from the “**affiliated person**” prohibition, if except for being on each board, that member otherwise meets the independence criteria.
- (c) a Committee member may not have been employed by the Corporation or by any parent or subsidiary or have a family member who is or was an executive officer of the Corporation within the past three years;
- (d) a Committee Member may not have been (nor have a family member who has been) employed as an executive officer of another entity where any of the executive officers of the Corporation serve or have served on the compensation committee of such other entity within the past three years; and
- (e) a Committee member may not be a former partner or employee of the auditor who worked on the Corporation’s audit engagement; have a family member who is a partner of the auditor or is an employee of the auditor and participates in the Corporation’s audit, assurance or tax compliance or was within the last three years a partner or employee of the auditor and personally worked on the Corporation’s audit.