



**SINO-FOREST CORPORATION**

Annual Information Form  
in respect of the year ended  
December 31, 2006

March 30, 2007

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## **FORWARD-LOOKING STATEMENTS**

This Annual Information Form, and the documents incorporated herein by reference, contains 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 securities laws. Forward-looking statements include without limitations, 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 and 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 Canadian dollar, 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 Canadian dollar translations have been made at the rate of Cdn\$1.165 to US\$1.00. All such H.K. dollar translations have been made at the rate of HK\$7.779 to US\$1.00. All such Renminbi translations have been made at the rate of RMB7.818 to US\$1.00. No representation is made that the Canadian dollar, 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.

“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 “bone dry metric ton” or “BDMT” is a measure of weight used in the forest products industry to measure bulk products such as wood chips. One bone dry metric ton would weigh one metric ton if all the moisture content were removed. A bone dry metric ton can be converted to cubic meters of logs depending on the wood density of the species concerned. For eucalyptus trees, one bone dry metric ton is equal to approximately two cubic meters of round logs.

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.

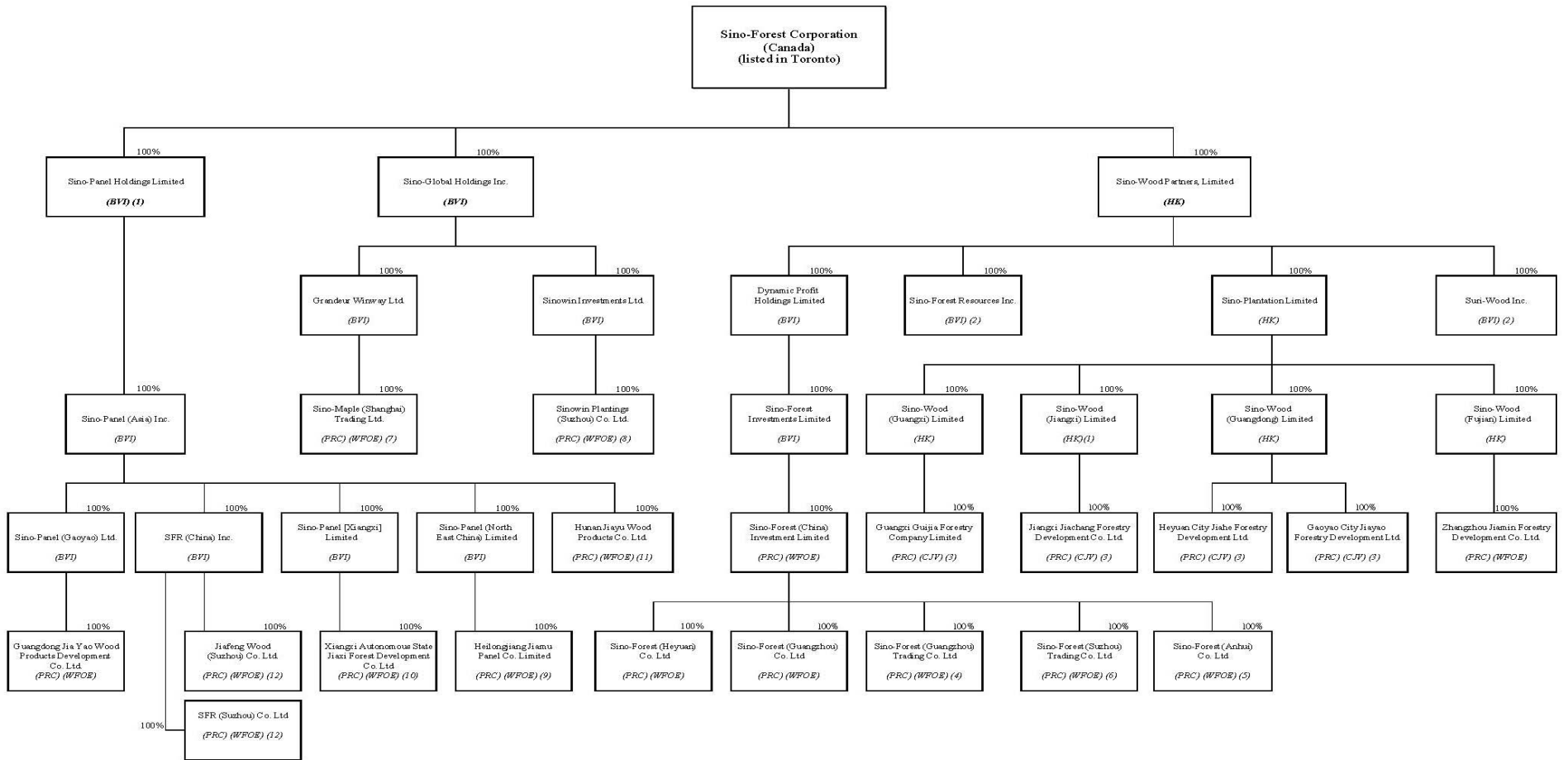
## **THE CORPORATION**

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 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**

The following chart, which does not include certain immaterial subsidiaries, shows our current corporate structure.



Notes:

- (1) In November 1997, the predecessor company to Sino-Panel Holdings Limited granted options (which were subsequently granted by Sino-Panel Holdings Limited) to certain members of our management for nominal consideration. On May 14, 2004, we repurchased a portion of such options which constitute the right to acquire 8.13% of Sino-Panel Holdings Limited, from current members of management and a company under the control of management. The remaining options to acquire 1.87% of Sino-Panel Holdings Limited are held by a British Virgin Islands company equally owned by a former member of management that is no longer an officer and director and a current member of our management. The option to acquire 1.87% of Sino-Panel Holdings Limited will remain outstanding. However, the current member of our management that is the joint owner and co-director of the British Virgin Islands company has undertaken that he will vote against the exercise of the option held by that company to acquire 1.87% of Sino-Panel Holdings Limited and will use other commercially reasonable efforts to ensure that such option is not exercised.
- (2) The trading activities of Sino-Forest Resources Inc. and Suri-Wood Inc. are conducted through authorized intermediaries. Sino-Forest Resources Inc. currently engages in standing timber sales and import of wood-based products while Suri-Wood Inc. engages in standing timber and wood chips sales.
- (3) The CJVs Guangxi Guijia Forestry Company Limited, Jiangxi Jiachang Forestry Development Co. Ltd., Heyuan City Jiahe Forestry Development Ltd., and Gaoyao City Jiayao Forestry Development Ltd. are in the progress of being converted into WFOEs.
- (4) Sino-Forest (Guangzhou) Trading Co. Ltd., a WFOE which was established on 31 March 2005, engages in city greening projects, research and development on forestry plantation, logging, processing and sale of logs, wood chips and wood-based products, technological consultation, forestry plantation management and other related services.
- (5) Sino-Forest (Anhui) Co. Ltd., a WFOE which was established on 25 July 2005, engages in forest nursery and research and development on forestry plantation, technology transfer and related services.
- (6) Sino-Forest (Suzhou) Trading Co. Ltd., a WFOE which was established on 26 July 2005, engages in wood products, flooring and paneling business.
- (7) Sino-Maple (Shanghai) Trading Ltd., a WFOE, engages in wood products, flooring and paneling business.
- (8) Sinowin Plantings (Suzhou) Co. Ltd., a WFOE, engages in sourcing, supplying and managing landscaping products for property developers and other organizations.
- (9) Heilongjiang Jiamu Panel Co. Limited, a WFOE, engages in manufacturing and sale of OSB and other wood-based products.
- (10) Xiangxi Autonomous State Jiayi Forest Development Co. Ltd., a WFOE in Inner Mongolia which was established on 25 September 2006, engages in wood logs and panel trading business.
- (11) Hunan Jiayu Wood Products Co. Ltd., a WFOE which was established on 6 April 2006, engages in finger-joint board production and wood logs and panel trading business.
- (12) SFR (Suzhou) Co. Ltd. and Jiafeng Wood (Suzhou) Co. Ltd are being merged together under PRC law. The two WFOEs engage in engineered wood flooring production.

## **GENERAL DEVELOPMENT OF THE BUSINESS**

### **Overview**

Sino-Forest Corporation is a leading foreign owned commercial forestry plantations operator in China. The Canadian corporation began operations in 1994 as the first foreign and privately managed company involved in forestry products in the Peoples Republic of China (“PRC”). Its principal businesses include the ownership and management of forestry plantation trees, sale of standing timber, wood chips and logs, and complementary manufacturing of downstream engineered wood products. Its executive



offices are located in Hong Kong and Toronto, and its common shares are traded on the Toronto Stock Exchange under the symbol TRE.

Our business operations are comprised of two main business segments: **Wood Fibre Operations** is the major revenue contributor while our **Manufacturing & Other Operations** enables us to realize added value from our downstream operations.

Revenues from Wood Fibre Operations are derived from three main sources as follows:

- Standing Timber – we acquire, cultivate and sell standing timber from our purchased and planted trees plantations;
- Wood Chips and Logs – we source logs from PRC suppliers and process and sell them as wood chips through an authorized intermediary and earn commission income from agency services in the sales of wood chips;
- Imported Wood-based 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 Gaoyao, Guangdong Province;
- Engineered Wood Flooring produced in Suzhou, Jiangsu Province, and sold over 200 stores nationwide in the PRC;
- Oriented Strand Board manufactured in Muling City, Heilongjiang Province;
- Finger-Joint Board produced in Hunan Province;
- Greenery & Nurseries operation based in Suzhou, Jiangsu Province; and servicing the Greater Shanghai region.

### **Historical Milestones**

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

- |      |  |
|------|--|
| 2004 | <ul style="list-style-type: none"><li>• Issued \$300 million, 9 1/8% Guaranteed Senior Notes due in 2011 listed on the Singapore Stock Exchange.</li><li>• Proceeds of financing from Senior Notes were used to fund the Heyuan Pine Undertaking, an undertaking to acquire up to 200,000 hectares of mature pine tree around Heyuan City, Guangdong Province.</li><li>• First commercial operator in China to receive Forest Stewardship Council ("FSC") Certification for plantations located in Gaoyao, Guangdong province.</li></ul> |
| 2005 | <ul style="list-style-type: none"><li>• Acquired 15% equity interest and invested \$15 million in the form of a subordinated loan in Mandra Forestry Holdings Limited ("Mandra"). Sino-</li></ul>  |

Forest provides plantation management service for receiving a yearly management fee of \$1 million and has the first of right to acquire timber harvested by Mandra with a 3% discount at prevailing market price. Sino-Forest will also have the option to acquire Mandra forestry depending on the performance.

- 2006
- Secured a syndicated loan facility with several financial institutions for a \$150 million five-year plus one day term loan.
  - Entered into a master agreement to secure 1.5 million cubic metres 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 respectively in third and fourth quarter to acquire a total of 400,000 hectares of Chinese fir and pine over next 14 years in the Hunan Province.
- 2007
- Entered into an agreement on March 23 to sell approximately 26 million common shares to several institutional investors, including Temasek Holdings and United Capital Investments Group. The placement offering is for gross proceeds of US\$200 million at a price of Cdn.\$9.15 per share. Proceeds of the offering will 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 an agreement on March 23 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.

## **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.

To achieve our vision, we strive to be at the forefront of our industry by creating regional “wood baskets” that ensure a sustainable and quality supply of wood fibre to downstream manufacturing operations. We also plan to introduce new technologies to improve productivity, quality and economic viability of China’s engineered wood products.

We focus on the strategies that have made Sino-Forest successful:

- Acquire additional forestry plantations and access to long-term supply of wood fibre in the PRC where regional markets with growing demand will be located;

- Improve the yields of our forestry plantations by continued investment in research and development;
- Practice environmentally responsible forestry;
- Strengthen our management processes and information systems to support the growth of our multi-faceted businesses;
- Strengthen our engineered wood manufacturing business to complement our plantation operations with an aim to increase value of our wood fibre;
- Widen and diversify our investor base and enhance our corporate image and profile.

## **WOOD FIBRE OPERATIONS**

### **Standing Timber**

Our plantations consist primarily of eucalyptus, poplar and pine forests. We have two types of forestry plantations : our own planted tree plantations and purchased tree plantations of third parties from which we purchase young trees that have not reached maturity. Our strategic goal is to produce and/or acquire on a sustainable basis 15 to 20 million cubic meters annually of wood fibre to supply to the PRC's wood panel, furniture, construction, interior decoration and pulp and paper industries.

Forestry plantations are a significant provider of wood fibre that we sell. We have a strong track record of acquiring and developing commercial forestry plantations. Since 1995, we have successfully executed our business model of purchasing and planting fast-growing trees at both purchased and planted plantations. Once we lease land at favourable forestry plantation locations, we operate plantations using advanced, environmentally prudent plantation management practices focused on the development of sustainable commercial plantations. We believe our eleven-year track record in the PRC using advanced plantation management techniques is a competitive advantage in the PRC, where the commercial forestry plantation industry is comparatively underdeveloped and where there are currently limited large-scale plantations using advanced plantation management practices.

As of December 31, 2006, Sino-Forest has 352,000 hectares of plantations under planted and purchased model, most strategically located in southern and eastern China, in the provinces of Guangdong, Guangxi, Jiangxi, Fujian and Hunan.

### **Recent Developments**

#### **Inner Mongolia**

The Corporation through one of its wholly-owned PRC subsidiaries has entered into a long-term Master Agreement with Inner Mongolia Forest and Timber Resources Company Ltd, (the "EJV"), an equity joint-venture company in the PRC, and Erlianhot Lianhe Forestry Bureau in the Inner Mongolia Autonomous Region, to secure a long-term supply of wood fibre while managing a regeneration programme of secondary forests.

Under the Master Agreement, the EJV will supply to Sino-Forest's subsidiary an aggregate annual volume of at least 1.5 million cubic metres (m3) of wood fibre that it will acquire from the forestry bureau, Under certain circumstances where the EJV fails to comply with its obligations to deliver wood fibre in accordance with the terms set out in the Master Agreement, the forestry bureau will supply the indicated volume of wood fibre.

Sino-Forest has committed a US\$10 million deposit which is refundable over the first 5 years of the contract. The annual volume of wood fibre will be in the form of logs and sawn timber for a period of 12 years, until 2018. The tree species to be supplied will be birch, larch or other species of similar grades. In view of the long-term nature of cooperation between the parties, the wood fibre will be sold to Sino-Forest at a fixed discount of RMB80 per cubic metre (currently equivalent to US\$9.70) to the lowest price at the timber trading market under the administration of the forestry bureau. The parties intend that the EJV will manage the harvesting, which generally will take place between October 1 to May 31, and delivery of the fibre, which is anticipated to begin in the fourth quarter of 2006.

Sino-Forest and the EJV intend to jointly manage the secondary regeneration programme with a goal of improving yield and ecological functions of the natural forest, while conserving species grown in the Inner Mongolia Autonomous Region.

Secondary regeneration forests are an alternative source of wood fibre supply. In countries like Canada, Finland, Sweden and others, a significant amount of the productive forests are secondary regenerated and managed professionally. A forest regeneration programme that combines selective harvesting with professional post-harvest management can improve the recovery rate and performance of a forest (as measured by quality and growth rate) in the long term.

The northeastern part of Inner Mongolia Autonomous Region has large areas of secondary forests, and is anticipated to provide significant source of wood fibre in the PRC. Over the years, due to inadequate funding and limited resources for managing selective harvesting and post-harvesting programmes, and due to the logging ban imposed in 1998, large tracts of the secondary forests have become mature or over-mature, resulting in a lower growth rate and sick trees falling. The State Administration of Forestry of the PRC has therefore lifted the ban on the felling of mature and over-mature trees to improve the performance of these forests and biodiversity. The regeneration programme will also boost development of local wood processing, transportation and sapling cultivation sectors.

Inner Mongolia Forest and Timber Resources Company Ltd, the EJV is headquartered in Hohhot, Inner Mongolia Autonomous Region. One of its shareholders has a team of forestry experts which specialises in research and development and forestry environment, and includes the internationally renowned forestry expert, Han Yifan, who specialises in genetic improvement of poplars with superior insect resistance. This shareholder also manages approximately 800 hectares of nursery plantation in the Jiangsu and Heibei Provinces.

## Hunan

On September 28, 2006 the Corporation announced that one of its wholly-owned subsidiary, Sino-Panel (Asia) Inc. ("Sino-Panel"), has today entered into a Master Agreement for Acquisition of Pine and Fir Forest ("Agreement") with Hongjiang City Forestry Technology Integrated Development Services Company ("Hongjiang City Forestry"), a state-owned enterprise in the People's Republic of China ("PRC") appointed to act as the authorized agent for the original plantation rights holders. Under the Agreement, Sino-Panel will purchase approximately 100,000 hectares of plantation trees in Hongjiang City, Hunan Province for RMB2,600,000,000 to RMB3,120,000,000 or approximately US\$328.3 million to US\$393.9 million over a 14-year period. The average purchase price per cubic meter is RMB260 or approximately US\$32.83. The number of hectares of plantations to be acquired each year will be determined by Sino-Panel's PRC subsidiaries by entering into specific plantation purchase agreements with Hongjiang City Forestry. The Agreement also provides Sino-Forest the right of first refusal to lease the land for 50 years after harvesting. The final terms of the lease are to be negotiated with Hongjiang City Forestry upon the authorisation of the original plantation rights holders.

The Hunan plantations contain mature species of pine and Chinese fir with an estimated fibre yield of 100m<sup>3</sup> to 120m<sup>3</sup> (cubic meters) per hectare, or 10 million m<sup>3</sup> to 12 million m<sup>3</sup> of wood fibre in total, which will generate immediate cash flow to fund a portion of the acquisition. The balance of the funding for this acquisition will be provided by the company's operating cash flow, and cash in hand.

On December 7, 2006 the Corporation announced the signing of an agreement to acquire an additional 300,000 hectares of plantation trees in Hunan Province through Sino-Panel (Asia) Inc. ("Sino-Panel"), a wholly-owned subsidiary. Sino-Panel had previously agreed to acquire 100,000 hectares of plantation trees in that region per the news release issued by the Company on September 28, 2006 bringing the total to 400,000 hectares. The Master Agreement for Acquisition of Pine and Fir Forest ("Agreement") is signed with Hongjiang City Forestry Technology Integrated Development Services Company ("Hongjiang City Forestry"), a state-owned enterprise in the People's Republic of China ("PRC") appointed to act as the authorized agent for the original plantation rights holders.

Under the Agreement, Sino-Panel will purchase an additional 300,000 hectares of plantation trees in Huaihua City, Shaoyang City and its surrounding areas in Hunan Province with a fixed cost not to exceed RMB260 per cubic meter (m<sup>3</sup>) or approximately US\$32.10 per m<sup>3</sup> over a 14-year period. The plantations in Hunan contain mature species of pine and Chinese fir with an estimated fibre yield of 100m<sup>3</sup> to 120 m<sup>3</sup> per hectare, or aggregate 30 million m<sup>3</sup> to 36 million m<sup>3</sup> of wood fibre. The terms and conditions of current agreement are substantially the same as the first agreement signed in late September 2006.

Under the provisions of the Agreement, Sino-Forest is given the right of first refusal to lease land for 50 years. The company intends to annually re-plant approximately the same hectares of trees harvested in the previous year over the 14-year period. The final terms of the lease are to be negotiated with Hongjiang City Forestry upon the authorisation of the original plantation rights holders.

## Yunnan

On March 23, 2007, the Corporation announced that one of its wholly-owned subsidiaries, Sino-Panel (Asia) Inc. ("Sino-Panel"), has entered into an agreement with Gengma Dai and Wa Tribes Autonomous Region Forestry Company Ltd., ("Gengma Forestry") established in Lincang City, Yunnan Province in the People's Republic of China ("PRC") (the "Agreement"), under which Sino-Panel will acquire approximately 200,000 hectares of non-state owned commercial standing timber in Lincang City and surrounding cities in Yunnan Province for approximately RMB5.5 to 11 billion or approximately US\$0.7 to 1.4 billion over a 10-year period. The purchase price is not to exceed RMB260 or approximately US\$33.6 per cubic metre (m<sup>3</sup>). The number of hectares to be acquired each year will be determined by Sino-Panel's PRC subsidiaries by entering into specific purchase agreements with Gengma Forestry. The Agreement also provides Sino-Forest with the rights of first refusal to lease the land for 50 years after harvesting. The final terms of the lease are to be further negotiated with Gengma Forestry.

The area of acquisition in Lincang City and surrounding cities in Yunnan Province contains mature species of pine, oak, birch and other broadleaved shaw with an estimated fibre yield of 105 to 210 m<sup>3</sup> per hectare or approximately 21 to 42 million m<sup>3</sup> of wood fibre in total. The funding of the acquisition will be provided by the strategic placement raised and led by Temasek Holdings, and future cash flow generated from operating in Yunnan Province. The economics of the Yunnan agreement are similar to those of the Hunan agreement announced in third quarter of 2006.

The operating model in Yunnan would be similar to the one in Hunan where we will harvest, re-plant, or, re-generate secondary forest to conserve bio-diversity, and to develop value-added processing

facilities by maximising the value of the wood fibre. It will also bring sustained economic benefits to local communities.

Yunnan Province is located in the southwest region of China and shares a border of 4,060 km with Myanmar to the west, Laos to the south, and Vietnam to the southeast and hence, has a tropical climate. Yunnan abounds in natural resources and diverse plants and species. The province has a forest area of 24 million hectares, with standing timber covering 15.6 million hectares of forested land.

## Operations Overview

### Purchased Tree Plantations

We acquire young trees from forestry bureaus or collectively-owned entities with the rights to sell them when trees reached maturity and will have the first rights to lease the land for replanting under a 30 to 50 years term contract.

The purchase price takes into account a variety of factors such as trees species, yield, age, size, quality and location of the tree plantation. Soil and weather conditions for replanting, log prices and regional market demand are also important considering factors.

We manage the silviculture of these trees until maturity and sell in standing timber form through authorized intermediaries representing downstream customers.

### Planted Tree Plantations

Our planted tree plantations are operated through four Cooperative Joint Ventures (CJVs) and two Wholly Foreign Owned Enterprises (WFOE) under PRC law.

Under the CJV model, the local partners provide land for planting and Sino-Forest introduces advanced silvicultural practices and know-how to improve plantation management. Upon maturing, Sino-Forest will split fibre 70/30 with local partners. Our first forestry plantations started maturing in 2002. To date our planted yield for eucalyptus is about 90 cubic meters (m<sup>3</sup>) per hectare per five to six-year cycle, compared to the PRC national average of approximately 60 cubic meters. We anticipate in the next growing cycle our plantation yield can achieve 100-120m<sup>3</sup> per hectare per five to six-year cycle for eucalyptus plantation.

We are in the process of converting our 4 CJV establishments to WFOEs to obtain greater control over plantation management through plantation land leasing rather than harvest profit sharing. Sino-Forest anticipates conversion which includes transfer of ownership and plantation rights to be completed in 2007. At the end of December 2006, three of the four CJVs, namely, Gaoyao City Jiayao Forestry Development Ltd, Jiangxi Jiachang Forestry Development Co. Ltd. and Guangxi Guijia Forestry Company Ltd have signed the conversion and transfer of interest agreements. The agreements will be lodged to the local government authorities for approval for the change of the constitution of the CJVs into WFOEs. Negotiation with local farmers and collective organisations for re-entering new plantation land lease contracts are in progress. There is no assurance that all CJV PRC Partners will agree to transfer of interest and that we can manage to secure all the plantation land use rights from the farmers and collective organisations.

The following table sets forth the rotation cycles, growth rates and yields of the tree species grown on our planted tree plantations.

<b>Species</b>	<b>Eucalyptus</b>	<b>Poplar</b>	<b>Pine</b>
Plantation cycle	5 years	7 years	12 years
Standing timber yield per hectare per cycle (in cubic meters)	90	128	132
Wood chip yield per hectare per cycle (in bone dry metric tons)	40	42	70

The rotation cycles described above are only for our planted tree plantations. These would only have a rotation cycle if we acquire plantation land use rights to the underlying land of the purchased tree plantation.

## Plantation Locations

The following map highlights the location of our forestry plantations in China.





The following table sets forth the total hectares of planted tree plantations and purchased tree plantations by geographical region as of December 31, 2006.

<b>Location</b>	<b>Planted Tree Plantations</b> (area by thousands of hectares)	<b>Purchased Tree Plantations</b> (area by thousands of hectares)
Guangdong Province Gaoyao City	5	17
Guangdong Province Heyuan City	33 (Note)	32
Guangxi Province	13	75
Jiangxi Province	8	99
Hunan Province	-	70
<b>Total</b>	<b>59</b>	<b>293</b>

Note :

The 33,000 hectares planted tree plantations in Guangdong Province Heyuan City include approximately 25,000 hectares planted by our WFOE.

#### Tree Species and Maturity

The following table sets forth our forestry plantations by tree species and maturity as of December 31, 2006.

	<b>Eucalyptus</b>		<b>Poplar</b>		<b>Pine</b>		<b>Other Species</b>		<b>Total Hectares</b>
	<b>Pre-Mature (Below 5 Years)</b>	<b>Mature (5 Years or Above)</b>	<b>Pre-Mature (Below 7 Years)</b>	<b>Mature (7 Years or Above)</b>	<b>Pre-Mature (Below 12 Years)</b>	<b>Mature (12 Years or Above)</b>	<b>Pre-Mature (Below 7 Years)</b>	<b>Mature (7 Years or Above)</b>	
<b>(area by thousands of hectares)</b>									
Planted tree plantations	38	14	3	2	-	-	2	-	59
Purchased tree plantations	-	-	-	-	207	85	-	1	293
<b>Total</b>	<b>38</b>	<b>14</b>	<b>3</b>	<b>2</b>	<b>207</b>	<b>85</b>	<b>2</b>	<b>1</b>	<b>352</b>

## Historical Purchased Tree Plantation Purchases

The following table sets forth the purchased tree plantations purchased by us from 1997 to 2006 (area by thousands of hectares).

	1997-2001	2002	2003	2004	2005	2006	Total
Heyuan Project	--	--	--	30	80	16	126
Gaoyao (Guangdong Province)	27	--	4	--	6	--	37
Heyuan (Guangdong Province)	10	14	34	24	--	--	82
Jiangxi Province	38	--	11	33	48	16	146
Guangxi Province	11	5	3	24	37	24	104
Hunan Province	-	-	-	-	-	73	73
Fujian Province & others	2	--	--	--	4	0	6
Total	88	19	52	111	175	129	574

## 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, use of improved planting materials, density and spacing control, fertilization and tending, monitoring and preventing damage to the trees. We generally engage third parties to perform the field operations 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 and fire, enhance environmental conservation and improve aesthetics. In addition, these practices result in more uniform forestry plantations, which increase harvesting efficiency and reduce waste through sawing and peeling.

We engage in planting the first cycle of our planted tree plantations. We may also engage in planting if we exercise our option to obtain the plantation land use rights for our purchased tree

plantations, as our strategy is to replant forestry plantations of other species with eucalyptus trees. We commenced planting trees from clones in 1998. As a result, approximately half of our forestry plantations currently consist of trees planted from traditional seedlings. Trees planted since 2000 have been produced from clones.

We produce cloned cuttings for our planted forestry plantations by using tender branchlets taken from mother plants raised in our nursery, which were developed in our tissue culture laboratory. By means of this type of vegetative propagation, the ramets of a clone receives the entire genetic code of the original tree. As a result, using cloned rooted cuttings can maximize favourable genetic attributes in forestry plantations as each of the trees has homogenous genetic characteristics. To reduce potential loss associated with cloned forestry plantations, due to the lack of genetic diversity, we currently deploy more than 10 different clones in our forestry plantations.

We grow cuttings or seedlings in the nursery for approximately three to four months before planting them in the forestry plantations. After site preparation, including clearing of existing plantation land or farmland, we generally plant the young seedlings, spaced two by three meters apart, in rows. The degree of site preparation will depend upon the slope of the hill on which the young seedlings are planted. For slopes between 5% and 20%, which is the slope on which the majority of our trees are grown, we generally provide a contour strip, or terrace, and plant the trees along the contour of the terrace. We apply basic fertilizers and then plant the cutting in a planting hole and apply top-dressing fertilizer and intensively tend trees for the first three years after their planting.

To optimize the yields of our plantations, we implement plantation management techniques, including the following:

- Detailed site assessments and choice and preparation of the plantation site where the trees are to be grown, including clearing and terracing;
- Superior planting material rearing, including proper clone choice, mother plant (hedge) management, cutting propagation and management, screening of cuttings;
- Planting at optimal times of the year with proper spacing;
- Taking measures to ensure that trees are properly tended, applied with fertilizer and protected from damage caused by pests and disease;
- Monitoring the forestry plantations, performing forestry plantation analysis and adjusting the care of the forestry plantations according to the results of this analysis;
- Conducting research and development activities that complement and support the above activities.

Our overall management objective is to manage our planted tree plantations on a sustainable basis, which means that the volume of timber harvested over time will not in general exceed the volume of incremental growth over the same period. We believe this will maintain and enhance the long-term health of our planted tree plantations, and should ensure sustainable harvests.

#### Mandra Forestry

In 2005, Sino-Forest formed an alliance with Mandra Forestry Holdings Limited by investing \$15 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 the Corporation's track record and expertise in plantation operation, Sino-Forest provides plantation management service for a yearly management fee of \$1 million and will have first of rights to acquire timber harvested by Mandra with a 3% discount at prevailing market price. Sino-Forest will also have the option to acquire Mandra Forestry depending on the performance.

#### Plantation Service Providers

We engage third parties for field management of our forestry 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 procedure 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, levelling of land, growth of seedlings, fertilization and applying pesticides, planting of trees and cultivation. 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.

#### Environmental Matters

Our forestry plantation operations are subject to PRC laws and regulations relating to the protection of the environment. Both the local forestry bureaus and the local environmental protection bureaus where our planted tree plantations are located have confirmed that our operations are substantially in compliance with applicable environmental laws and regulations in the PRC. There are currently no environmental proceedings against us.

We maintain an Environmental Management System. This system is designed to ensure environmentally responsible resource management. It sets forth policies on the social, ecological and environmental aspects of our forestry plantation operations and detailed operating procedures on environmental compliance. Our Environmental Management System focuses on the integration of forestry plantation management with the conservation of soil and water resources, the protection of biodiversity and natural habitats, the improvement of environmental conditions, such as air, water quality and biodiversity, and environmental performance assessments. The most recent assessment, conducted in 2005, reported that plantation management practices on our planted tree plantations are meeting the environmental protection objectives set out in PRC laws and regulations and our environmental policies.

We have designed our environmental policies to comply with relevant PRC regulations and provide guidelines governing plantation establishment, management, harvesting and sustainability. Our Environmental Management System has been developed with the aim of ensuring compliance with these regulations and policies. We adhere to the philosophy that environmentally sound management practices contribute to our profitability and the prosperity of our employees and the communities in which we operate by providing greater predictability and sustainability in the management of natural resource assets.

We have obtained ISO 9001:2000 (certification in 2001) and ISO 14001:2004 (certification in 2002) for the Environmental Management System of the forestry plantation operations of our CJV in Guangxi Province. We have also received from SmartWood, a program of the Rainforest Alliance, an international non-profit environmental group, the FSC of Forest Management certification for 5,300

hectares of forestry plantations in Guangdong Province. We plan to seek to extend the FSC and ISO certifications to all of our planted tree plantations.

## Research and Development

Research and development is an important function of our forestry plantation operations. The goal of the research and development efforts is to improve forestry plantation yields and the quality of the trees grown on our forestry 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 and selection of planting materials that perform better, including improved yield, quality and resistance to pests and diseases;
- Vegetative propagation technology, including lab tissue culture and nursery cutting and mass-propagation;
- Site 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;
- Development of sustainable management system of commercial plantation ecosystems;
- Wood properties and processing (such as change of water content and properties and of short-rotation eucalyptus plantation wood) and value-added products;
- 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 collaborated with, and receive assistance from, research and academic institutions in the PRC. We once collaborated or are collaborating with the Research Institute of Tropical Forestry, the Chinese Academy of Forestry, Forestry Academy of Jiangxi Province, Qinzhou Forestry Research Institute, Nanjing Forestry University, Forestry Academy of Guangxi Province, Science & Technology Department of the National Forestry Administrations, China Eucalyptus Center, the Forest Administration of Guangdong Province, Forestry Academy of Guangdong Province, Guangxi University and South China Agricultural University.

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 23 years of experience in forestry and plantation management practices.

## Insurance

We maintain insurance policies against risks of loss of our forestry plantations. We have insurance policy over 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 indemnity of our insurance policy will be at 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 RMB 10 millions. Perils insured for our tree plantations include fire, lightning, aircraft, explosion, floods, windstorm and subterranean fire. While we do not insure all of our plantations against losses from all natural and other disasters, we believe our insurance coverage is consistent with the practice of other PRC forestry plantation operators. In addition, we believe the risk of loss from fire and other natural disasters is reduced because our forestry 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 forestry 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 insurance policies against risks of damage or destruction of our manufacturing facilities under Property All Risks and Public Liability Insurances. 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.

### **Wood Chips and Logs**

Wood chips and logs sales comprised 14% of total revenue in 2006, compared to 31.6% of total revenue in 2005.

Wood logs are sourced in the PRC through a domestic wood dealer who act as our authorized intermediary (“AI”) to purchase timber supplies and also process into wood chips and then sell to customers. This AI has the license to process wood chips and sell chips and logs in the PRC. The supplies of wood logs are generally state-owned or collectively-owned wood farms in the PRC and the customers are typically pulp and paper mills, as well as reconstituted wood panel mills.

In 2006, revenue from sales of wood chips and logs decreased 41% to \$83.9 million in 2006. Sales volume declined during the year for two reasons. Firstly, in Q4 2005, one of the two AIs who processed wood chip for us was acquired and ceased to provide wood chipping services to us. Secondly, in Q4 2006, the volume of wood chips processed by the remaining AI decreased as the AI’s wood chipping capacity was not available to us due to strong competition. Management is of the view that the wood chip revenue will continue to decline over the next few quarters if we are not able to access the wood chip capacity. We still retain the ability to acquire the same volume of fibre that was previously processed into wood chips and we plan to utilize the fibre in our own manufacturing facilities in the future.

In addition to purchase and sale trading activities conducted through AI, we introduce timber suppliers and wood chip customers directly to wood dealers. We receive a commission for these services. As the availability to us of wood chipping capacity decreases, commission revenue will decline. In the fourth quarter of 2006, commission revenue was nil.

### **Operational**

The relationship with our AI is governed by master agreement (“Master Agreement”), as supplemented by certain operational procedures relating to the wood chips sales transactions (the “Operational Procedures”). Under the Master Agreement, as supplemented by the Operational Procedures, we appoint the AI to manage our wood chips trading transactions on our behalf. The AI agrees to enter into contracts to purchase timber from suppliers, process the timber into wood chips and deliver wood chips to customers pursuant to sales contracts entered into between the AI and customers. We agree to reimburse the costs of the AI, including the cost of the purchase of raw timber, and to pay both a processing fee and a management fee, all of which are deducted from the sales proceeds of the

wood chips. All of the contracts are entered into by the AI, and we have no direct contractual relationships with suppliers of logs or customers of wood chips in the PRC. We typically specify annual quotas of the authorized volume of wood chips trading transactions, which are subject to adjustment by us and the AI.

The Operational Procedures delineate our and the AI's rights and obligations with respect to the purchase of raw timber, the processing of raw timber into wood chips and the sale of wood chips. Under the Operational Procedures, the AI assumes the risks and obligations relating to the raw timber from the time the raw timber is purchased until it is delivered to the AI's premises. We assume all risks and obligations relating to the raw timber once it arrives at the premises of the AI until it is processed into wood chips, except for any loss arising as a result of the AI's default. Once the raw timber is processed into wood chips, the AI is responsible for selling wood chips to customers and it assumes all rights and obligations relating to the wood chips under its sales contracts with customers. The Operational Procedures provide that the AI is responsible for selling wood chips to customers within time limits agreed between the AI and us, and that they assume all risks and obligations for failing to meet these delivery requirements.

In a typical transaction, the AI enters into a contract with a supplier for the delivery of raw timber. Once the raw timber arrives at the processing site of the AI, the AI, on our behalf, first inspects the delivery of timber to ensure that the appropriate amount of timber is delivered. The AI then processes the raw timber into wood chips and sells and delivers the wood chips to customers, pursuant to contracts entered into between the AI and the customers.

Pursuant to the Master Agreement, we issue invoices to the AI for the wood chip sales transactions on a quarterly basis, and the AI pays us the sales proceeds after deducting the costs of the timber, a processing fee and a management fee.

Because of the provisions in the Operational Procedures that specify when we and the AI assume the risks and obligations relating to the raw timber or wood chips, as the case may be, we treat these transactions for accounting purposes as providing that we take title to the raw timber when it is delivered to the AI. Title then passes to the AI once the timber is processed into wood chips. Accordingly, we treat the AI for accounting purposes as being both our supplier and customer in these transactions.

The amount we receive from these activities is on a net basis after withholding of applicable taxes by the AI. The AI is responsible for filing tax returns with the PRC government, and withholding and paying our relevant taxes in relation to these activities, although we make appropriate provisions for income taxes in our accounts.

### **Imported Wood-based 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 Malaysia, Suriname, Papua New Guinea, 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.

## MANUFACTURING 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 forestry plantations operations using small diameter logs to manufacture quality wood-based products that are traditionally made from large-diameter logs. To-date, we have established manufacturing operations in China, including particleboard plant in Gaoyao, Guangdong Province; engineered wood flooring plant in Suzhou, Jiangsu Province; oriented strand board plant in Heilongjiang Province, close to the Russian border and finger-joint board processing facilities in Hunan Province.

### Particleboard Operation

The Gaoyao operation has a total land area of 170,000 m<sup>2</sup> and a total building area of 30,000 m<sup>2</sup>, located within the Economic Development Zone of Pearl Delta River. The plant produces quality particleboard and a melamine-faced chipboard, targeting one of the largest furniture manufacturing markets in China.

The Gaoyao operation is currently undergoing expansion by increasing its production capacity from 100,000 m<sup>3</sup> to approximately 275,000 m<sup>3</sup> and melamine lamination from 2,000,000 m<sup>2</sup> to 6,400,000 m<sup>2</sup>. The building will then house three particleboard production lines and two melamine faced chipboard production lines. After expansion, the Gaoyao particleboard mill will ranked among the top five in terms of production capacity in China. The expansion is expected to be completed by 2007.

### Engineered Wood Flooring

The flooring business was established in 2004 and product was manufactured by OEM. 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 65,000 m<sup>2</sup> and a total building area of 12,000 m<sup>2</sup>. 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 4 million m<sup>2</sup>. Subject to the production utilization and profitability of the current facility, the second phase is tentatively scheduled to be built in 2007. With the second phase complete, the combined capacity will be approximately 8 million m<sup>2</sup>. Sino-Maple flooring products is distributed through more than 200 outlets nationwide, including B&Q's mega 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 China due to its environmentally conscious use of forest plantation logs over large diameter natural forest logs. Sino-Maple is ranked amongst the top three engineered-wood flooring brands in China.

In addition, this facility recently received accreditation from the Forest Stewardship Council (FSC certification) for its flooring products. With the rise in China's economic development, and the high demand in residential renovation projects throughout China, Sino-Forest estimates annual revenue of approximately US\$130 million when the facility is completed and operating at full capacity of 8 million m<sup>2</sup> of production.

### Oriented Strand Board

Heilongjiang Jiamu Panel Co. Limited, a WFOE was established in fourth quarter of 2005 to manufacture oriented strand board ("OSB") and other wood-based products. The facility is located at



Muling City, Heilongjiang, close to the Russian borders, where abundant supply of wood can be found. 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 12,000m<sup>3</sup>.

### **Finger-Joint Board**

We acquired processing facilities, primarily producing finger-joint boards, with a total annual capacity of 68,000m<sup>3</sup> for US\$1.3 million in Hunan Province. Our strategy in Hunan is to maximize the value of our wood fibre through value-added processing.

### **Greenery and Nursery Operation**

According to China's 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 ten 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, Sino-Forest decided to pursue opportunities in this forest product business segment. With its plantation resources and expertise, the Corporation established Sinowin Plantings (Suzhou) Co. Ltd. to source, supply and manage landscaping products for property developers and other organizations.

The Nursery Operation began in 2003, with sales of \$0.2 million. For the year ended December 31, 2006, total sales from the Nursery Operations were \$4.8 million.

## **OTHER INFORMATION**

### **Sales and Marketing**

Substantially all of our sales are made in the PRC. In 2004, 2005 and 2006 our domestic sales of wood-based products, wood chips and standing timber accounted for most of our revenue. We also earn commission income from referral of business opportunities to wood dealers in the PRC, which in 2004, 2005 and 2006, accounted for 4%, 2% and 1% of total sales, respectively.

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 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. With respect to the authorized trading activities in the PRC, the delivery period of wood chips is usually one to two months from the date of the sales contracts entered into between the authorized intermediaries and the customers. We issue invoices to our authorized intermediaries in the PRC on a quarterly basis. Sales are usually denominated in Renminbi. Payments are usually settled within 60 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 and sales are 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 payment of 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.

Commission fees are generally paid within 60 to 180 days.

Our wood-based product manufacturing plants currently consist primarily of sales of particleboard 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-term 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 Malaysia, Suriname, Papua New Guinea, Solomon Islands, Russia and New Zealand. In 2004, 2005 and 2006, our five largest suppliers accounted for approximately 73%, 72% and 48% of our total costs of sales, respectively. The largest supplier accounted for approximately 26%, 20% and 16% of our total costs of sales, respectively, during such periods. 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.

The source of supply for our standing timber sales is our forestry plantations. In the future, we expect to increase timber supply from our forestry plantations with species range from eucalyptus, Chinese fir, pine, birch and larch for our trading activities.

### **Transportation**

Historically, we have not transported logs and wood-based products to customers ourselves. With respect to authorized trading of wood chips in the PRC, the transportation of the wood chips is the responsibility of either the ultimate customer of the wood chips or our authorized intermediary. With respect to sales of timber from our planted tree plantations and purchased tree plantations, as of December 31, 2006, we have only engaged in sales of standing timber from these 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 southern China.

### **Customers**

Our customers and authorized intermediaries 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 2004, 2005 and 2006, our five largest customers (including authorized intermediaries) accounted for approximately 75%, 56% and 54% of our revenue, respectively. In the same periods, our largest customer (including authorized intermediaries) accounted for approximately 23%, 18% and 13% of our revenue, respectively.

### **Competition**

The market for logs and wood-based products in the PRC is highly fragmented, with a large number of small operators of forestry plantations. There are also large operators of forestry plantations in the PRC, including Asia Pulp and Paper, with operations in Hainan, Guangdong and Guangxi Provinces,

Gaofeng Tree and Paper Group, with operations in Guangxi Province. Guangdong Petro-Trade, an exporter of wood chips and Hunan Tiger Forest and Paper in Hunan Province where wood fibre is mainly for its own consumption. In addition, local forestry bureaus, including the Leizhou Forestry Bureau, Hainan Forestry Bureau and Guangxi Forestry Bureau, also manage natural and plantation forests in the PRC, although their primary emphasis is administering and overseeing the protection, use and renewal of forestry resources in their areas, rather than operating commercial forestry plantations.

We also compete with producers of wood chips in Australia, Malaysia, Thailand and North and South America selling hardwood chips in the PRC and elsewhere in East Asia.

The market for wood-based panels in the PRC is also highly fragmented, with a large number of small manufacturers, and has 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, kitchen cabinets and composite doors. A number of domestic and foreign mills have commenced or announced plans to build wood-based panel mills in the PRC, which is 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.

## Employees

As of December 31, 2006, we had 1,181 full-time employees. The following table sets forth the number and location of our employees according to category as of December 31, 2006.

	Canada	Hong Kong	PRC	Total
Executives and Senior Management	1	2	12	15
Plantation Operation ( 1)	-	1	88	89
Personnel and Administration and IT	1	9	134	144
Finance, Accounting and Risk Management	2	6	45	53
Corporate and Organization Development	-	12	17	29
Sales and Marketing (import trading)	-	1	13	14
Research & Development and Environmental	-	4	3	7
Manufacturing ( 2)	-	7	823	830
Total	4	42	1,135	1,181

Notes :

- (1) Plantation Operation comprises of staff working in plantation, forestry project, quality control and purchase related to plantations, including forestry engineers, technicians, and forester.
- (2) Manufacturing comprises of staff such as engineers, technicians, factory workers, quality control and purchase personnel and warehouse and security guards.

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 labour dispute, strike or employee dispute.

## GOVERNMENT REGULATION

### WOOD FIBRE 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) dated June 25, 2003. This notice records the decisions of the PRC Central Government concerning the following main areas:

- 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 China;
- 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, pledges and making investments in joint ventures for plantations;
- To strengthen financial support to the development of the plantation industry by continuing to provide long-term and low interest rate credit facilities and by encouraging plantation operators to raise funds from the public.

### **Forest Classifications**

Under the PRC Forestry Law implemented on January 1, 1985 and amended on April 29, 1998 (the “PRC Forestry Law”), the PRC recognizes five classifications of forests in the forestry/plantation industry. They are:

- Protection forests—forests used for ecological protection, including for the conservation of water resources, retention of water and soil, as wind cover and for protection of farms, fields and roads;
- Commercial forests—forests used for the production and harvesting of wood logs;
- Economic forests—trees used for the production of fruit, oils, beverages, medicines and other industrial materials;
- Firewood forests—forests used for the production of firewood and other fuels;
- Special purpose forests—forests used for national defense, environmental protection and scientific research.

## **Right to Own or Use Plantation Land and Right to Own or Use Plantation Trees**

The PRC Forestry Law and the Implementation Regulations of the PRC Forestry Law implemented on January 29, 2000 (“Implementation Regulations”) stipulate that the PRC has implemented a registration and licensing system for ownership of the plantation/forestry land, forestry/plantation land use rights, ownership of the plantation/forestry trees; and the right to use the plantation/forestry trees. Under the PRC Forestry Law, the PRC recognizes four types of rights in the forestry/plantation industry:

<b>Type</b>	<b>Description</b>
Plantation Land Ownership	Right to own the plantation land for use as commercial forestry plantations
Plantation Land Use Rights	Right to use the plantation land for use as commercial forestry plantations
Plantation Tree Ownership Rights	Right to own the trees on commercial forestry plantations
Plantation Tree Use Rights	Right to use of the produce (i.e. fruit) of the trees

Under the PRC Forestry Law, it is not necessary for the four categories of rights identified above to be held by one entity. All forestry/plantation land in the PRC is either owned by the State or collectively-owned by collective organizations. Ownership of forestry/plantation land is not transferable in the PRC. Plantation land use rights and ownership of plantation trees in respect of “commercial” plantations are transferable, provided the transfer is conducted in accordance with PRC law.

The Implementation Regulations stipulate that all entities and individuals using forests, wood and forest land owned by the State or collective organizations must apply for registration with the forestry department of the local PRC government at the county level or above. The local PRC government at the county level or above has the power to issue certificates to confirm the use of rights of forests, wood and forest land and the users’ ownership of wood. Any change in the ownership or use rights of forests, wood and forest land must be registered. The PRC State Forestry Bureau promulgated and implemented the Forest Tree and Forest Land Ownership and Use Right Registration Administrative Measures on December 31, 2000 (“Administrative Measures”) which further stipulate detailed rules for registration of ownership and use rights. According to the Administrative Measures, the forestry bureaus at the county level or above are responsible for registering land use rights.

According to the PRC Forestry Law, the Implementation Regulations and the Administrative Measures, except for key forest zones and those crossing the boundaries of a related administrative region, forestry bureaus of the local PRC government at the county level or above can confirm the use rights in relation to the local forest land and the ownership of forest trees. Forestry bureaus at the county level or above are responsible for registering the use rights of forest land and the ownership of forest trees.

Under PRC laws, forestry land is either collectively owned or owned by the State. Under the PRC Forestry Law, the PRC implements the system of issuing plantation rights certificates to the persons

having the right to use the plantation land (in the case of the planted forestry plantations) or to the owners of the plantation trees (in the case of the purchased tree plantations).

The forestry bureaus at the county level and above are the only PRC authorities delegated by the PRC government responsible for the forestry industry in the PRC. Prior to the issuance of the plantation rights certificates, the forestry bureaus are responsible for conducting the investigation and review, registration and filings in relation to such issuance.

Since 2000, the PRC has been improving its system of registering plantation land ownership, plantation land use rights and plantation ownership rights and its system of issuing certificates to the persons having plantation land use rights, to owners owning the plantation trees and to owners of the plantation land. In April 2000, the PRC State Forestry Bureau announced the “Notice on the Implementation of Nationwide Uniform Plantation Right Certificates” (Lin Zi Fa [2000] No. 159) on April 19, 2000 (the “Notice”). Under the Notice, a new uniform form of plantation rights certificate is to be used commencing from the date of the Notice. The same type of new form plantation rights certificate will be issued to the persons having the right to use the plantation land, to persons who own the plantation land and plantation trees, and to persons having the right to use plantation trees.

The PRC government is gradually in the process of issuing new form certificates on a national scale. According to the Notice, the issuance of new certificates started in 2000. During the PRC State Forestry Bureau’s meeting held in July 2002, the PRC State Forestry Bureau confirmed its target for the PRC State Forestry Bureau to complete the issuance of new form plantation rights certificates within one to five years.

However, due to the complicated historical reasons, the difference among the localities and other practical reasons, the registration and issuance of the new form plantation rights certificates by PRC State Forestry Bureau have not been fully implemented in a timely manner in certain places of the PRC.

### **Permits and Quotas**

Logging applicants must apply to the forestry bureau of the local PRC government at the county level or above for a logging permit. Logging of forests must be conducted in accordance with the logging permit. Logging permits will not be issued to the applicant under the following circumstances:

- If the applicant has not replanted the forest trees logged in the previous year;
- If there were any large scale forest fires, significant unlawful logging or large scale destruction caused by forest pests in the previous year and the applicant has not adopted appropriate preventive measures or improved measures to prevent such occurrence; or
- If the application is for logging in a conservation forest zone or in special use forest zone which is not sustainable.

Under the PRC Forestry Law, the PRC strictly implements a quota system for the logging of forest trees. The forestry bureaus at the provincial level set annual logging quotas. The annual quota is reviewed by the local PRC government at the same level and is submitted to the PRC State Council for approval. According to the Implementation Regulations, the annual quota for certain key forest zones will be set by the PRC State Forestry Bureau, approved by the PRC State Council, and the quota will be reviewed every five years. There is priority treatment for quota allocations by local government bodies.

The Implementation Regulations stipulate that for timber forests which a foreign investor has invested in and operates, the forest trees should only be logged within the annual logging quota set by the

PRC State Council, upon obtaining approval from the forestry bureaus at the provincial level or above if the volume of forest that needs to be logged is of a significant scale.

### **Timber Transportation Permits**

According to the PRC Forestry Law, any entity which needs to transport the forest trees (unless those forest trees can only be removed by the State) out of the forest zones must apply for a timber transportation permit issued by the forestry bureau at the county level or above. According to the PRC Forestry Law and the Implementation Regulations, after the entity obtains the timber logging permit, the forestry bureaus shall issue a timber transportation permit to the entity for transporting the timber out of the forest zone.

### **Timber Operations and Processing Permits**

Timber operations and processing in the forest areas must be approved by the forestry bureau at the county level or above.

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

As outlined above, we are required to obtain the following permits and approvals for the operation of our forestry 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;
- Timber transportation permits.

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

The PRC Forestry Law and the Implementation Regulations implement the system of land ownership and land use rights registration and issuance of certificates. The Implementation Regulations stipulate that all entities should apply to the forestry department of the local PRC government at the county level or above for land use rights registration and the local PRC government at the county level or above must be responsible for issuing the plantation land use rights certificates. Applicants of the plantation land use rights must submit land use 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 department.

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

Based on the supplemental purchase contracts and the plantation rights certificates issued by the relevant forestry departments, we have the legal right to own our purchased tree plantations.

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

The Implementation Regulations stipulate that in foreign invested plantation projects, the forest trees should only be logged within the annual logging quota set by the PRC State Council, upon obtaining approval from the forestry departments at the provincial level or above. The Implementation Regulations are not clear as to who should be responsible for issuing timber logging permits to foreign invested



plantation projects. Each of the CJVs, Zhangzhou WFOE and Heyuan WFOE has obtained approval from the forestry departments at the provincial level guaranteeing its logging quota target. Upon obtaining the approval from the forestry departments at the provincial level for the logging quota targets and the relevant written confirmations from the forestry departments at the county level, there should not be any legal constraints for the CJVs to obtain timber logging permits provided that the CJVs also provide information including area, volume and location of the plantation trees and replanting measures.

There are no logging limitations applicable to the CJVs, Zhangzhou WFOE and Heyuan WFOE under the approved business scale of these ventures.

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

### **Timber Transportation Permit**

Upon the obtaining of the timber logging permit and the provision of certain supporting documents such as the quarantine certification, there should not be any legal constraints for the CJVs and 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 processing timber) in forestry areas must obtain approval from the forestry department of the local PRC government at or above the county level. Certain 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 department of the appropriate jurisdiction.

### **Regulations that Apply Nationwide**

The Implementation Regulations provide that corporations that engage in the timber business (including processing of timber) in forestry areas must obtain approval from the forestry department at the county level or above. Any violation of this regulation will result in the confiscation of the timber and any illegal gains, and payment of a fine up to two times 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 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 departments, then apply for registration with the relevant Administration for Industry and Commerce by obtaining a business license and comply with the business objectives as stated on the license.

The Administration of Standardization of Forestry Regulations, implemented on September 1, 2003, provide that the technical requirements of forestry products, quality of timber saplings, safety, hygiene standards, testing, inspection methods, packaging, storing and transportation must be standardized.

### **Eleventh Five-year Plan**

The 11<sup>th</sup> Five-Year Plan (2006-2010) implemented during the Tenth National People's Congress held in March 2006, stipulated plans to improve "three rural problem" in the agricultural sector in relation

to agricultural, rural areas and farmers. Top priority will be given to solve the issues of rural poverty with an aim to narrow poverty gap between urban and rural dwellers. The Plan calls for infrastructure improvement, and social development in the rural area, and creation of regional markets to promote a “new socialist countryside”. On the forestry front, the State of Forestry Administration plans to speed-up the development of fast-growing high-yield plantation and forestry integration by creating synergy between upstream forestry plantation to downstream pulp mills and manufacturing operations.

### **Regulations that Apply on the Local Provincial Level**

*Guangdong Province.* According to the Guangdong Province Temporary Administration of Timber Business Management, any entity engaged in business relating to the processing of or business in timber and its products, must comply with the following requirements:

- The entity must submit any related documents, evidence and applications proving its qualifications to engage in the business;
- The relevant forestry department at the county level or above shall have assessed the entity’s business objectives, methods, source of raw materials, and type and scope of business to ensure compliance with applicable standards.

*Jiangsu Province.* According to the Implementing Measures of Jiangsu Province for the PRC Forestry Law, promulgated on June 24, 2003, no entity is allowed to engage in the timber or timber processing business without first obtaining approval from the Forestry Supervision Department; and further, no unit or person engaged in the timber or timber processing business is allowed to purchase timber that does not possess a logging permit or is not from an authorized legal jurisdiction.

## **RISK FACTORS**

*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. Prices and demand for logs and wood chips have been, and in the future are expected to be, subject to cyclical fluctuations. 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 design 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;
- Governmental regulations and policies;
- Interest rates;

- Population growth and changing demographics;
- Seasonal weather cycles (e.g., dry summers, wet winters) and other factors.

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.

***Our ability to expand our forestry plantation resources and our manufacturing plants will require substantial future capital expenditures and we may be unable to obtain adequate financing to fund our capital and other requirements***

Our forestry plantation resources have grown by acquiring purchased tree plantations, which require intensive capital investment. Typically, the cycle of such plantation trees for harvesting can range from approximately 5 to 12 years, depending upon the tree species, in 2004, 2005 and 2006 we incurred approximately \$173 million, \$283 million and \$407 million, respectively, for expanding our planted tree plantations and purchased tree plantations. We finance our forestry plantation expansion activities primarily from internal cash flows, and debt and equity financing. We may have to obtain financing in order to acquire additional hectares of forestry plantations. We can give no assurance our cash flows will be sufficient to finance our operations or our future forestry plantation expansion. In addition, we can provide no assurance that debt or equity financing will be available in the future on attractive terms or at all. If we are not able to obtain financing, our business, financial condition and results of operations may be materially and adversely affected.

Our manufacturing operations have grown by investing in an engineered wood flooring plant in Suzhou, an oriented strand board plant in Heilongjiang and finger-joint plants in Hunan. As of December 31, 2006, we had incurred approximately \$99 million in constructing our manufacturing facilities in the PRC. Our need to make capital expenditures for our manufacturing facilities may have a material adverse effect on our business, financial condition and results of operations.

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

All of our forestry plantations are located in China. 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;
- 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;
- Reduction in tariff protection and other import restrictions.

In addition, the growth of demand in China for forestry products depends heavily on economic growth. Between 1978 and 2004, China's GDP increased from approximately RMB362 billion to approximately RMB14 trillion. The annual per capital GDP had also risen during this period, from RMB379 to RMB10,502. The central government has been prompt to take corrective measures and actions to stabilize the country's economy and any possible social unrest. After the country's soft landing from an overheating economy, the central government implemented various measures in strengthening and improving macroeconomic regulation and slowly pushing forward reform programmes to create stable momentum growth. We cannot assure that such growth will be sustained in the future. In addition, there have been concerns about rising labour demand, shrinking supply of traditional unskilled labour and increase in workforce wages. While the rise in wages may increase consumption power, it may increase inflationary pressures in the economy. The reform programmes and shortage of supply of labour may have an adverse impact on our business, financial condition and results of operations will 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, and due to the limited volume of published cases and judicial interpretation and their lack of precedential force, interpretation and enforcement of these laws and regulations involve significant uncertainties. At present, the legal framework for the forestry 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 provide any assurance 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.

***Our forestry 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 and its Implementation Regulations, the Forest Tree and Forestry Land Ownership and Use Rights Registration Administrative Measures and the Administrative Measures on Foreign Investment Forestation of Guangdong Province. Violations of a variety of PRC laws and regulations, including PRC environmental policies and programs that apply to our forestry

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:

- Forestry 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;
- Timber processing and manufacture and sale of wood panels.

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

In the future, we expect to receive a greater percentage of our revenue from sales of standing timber sourced from our own forestry plantations, either planted tree plantations or purchased tree plantations. As of December 31, 2006 we had approximately 58,000 hectares of planted tree plantations. As of December 31, 2006, we also had approximately 294,000 hectares of purchased tree plantations and we expect to acquire additional purchased tree plantations in the future. Under our agreements for our purchased tree plantations, we have an option to require the transfer of the plantation land use rights through a long-term lease for a maximum period of up to 30 to 50 years, subject to negotiation of a price for the transfer of the plantation land use rights and receipt of relevant governmental approvals, and satisfaction of registration requirements.

In order for us to operate our purchased tree plantations as sustainable, rotational forestry plantations, we will have to exercise our option to obtain the relevant plantation land use rights through long-term leases and enter into plantation land use rights transfer agreements with the local landowners or the holders of the land use rights to the plantations. We cannot give any assurance that we will exercise any of these options or enter into plantation land use transfer agreements. Our decision and ability to exercise our option or enter into agreements with respect to our purchased tree plantations will depend on, among other factors, our ability to negotiate a final price, whether the area is desirable for forestry plantations and the availability of future financing. We cannot give any assurance that the purchased tree plantations will be attractive areas for further rotations of forestry plantations.

We also cannot give any assurance that we will be able to enter into any plantation land use rights transfer agreements with the local landowners or land use rights holders on commercially acceptable terms. The price could be affected by a variety of market and other factors, including the level of development in the area, the desirability of the area for uses other than forestry plantations and general economic conditions.

In addition, we cannot give any assurance that we will obtain any or all of the maximum of approximately 583,000 hectares that we have a right to obtain from our PRC CJV Partners and other parties with respect to our planted tree plantations. Our decision and ability to do so will depend on, among other factors, whether a particular area is desirable for forestry plantations, the availability of purchased tree plantations for expansion of our operations, our view of the relative financial and other benefits of operating purchased tree plantations compared to operating planted tree plantations and the availability of future financing. Should we be unable to exercise our rights to obtain additional forestry plantations, our business, financial condition and results of operations could be materially and adversely affected.

***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;
- Pay out dividends to our shareholders.

Our subsidiary companies in China do not require prior approval from the State Administration for Foreign Exchange 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 labour services, and the declaration of and payment of dividends out of 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 China licensed to engage in foreign exchange.

Foreign exchange transactions under the capital account, however, will be subject to the registration requirements of the State Administration for Foreign Exchange. 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 CJVs 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 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 or to satisfy their other foreign currency requirements. Since foreign exchange transactions under the capital account are still subject to limitations and require approval from the State Administration for Foreign Exchange, 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.

***Our manufacturing plants have a short operating history and they may not be successful***

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;
- Raise working capital and fund capital expenditures for the expansion of the manufacturing plants.

In 2006 we reassessed our manufacturing development plan and continue to concentrate on our facility in Gaoyao with a plan to expand its particle board operating capacity to 275,000m<sup>3</sup> from 100,000m<sup>3</sup>, and the capability to produce 6,400,000m<sup>2</sup> of laminated particleboard from 1,000,000m<sup>2</sup> annually; invest in an engineered wood flooring plant in Suzhou with a production capacity of 4,000,000m<sup>2</sup>; an oriented strand board plant in Heilongjiang with a production capacity of 12,000m<sup>3</sup> and; finger-joint board processing facilities in Hunan Province with a total annual production capacity of 68,000m<sup>3</sup>.

We can give no assurance that the facility will operate at planned operating capacity.

***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, labour 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.

***If our subsidiaries incorporated in the PRC are restricted from paying dividends and other distributions to us, our primary source of funding would decrease***

We are a holding company with no significant assets other than our equity interests in our wholly owned subsidiaries in the PRC, Hong Kong and the British Virgin Islands. As a result, we rely on dividends paid to us by our subsidiaries and affiliated entities in the PRC, including the funds necessary to service or repay any debt we may incur. If our subsidiaries incur debt on their own behalf in the future, the instruments governing the debt may restrict their ability to meet our financial obligations and to pay dividends or make other distributions to us, which in turn would limit our ability to pay dividends on our shares. 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 standard and regulations to fund certain reserve funds that are not distributable as cash dividends.

***We are subject to risks presented by fluctuations in foreign currencies***

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

Since 1994, the conversion of Renminbi into Canadian and 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 PRC government has stated publicly that it intends to make Renminbi freely convertible in the future. However, we cannot predict when the PRC government will allow free conversion of Renminbi into foreign currencies. Renminbi devaluation and exchange rate fluctuations may adversely affect our results of operations and

financial condition and may result in foreign exchange losses because of our substantial foreign currency-denominated indebtedness, expenses and other requirements. 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.

At December 31, 2006, we have indebtedness of RMB167.9 million and \$499.5 million. Other than a currency swap agreement to fix interest payments at \$27.4 million per annum over the next five years with respect to the Guarantee Senior Notes, we do not hedge exchange rate fluctuations between the Renminbi and other currencies and currently have no plans to do so.

Any significant fluctuation in the exchange rates between the Renminbi and other currencies, such as the Canadian dollar, U.S. dollar, Euro or Hong Kong dollar, or in the U.S. dollar against the Renminbi, the Canadian dollar, the Euro or the Hong Kong dollar, may have an adverse impact on our results of operations and may adversely affect the value, translated or converted into Canadian dollars, U.S. 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 forestry plantations or engage in our trading activities:

- Unfavourable local and global weather conditions, such as prolonged drought, flooding, hailstorms, windstorms, typhoons, frost and winter freezing;
- 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 coastal areas of southern China suffer a number of typhoons each season, which lasts from July to September, which occasionally result in significant damage. Further, there have been several incidences of forest fires in Guangdong Province. Dry weather conditions brought by the El Nino 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. Similar conditions may occur 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 forestry plantations are located, 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 forestry plantations***

The success of our business depends upon the productivity of our forestry plantations and our ability to realize yields at estimated levels. We estimate that the current average standing timber yield for our eucalyptus trees is approximately 90 cubic meters per hectare per five to six-year cycle. See “Operations Overview – Planted Tree Plantations”. However, our current average standing timber yield is based upon a short operating history of one rotation and we may not be able to maintain this yield for future rotations. In addition, forestry plantation yields depend on a number of factors, many of which are beyond our control. These include damage by disease and pests and other natural disasters, and weather, climate and soil conditions. Our ability to maintain our yields will depend on these factors, and in



particular the weather, climate and soil conditions for additional forestry plantations that we may obtain in the future.

In addition, we may not be able to meet our expectations that the yield of our eucalyptus forestry plantations will improve over time. 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 species of eucalyptus trees and our ability to implement improved silvicultural practices as we gain experience in managing eucalyptus forestry 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.

### ***Estimation of the Company's provision for income and related taxes***

Two of the Company's principal operating subsidiaries incorporated in the British Virgin Islands (the "BVI Subsidiaries") are engaged in the sale of wood chips and standing timber and earning commission income ("Authorized Sales Activities") in the PRC through authorized intermediaries ("AI") that are domestic enterprises. In accordance with Income Tax Laws, foreign companies deriving income from sources in the PRC are subject to foreign enterprise income tax. Under the terms of the master agreements, relevant sales and purchase contracts and commission agreements made with the AI, the AI are responsible for paying all PRC taxes on behalf of the BVI subsidiaries that arise from the Authorized Sales Activities, including but not limited to, income tax, value-added tax and business tax. Accordingly, the BVI Subsidiaries did not directly pay any PRC taxes with respect to the profits earned in the PRC. The relevant income remitted to the Company should have already been taxed and not subject to additional PRC taxes.

If PRC tax authorities were to determine that the AI did not pay applicable PRC taxes as required on the Authorized Sales Activities on behalf of the BVI Subsidiaries, they may attempt to recover the applicable PRC taxes or any shortfall from the BVI Subsidiaries. Since the BVI Subsidiaries are unable to ascertain whether the AI have properly handled such tax settlements and/or able to recover relevant PRC taxes required to be paid by the BVI Subsidiaries from the AI, a provision for income tax at an amount representing management's best estimate of the amount the PRC tax authorities might seek to recover, is recognized in the financial statements each year. The yearly provision is reversed to the income statement after a period of three years based on management's best estimate of the liability. This means that the Company always maintains a three-year provision for tax on the profits earned from the Authorized Sales Activities of the three most recent years.

As at December 31, 2006, the balance of the provision for these tax related liabilities amounting to \$39.1 million (2005 – \$25.4 million) was provided on the profits of the Authorized Sales Activities earned by the BVI Subsidiaries over the three previous years.

The provision for income taxes and tax related liabilities is subject to a number of different estimates and judgment made by management. A change in these estimates and judgment could have a material effect on the Company's tax expense. The Company has operations in various countries (mainly in the PRC and Hong Kong) that have different tax laws and rates. Income tax and other taxes are subject to audit by both domestic and foreign 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 the Company operates, changes in tax laws in these jurisdictions, changes in tax treaties between various tax jurisdictions in which the Company operates. It is probable that profits already taxed by one tax jurisdiction could be taxed by another tax jurisdiction. 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 three 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.

Management evaluates the provision for tax related liabilities on an annual basis or as necessary and believes adequate but not excessive provision for tax related liabilities has been recognized in the financial statements.

***The PRC Corporate Income Tax Reform may increase the Company tax cost***

On March 16, 2007, the National People's Congress have passed a unified tax rate of 25% for all types of enterprises. Currently there are dual income-tax structures under which domestic companies pay income tax at a nominal rate of 33 percent while their foreign counterparts -- who benefit from tax waivers and incentives to encourage investment in China -- pay an average of 15 percent. Although the actual income-tax gap between businesses is less wide -- domestic companies pay around 24 percent and overseas-funded businesses 14 percent -- many believe that it handicaps domestic players who've been facing tougher competition since China joined the World Trade Organization in 2001.

Dual income-tax structures were quite necessary in the past and played a crucial role in attracting foreign investment and facilitating China's economy. However, along with China's World Trade Organization entry, the advancement of economic globalization, the establishment and optimization of the socialist market economy mechanism, the dual income-tax structure triggered new contradictions and problems. The PRC State Administration of Tax does not see the practice accord with the national treatment principle required by World Trade Organization rules, is detrimental to the fair competition between companies of various forms and also triggered illegal tax evasion as some domestic companies had been found falsely passing themselves off as foreign companies to claim low rates.

The State Administration of Tax will map out coordinated methods to secure a smooth reform, though the outcry from foreign firms over the phasing-out of their tax privileges remain strong.

The implementation of the tax reform will increase our Corporate tax costs and adversely affect our business financial results.

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

As of December 31, 2006, we had 351 employees (excluding manufacturing staff) in Hong Kong and the PRC to manage our forestry plantations. We currently engage third parties to perform the day-to-day operations of our forestry plantations. However, as we expand the area of our forestry 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 forestry 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 the business. Should we fail to take these measures, 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.

***We are subject to increased credit risk and risks of provisions and write-offs as a result of our increased sales of standing timber***

We began selling standing timber in 2002 and expect sales of standing timber to increase as a percentage of revenue in the future. We recognize revenue from sales of standing timber when the buyer has signed the sales contract. As a result of our sales of standing timber, our accounts receivables have increased significantly beginning in 2002. To the extent that customers that have purchased or will purchase in the future standing timber fail to pay, in a timely fashion or at all, 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 forestry plantations and standing timber, wood chips and wood-based products trading activities, we are subject to increasing competition from other large domestic and foreign owned forestry plantations in the PRC, as well as wood dealers and local forestry bureaus, all of which provide logs, wood chips and wood-based products for sale in the PRC. We also compete with a number of overseas forestry companies selling wood chips in the PRC and elsewhere in East Asia.

Our manufacturing plants face competition from other large domestic and foreign owned manufacturers in the PRC, as well as manufacturers in other countries importing into China. In this regard, other manufacturers are currently constructing new production facilities in the PRC that will substantially increase the production capacity. 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.

***Operational Licenses and Permits***

Currently, PRC laws and regulations require forestry plantation companies to obtain licenses and permits to operate forestry plantations, harvest logs on the forestry plantations and transport the logs out of the forest areas. The forestry 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 government allocates logging quotas and transportation quotas annually for plantations that are to be harvested, rather than granting permits at the time the forest is established. We have confirmation from the relevant forestry bureaus that they will allocate to us on an annual basis the logging quotas to assure that we are able to harvest the mature trees in the forestry plantations we currently operate. However, 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 forestry plantation companies to conduct these activities in the PRC.

In addition, PRC laws and regulations require foreign companies to obtain licenses to engage in any business activities in the PRC. As a result of these requirements, we currently engage in our trading activities through PRC authorized intermediaries that have the requisite business licenses. There is no assurance that the PRC government will not take action to restrict our ability to engage in trading activities through our authorized intermediaries. In order to reduce our reliance on the authorized intermediaries, we intend to use a WFOE in the PRC to enter into contracts directly with suppliers of raw timber, and then process the raw timber, or engage others to process raw timber on its behalf, and sell logs, wood chips and wood-based products to customers, although it would not be able to engage in pure trading activities.

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 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. Since we are not operating timber manufacturing plants in the forestry areas, it is not required that we apply for the Timber Operation (Processing) Permit. 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 strict 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. 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. Currently, it is a general policy of the PRC that a person who harvests trees is required to replant the harvested lands. Our forestry 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 forestry 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. Compliance with environmental laws and regulations may adversely affect our business, financial condition and results of operations.

### ***Plantation Land Use Rights***

Our PRC CJV Partners are required under the CJV contracts to obtain plantation land use rights certificates for the forestry plantations to be contributed to the CJVs. Our PRC CJV Partners generally obtain the plantation land use rights from third parties, who are generally rural collective organizations, and then contribute plantation land use rights to the CJVs. Under the Rural Land Contracting Law in the PRC, which took effect on March 1, 2003, our PRC CJV Partners must fulfill all relevant legal formalities

for the transfer of plantation lands and the rights to operate and manage the plantations. These include obtaining consents from all members of the farming households who have contracted to transfer the plantation lands, from all members of the collective organizations where such farms are located to waive their pre-emptive rights and from the contracting parties who have rights to operate and manage the plantations. Because of the additional requirements of the Rural Land Contracting Law, our PRC CJV Partners may not be able to obtain sufficient plantation land use rights from the rural collective organizations or the farming households, which would adversely affect their ability to make their required contributions to the CJVs. As a result, our PRC CJV Partners may not be able to provide us with the plantation land use rights to all the forestry plantations that we have the right to obtain.

In order to simplify our structure, we are currently in discussions with our four PRC CJV Partners regarding our proposal to terminate the respective CJV contracts. The termination of the four CJV contracts and the conversion of the CJVs into WFOEs is in progress. Once the conversion is complete, our WFOEs will need to obtain plantation land use rights certificates for the forestry plantations to be contributed to the WFOEs. There can be no assurance that WFOEs will be able to provide us with the necessary plantation land use rights certificates.

### ***Implementation 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 rights and of issuing certificates to the persons having land use rights, to owners owning the plantation trees and to owners of the plantation land. In April 2000, the State Forestry Bureau 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 issuing the new form of certificates, which were first issued in 2000, on a nationwide scale. The State Forestry Bureau indicated in a meeting held in July 2002 that they intend to complete the issue of new form certificates within one to five years.

We have obtained from the relevant local forestry bureaus at the county level or above written confirmations issued to our CJVs and WFOE that they have the legal right to use the land for which we have not received certificates. We have obtained confirmation from the offices of the Heyuan, Gaoyao and Zhangzhou people's governments that the confirmation letters issued by the Heyuan, Gaoyao and Zhangzhou forestry bureaus are true and accurate. We are applying for the relevant people's governments' confirmation on the other confirmation letters issued by local forestry bureaus in Guangxi and Jiangxi Provinces. In addition, for the purchased tree plantations, we have obtained confirmations from the relevant forestry bureaus that we have the legal right to own the purchased tree plantations for which we have not received certificates. Currently, we have obtained part of the new plantation rights certificates mainly from the Jiangxi and Guangdong Provinces. However, we can give no assurance when the official plantation rights certificates will be issued to all our purchased tree plantations and planted tree plantations by the people's government. Until official new-form plantation rights certificates are issued, there can be no assurance that our rights to our forestry 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 right to any of our forestry plantation lands is 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***

The PRC government levies taxes and other related forestry fees at the time trees are harvested or sold. These taxes and fees add to the cost of harvesting for PRC produced wood and are above the levels imposed in other major forestry plantation countries. These taxes and fees are imposed by the provincial governments and vary from province to province. The taxes and fees include agricultural taxes and

reforestation and maintenance fees. Agricultural taxes generally amount to approximately 8% of the selling prices or government standardized prices, depending upon the entity and the province in which it operates. In certain provinces where our forestry plantations are located, the agricultural taxes are exempted or reduced. Reforestation and maintenance fees are charged at 20% of sales, but are subject to a 50% reduction and a rebate of 50% to 70%, subject to approval, if the enterprise replants the land. There is also a forest protection fee of RMB5 per cubic meter of wood harvested. No assurance can be given that these taxes and fees will not be increased in the future. According to a notice issued by the Finance Bureau, State Development Reform Committee and State Forestry Bureau 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 forestry plantations are located.

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

Consistent with PRC forestry industry practice, we maintain insurance for our forestry plantations for an indemnity with a loss limit. We have insurance for our planted and purchased tree plantations in various locations in PRC against losses from fires, lightning, aircraft, explosion, floods, windstorm, subterranean fire and flood. We do not insure all our plantations against losses from all natural and other disasters 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 forestry plantations. If we were to suffer an uninsured loss to our forestry plantations, our business, financial condition and results of operations could be materially adversely affected. We also maintain insurance policies against risks of damage or destruction of our manufacturing facilities under Property All Risks and Public Liability Insurances. We maintain 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 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.

***We rely on our relationships with joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers for our forestry plantations and trading activities***

We rely on our relationships with joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers for our forestry plantations and trading activities. These relationships are discussed below.

***Joint Venture Partners and Contract Parties***

We have joint venture arrangements with our PRC CJV Partners and contractual arrangements with China Fujian Zhangzhou Lumin Development Company (“Zhangzhou Lumin”) for our WFOE, which operates our forestry plantation in Fujian Province. These, and possible future joint ventures and contractual arrangements with other third parties in connection with forestry plantations in the PRC, may involve certain risks. These risks include, among others, the possibility that the joint venture partners and contract parties may be unable or unwilling to fulfill their obligations, whether of a financial nature or otherwise, under the relevant joint venture or other agreements, or that the joint venture partners or contract parties could terminate our arrangements with them before the end of the term of the relevant contract or refuse to renew such arrangements when the term of the relevant contract expires. Although we have not experienced any significant disputes with our PRC CJV Partners or contract parties, a serious dispute over joint venture and contractual obligations, timber-sharing arrangements or otherwise, or an early termination of our arrangements with them, could adversely affect our business, financial condition and results of operations.

In order to simplify our structure, we are currently in discussions with our four PRC CJV Partners regarding our proposal to terminate the respective CJV contracts. The termination of the four CJV contracts and the conversion of the CJVs into WFOEs is in progress. Once the conversion is complete, there can be no assurance that WFOEs are able to serve as adequate replacement of PRC CJV Partners.

### ***Authorized Intermediaries***

In 2006, we relied on one authorized intermediary for our authorized wood chips trading transactions in the PRC. In the fourth quarter of 2005, one of the two authorized intermediaries that processes wood chip for us was acquired and ceased to provide service for us. In order to minimize impact on our operation, we shifted some of the logs to the remaining authorized intermediary for processing. We anticipate risks relying solely on one authorized intermediary, therefore, we are slowly shifting the remaining logs quota to our manufacturing operations for downstream production and utilization.

### ***Customers***

A few large customers account for a significant percentage of our total revenue. During 2004, 2005 and 2006, our top five customers accounted for approximately 75%, 56% and 54%, respectively, of total revenue. For the same periods, our largest customer accounted for approximately 23%, 18% and 13%, respectively, of total revenue. These top customers are all wood dealers and our authorized intermediaries who sell logs, wood chips 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.

### ***Suppliers***

A few large suppliers account for a significant percentage of our timber supply. In 2004, 2005 and 2006, our five largest timber suppliers accounted for approximately 73%, 72% and 48%, respectively, of our total costs of sales. For the same periods, our largest supplier of timber accounted for approximately 26%, 20% and 16%, respectively, of our total costs of sales. These top suppliers are all wood dealers and our authorized intermediaries. 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.

### ***Service Providers***

We rely to a significant extent on third party service providers for day-to-day operation of our forestry plantations. The operations performed by third party service providers include: site preparation, planting, plantation management, fertilization and harvesting. We occasionally experience seasonal labour shortages in May and September as farmers become fully engaged in the planting and harvesting of rice. If we are unable to obtain 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 PRC CJV Partners, major customers and others. We have no long-term contracts with any of 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 do not have key person life insurance policies covering any of our employees, including our senior management.

***Difference in Hunan business model may pose execution risks***

Hunan is a new region that we entered into in the fourth quarter of 2006 and our intention is to acquire 400,000 hectares of Chinese fir and pine over 14 years. Despite the strong support and collaboration we received from the local governments and forestry bureaus, there remain risks such as disagreement with collectively-owned farmers, execution risks of large-scale harvesting and replantation programme given climate difference as most of Sino-Forest's plantation are located in the warmer southern region.

***Increase in export logs taxes from Russia may put pressure our revenue***

The Russian government announced in early 2007 that it will significantly increase the export tax on logs from the current level of 6.5% to 20% in July 2007, 25% in April 2008 and 80% in January 2009. Although taxes levied will be passed on to our customers, we do anticipate import demand from Russia might decrease and/or our margins will be penalized. To mitigate such risks, we will expand our sourcing network globally.

***Rise in land lease cost***

Given China's robust economic growth over the past decade and demand for wood fibre continue to climb, cost for trees and land lease rental have been rising gradually, about an average 10% year-on-year. In addition, China's 11<sup>th</sup> five-year plan to improve rural living standard and develop regional economic zones will increase cost along the coastal and second to third tier cities. In anticipating such occurrence, we have been moving to inner areas where trees acquisition and land lease costs remain competitive.

**DIVIDEND RECORD AND POLICY**

We have not declared any dividend on our shares. The covenants of Senior Notes and syndicated loan facility prohibit the Company 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

On August 17, 2004, we issued \$300,000,000 principal amount of 9 1/8% guaranteed senior notes (the “Guaranteed Senior Notes”) with a maturity date of August 17, 2011. The Guaranteed Senior Notes have been given a Ba2 (stable) rating by Moody’s Investors Services and a BB- (stable) rating by Standard & Poor’s Ratings Services. On March 27, 2007, Standard & Poor’s Ratings Services raised the issue rating on our Guaranteed Senior Notes to ‘BB’ from ‘BB-’.

The rating on our company reflects our good business profile, which is supported by management’s ability to successfully develop forestry plantations, strong demand for wood products in mainland China and adequate financial flexibility. These strengths are partially offset by our company’s modest size, active acquisition program, the cyclical nature of the industry, regulatory risk in mainland China and exposure to foreign currency risk (Source: Standard & Poor’s).

A rating of BB by Standard and Poor’s Ratings Services suggests the company is less vulnerable to nonpayment than other speculative grade issues (i.e. B, or CCC rated companies). However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions that could lead to the obligor’s inadequate capacity or willingness to meet its financial commitment on the obligation. A rating of Ba2 by Moody’s Investors Service is a speculative grade, suggesting the future of these bonds cannot be considered as well-assured. The ratings address our ability to perform our obligations under the terms of the Guaranteed Senior Notes and credit risks in determining the likelihood that payments will be made when due under the Guaranteed Senior Notes. 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 Guaranteed Senior Notes of any such revision, downgrade or withdrawal. A suspension, reduction or withdrawal at any time of the rating assigned to the Guaranteed Senior Notes may adversely affect the market price of the Guaranteed Senior Notes.

## MARKET FOR SECURITIES

### Trading Price and Volume

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

Calendar Period	High	Low	Average Daily Volume
January 2006	6.10	4.65	586,943
February 2006	6.25	5.55	359,437
March 2006	7.00	5.83	646,476
April 2006	6.35	4.76	609,202

May 2006	6.59	5.10	491,556
June 2006	5.78	4.82	301,497
July 2006	6.01	5.48	213,549
August 2006	5.79	4.16	321,225
September 2006	4.63	3.60	484,634
October 2006	5.84	4.22	710,380
November 2006	6.94	5.46	614,139
December 2006	7.97	6.72	640,317

### DIRECTORS AND EXECUTIVE OFFICERS

The table presented below provides the names of our current directors and executive officers<sup>(5)</sup>, the offices held by them and the date of their first appointment.

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	-
Chen Hua China	Senior Vice President, China Operations and Finance	Officer of the Corporation	-
Alfred Hung Hong Kong	Vice President, Corporate Planning, Banking and Sales	Officer of the Corporation	-
James M.E. Hyde <sup>(2)(3)(4)</sup> Ontario, Canada	Director	Executive Vice President and Chief Financial Officer, Resolve Business Outsourcing Income Fund, a progressive business process outsourcing (BPO) firm	2004
Albert Ip Hong Kong	Senior Vice President, Project, Hong Kong	Officer of the Corporation	-
James A.C. Lau Hong Kong	Vice President, Operations, Sino-Panel (Asia) Inc., China	Officer of the Corporation	-
Jay A. Lefton Ontario, Canada	Corporate Secretary	Partner, Aird & Berlis LLP Barristers & Solicitors	-
Alvin Lim Hong Kong	Vice President Finance and Group Financial Controller	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>
Edmund Mak <sup>(2)(3)</sup> British Columbia, Canada	Director	Real estate marketing agent, Re/Max Select Properties	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

**Notes:**

- (1) All our directors serve until the next annual meeting of shareholders or until such director's successors 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.
- (5) As at December 31, 2006, Kee Y. Wong has resigned as the Company Vice Chairman and Director.

**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, 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 a 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.

Prior to joining our company in 2002, Chen Hua was the board chairman and general manager of Suzhou New-Developed Area Economic Development Group in the PRC. Ms. Chen had also served as deputy director of Suzhou New-Developed Area Supervisor Committee, vice-chairman of Suzhou Commercial Bank, director of Jiangsu Fujitsu Communication Company and director general of the Auditor Bureau of Suzhou New-Developed Area.

Mr. James Hyde was 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. From April to December 2006, Mr. Hyde was a Consultant to A.O. Smith Corporation. Before October 2002, Mr. Hyde was with Ernst & Young LLP (an accounting and auditing firm) for 24 years, including twelve years as a Partner.

Prior to joining our company, James Lau was an advisor with VGI Global Media (an outdoor media advertiser and leasing agent) from June 2001 until March 2003, Chief Officer, Sales and Marketing, of Chen Hsong Machinery Co. Ltd. (a plastic injection moulding machine manufacturer) from

September 2000 until May 2001 and Managing Director of The Ultimate Collection Ltd. (a kitchen manufacturer and trading company) from February 1999 until August 2000.

Prior to joining our company, Alvin Lim was an Investment Manager with a private equity investment firm from July 2000 until October 2002 and Audit Manager with an international accounting and auditing firm from November 1993 until June 2000.

Prior to joining our company, Zhao Wei Mao was General Manager with Everbright Timber (Shenzhen) Industry Co., Ltd. (a wood panel manufacturer) from August 1988 until April 2002.

Judson Martin was Senior Executive Vice President and Chief Financial Officer of Alliance Atlantis Communications Inc. (“Alliance Atlantis”) from March 2003 to June 2005 and was 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 Chief Financial Officer until September 2004. From November 2002 until January 2003, Mr. Martin was President and Chief Executive Officer of TGS North American REIT. From July 1995 to September 1997, Mr. Martin was 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 Chairman of Skypower Wind Energy Fund LP and serves as Chair of the audit committee.

Prior to joining our company, 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.

## **Shareholdings**

As of March 30, 2007, our directors and executive officers as a group beneficially owned, directly or indirectly or exercised control over, 9,033,358 Common Shares, representing approximately 6.55% of the issued and outstanding Common Shares.

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

Other than as disclosed below, none of our directors or executive officers, or persons or companies that are the direct or indirect beneficial owners of, or who exercise control or direction over, more than 10% of our outstanding Common Shares, or any associate or affiliate of any of the foregoing, has any interest, direct or indirect, in any material transactions in which we have participated during the three financial years ending December 31, 2006 or since January 1, 2007 which has materially affected or will materially affect the Corporation.

## **Exchangeable Notes**

In 2003, Sino-Wood issued to Ruby Worldwide Limited 66,325 class B shares of Sino-Wood which are convertible into ordinary shares of Sino-Wood on a one-for-one basis. In 2004, we purchased all of the outstanding class B shares held by Ruby Worldwide Limited at a price of HK\$1.00 per class B

share. Ruby Worldwide Limited is a wholly owned subsidiary of General Enterprise Management Services Oriental and General Fund Limited, a Cayman Islands company, (“GEMS Fund”). Mr. Simon Murray, one of our directors, is a shareholder and the Chairman of General Enterprises Management Services (International) Limited, a British Virgin Islands company, which has an agreement to provide certain advisory, management and general administrative services to GEMS Fund.

#### Purchase of Rights from Management

In connection with our intention to effect an initial public offering and listing of Sino-Wood on the Hong Kong Stock Exchange, in March 2003, we granted rights to Allen T.Y. Chan, Kai Kit Poon and Kee Y. Wong, conditional upon completion of the initial public offering and Hong Kong Stock Exchange listing, to acquire 5% of the equity of Sino-Wood for nominal consideration (the “Rights”). In May 2004, although Sino-Wood had not yet completed an initial public offering and the listing of its shares on the Hong Kong Stock Exchange, our independent directors determined, in view of the public offering (the “Offering”) of Common Shares completed in May 2004, that it was appropriate to restructure the Rights.

Accordingly, on May 7, 2004, we agreed to purchase the Rights for an aggregate purchase price not to exceed approximately Cdn\$12 million (\$9.4 million) to be paid by the future issuance of an aggregate of 2.4 million Common Shares. Of such Common Shares, 50% were issued on each of August 14, 2004 and May 14, 2005. In consideration of our intention to purchase the Rights, and in recognition of the Offering, Messrs. Chan, Poon and Wong agreed to the cancellation of existing options originally granted to them in November 1997, to acquire up to approximately 8.1% of the equity of a predecessor to Sino-Panel Holdings, Limited, one of our subsidiaries (which was subsequently changed to approximately 8.1% of the equity of Sino-Panel Holdings, Limited) for nominal consideration, including any shares issuable as a result of a public offering of Sino-Panel Holdings, Limited.

#### **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, 2006; or (ii) prior to January 1, 2007 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 \$300,000,000 9 1/8% Guaranteed Senior Notes Due 2011, 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 \$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 will

purchase and subscribe from Mandra Forestry Holdings Limited 15% issued 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 \$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. A Master Agreement dated July 31, 2006 between Sino-Forest (Guangzhou) Trading Limited and Inner Mongolia Forest and Timber Resources Co., Ltd, an equity joint-venture company in the PRC, and Erliahaote Joint Forestry Bureau in the Inner Mongolia Autonomous Region, to secure a long-term supply of wood fibre over the period of 12 years. A payment of US\$10 million has been made as deposit which is refundable over the first 5 years of the contract.
6. A Master Agreement dated September 28, 2006 between Sino-Panel (Asia) Inc. with Hongjiang City Forestry Technology Integrated Development Services Company, a state-owned enterprise in the PRC and an authorized agent for the original plantation holders whereby Sino-Panel (Asia) Inc. will, through its PRC wholly-owned subsidiaries, purchase approximately 100,000 hectares of plantation trees, containing pine and Chinese fir, in Hunan Province. Another agreement dated December 7, 2006 between Sino-Panel (Asia) Inc. and Hongjiang City Forestry Technology Integrated Development Services Company to acquire an additional 300,000 hectares of plantation trees in Hunan Province bringing the total to 400,000 hectares for an aggregate of approximately \$1,291.3 million to \$1,549.5 million over a 14-year period.

The following are the contracts that are material to the Corporation that have been entered into after the financial year ended December 31, 2006 but prior to March 30, 2007, other than contracts entered into in the ordinary course of business:

1. Subscription Agreement dated March 23, 2007 between the Corporation and several institutional investors including Aranda Investments Pte. Ltd., and Ellington Investments Pte. Ltd. (collectively, the "Temasek"), each, and indirectly wholly owned subsidiary of Temasek Holdings (Pte) Ltd., an Asia investment firm headquartered in Singapore and Golden China Master Fund ("Golden China") managed by Greenworld Asset Management and United Capital Investment Group Limited ("United Capital"), whereby the Corporation will sell approximately 26 million common shares to the institutional investors, which will represent approximately 16% of the diluted total shares outstanding.

Temasek, Golden China and United Capital will be subscribing respectively for approximately 85%, 8.75% and 6.25% of the placement offering. The offering is for gross proceeds of US\$200 million at a price of Cdn\$9.15 per share, which represents a discount of approximately 9% to the volume-weighted market price over the past 30 days.

Upon completion of the offering, Temasek will be entitled to nominate a member to the Board of Directors of the Corporation. Certain senior members of the Corporation's management will agree with the subscribers to restrict their ability to dispose of securities of the Corporation for a one-year period, while the restriction on the CEO and Chairman of the Corporation will extend for a two-year period; each of these members of management will forfeit 50% of their securities if, in certain circumstances, such person ceases to be employees prior to the end of the restricted

period. The Subscribers have each agreed to a six-month lock up period on the shares acquired under the placement.

2. An Agreement dated March 23, 2007 between Sino-Panel (Asia) Inc. (“Sino-Panel”), a wholly-owned subsidiary of the Corporation with Gengma Dai and Wa Tribes Autonomous Region Forestry Company Ltd., (“Gengma Forestry”) established in Lincang City, Yunnan Province, under which Sino-Panel will acquire approximately 200,000 hectares of non-state owned commercial standing timber including pine and broadleaved shaw in Lincang City and surrounding cities in Yunnan Province for approximately RMB5.5 to 11 billion or approximately US\$0.7 to 1.4 billion over a 10-year period. The purchase price is not to exceed RMB260 or approximately US\$33.6 per cubic metre (m<sup>3</sup>). The number of hectares to be acquired each year will be determined by Sino-Panel’s PRC subsidiaries by entering into specific purchase agreements with Gengma Forestry. The Agreement also provides the Corporation with the rights of first refusal to lease the land for 50 years after harvesting. The final terms of the lease are to be further negotiated with Gengma Forestry.

### **INTERESTS OF EXPERTS**

Pöyry Consulting (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 22, 2005, March 8, 2006 and March 26, 2007 regarding the description and valuation of Sino-Wood’s plantation forest assets in Southern China. To our knowledge, the partners and associates of Jaakko Pöyry, as a group, beneficially own, directly and indirectly, less than 1% of our outstanding Common Shares.

The auditors of Sino-Forest are BDO McCabe Lo Limited, Certified Public Accountants. Sino-Forest’s consolidated financial statements as of December 31, 2006 and for the year then ended have been filed under National Instrument 51-102 in reliance on the report of BDO McCabe Lo Limited, Certified Public Accountants, given their authority as experts in auditing and accounting. As of March 30, 2007, the directors and employees of BDO McCabe Lo Limited as a group did not beneficially own, directly or indirectly, any of Sino-Forest’s outstanding securities.

### **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 Multilateral Instrument 52-110 - Audit Committees (“MI 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 MI 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 \$315,000 and \$483,000 during the financial years ended December 31, 2005 and 2006, respectively, for audit fees.

*Audit-Related Fees* - We did not pay any audit-related fees during the financial years ended December 31, 2005 and 2006 for assurance and related services that are reasonably related to the performance of the audits or reviewing our financial statements and which are not included under "Audit Fees" set out above.

*Tax Fees* - Our external auditors billed us approximately \$69,000 during the financial year ended December 31, 2005 and no fee was incurred for the financial year ended December 31, 2006 for services related to tax compliance, tax advice and tax planning.

*All Other Fees* - Our external auditors billed us at \$2,200 during the financial years ended December 31, 2006, for services other than those reported above.

## **ADDITIONAL INFORMATION**

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

Additional information relating to our company, 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 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, 2006.



## **Exhibit “A”**

### **SINO-FOREST CORPORATION**

**(the “Corporation”)**

#### **AUDIT COMMITTEE CHARTER**

##### **1 PURPOSE**

The overall purpose of the Audit Committee (the “Committee”) of the Corporation is to monitor the Corporation’s system of internal financial controls, to evaluate and report on the integrity of the financial statements including the management’s discussion and analysis and related press releases of the Corporation, to enhance the independence of the Corporation’s external auditor and to oversee the accounting and financial reporting processes and audits of financial statements of the Corporation.

##### **2 COMPOSITION, PROCEDURES AND ORGANIZATION**

- 2.1 The Committee shall consist of at least three members of the board of directors of the Corporation (the “Board”), each of whom shall be, in the determination of the Board, “independent” as that term is defined by the Canadian Securities Administrators in Multilateral Instrument 52-110 - Audit Committees, as amended from time to time.
- 2.2 All members of the Committee shall be, in the determination of the Board, “financially literate”, as that term is defined by the Canadian Securities Administrators in Multilateral Instrument 52-110 - Audit Committees, as amended from time to time.
- 2.3 At least 50% of the members of the Committee shall be resident Canadians.
- 2.4 The Board, at its organizational meeting held in conjunction with each annual meeting of shareholders, shall appoint the members of the Committee for the ensuing year. The Board may at any time remove or replace any member of the Committee and may fill any vacancy in the Committee. Any member of the Committee ceasing to be a director shall cease to be a member of the Committee.
- 2.5 New Committee members will participate in such training and orientation as may be deemed by the Board or the Corporate Governance Committee to be necessary or appropriate in the circumstances.
- 2.6 Unless the Board shall have appointed a chair of the Committee, the members of the Committee shall elect a chair from amongst their number.
- 2.7 The Committee shall have access to such officers and employees of the Corporation and to the Corporation’s external auditor and its legal counsel, and to such information respecting the Corporation as it considers necessary or advisable in order to perform its duties.
- 2.8 Notice of every meeting shall be given to the external auditor, who shall, at the expense of the Corporation, be entitled to attend and to be heard thereat.
- 2.9 Meetings of the Committee shall be conducted as follows:

- (a) the Committee shall meet on a regular basis, at least four times per year and at such times and at such locations as the chair of the Committee shall determine;
  - (b) the external auditor or any member of the Committee may call a meeting of the Committee;
  - (c) any director of the Corporation may request the chair of the Committee to call a meeting of the Committee and may attend such meeting to inform the Committee of a specific matter of concern to such director, and may participate in such meeting to the extent permitted by the chair of the Committee; and
  - (d) the external auditor and management employees shall, when required by the Committee, attend any meeting of the Committee.
- 2.10 The external auditor shall be entitled to communicate directly with the chair of the Committee and may meet separately with the Committee. The Committee, through its chair, may contact directly any employee in the Corporation as it deems necessary, and any employee may bring before the Committee any matter involving questionable, illegal or improper practices or transactions.
- 2.11 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).
- 2.12 The Committee is authorized, at the Corporation's expense, to retain independent counsel and other advisors as it determines necessary to carry out its duties and to set their compensation.

### **3 AUDITORS**

The Committee shall recommend to the Board: (a) the external auditor to be nominated for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Corporation; and (b) the compensation of the external auditor.

The external auditors of the Corporation shall both report to, and ultimately be accountable to, the Committee and the Board as representatives of the shareholders. The Committee is directly responsible for overseeing the work of the external auditor engaged for the purpose of preparing or issuing an auditor's report or performing other audit, review or attest services for the Corporation, including the resolution of disagreements between management and the external auditor regarding financial reporting.

### **4 DUTIES**

Management is responsible for preparing the interim and annual financial statements of the Corporation and for maintaining a system of internal controls to provide reasonable assurance that assets are safeguarded and that transactions are authorized, recorded and reported properly. The Committee is responsible for reviewing management's actions in that regard. The Committee shall:

- 4.1 pre-approve all non-audit services to be provided to the Corporation or any subsidiaries by the Corporation's external auditor. The Committee may delegate to one of its

members the approval of such services, in which case the items approved will be reported to the Committee at its next scheduled meeting following such pre-approval;

- 4.2 review with management and the Corporation's internal and external auditors the Corporation's financial reporting in connection with the annual audit and the preparation of the financial statements, including, without limitation, the judgment of the external auditors as to the quality and appropriateness of the Corporation's accounting principles as applied in its financial reporting;
- 4.3 review with the auditors, before completion of the annual audit of the Corporation, the financial statements and the report of the auditors thereon, in order to ensure that the auditors are satisfied with the disclosure made to them of the required information and with the content of the financial statements;
- 4.4 review and recommend to the Board of Directors for approval, prior to public dissemination:
  - (a) the financial statements of the Corporation;
  - (b) management's discussion and analysis of the financial condition and results of operations ("MD&A") with regard to the financial statements;
  - (c) the annual information form;
  - (d) the contents of the annual report to shareholders;
  - (e) annual and interim earnings press releases;
  - (f) all certifications that may be made by the Chief Executive Officer and Chief Financial Officer on the annual or quarterly financial results, disclosure controls and procedures and internal controls over financial reporting;
  - (g) any financial information contained in any prospectus, information circular or other disclosure documents or regulatory filings containing financial information of the Corporation; and
  - (h) any other similar disclosure filings to be made by the Corporation under the requirements of securities laws or stock exchange rules applicable to the Corporation;

The Board may delegate responsibility for the approval of the interim filings of the Corporation under (a), (b), (e) and (f) above to the Committee, who shall then be responsible for approval, prior to public dissemination.

- 4.5 be satisfied that adequate procedures are in place for the review of the Corporation's public disclosure of financial information extracted or derived from the Corporation's financial statements, other than the public disclosure referred to in paragraph 4.4 above, and must periodically assess the adequacy of those procedures;
- 4.6 review, as appropriate, any report required by the appropriate regulatory authority to be included in the annual management information circular related to the matters covered by

this Charter including the disclosure of the external auditors' services and fees, Committee members and their qualifications and activities of the Committee;

- 4.7 discuss with management the Corporation's policies and procedures for managing the principal risks of its business to determine that management has identified the principal risks of the Corporation's businesses and has implemented and is maintaining systems and procedures to manage those risks;
- 4.8 review the audit plans of the internal and external auditors of the Corporation, including the degree of detail of those plans and the co-ordination between those plans;
- 4.9 review and consider, as appropriate, any significant reports and recommendations issued by the Corporation or by any external party relating to internal audit issues, together with management's response thereto;
- 4.10 review the internal control procedures to determine the effectiveness of the Corporation's internal controls and to determine that the Corporation is in compliance with legal and regulatory requirements and with the Corporation's policies;
- 4.11 review management's plans regarding any changes in accounting practices or policies and the financial impact thereof;
- 4.12 review with management, the external auditors and, if necessary, legal counsel, any litigation, claim or contingency, including tax assessments, that could have a material effect upon the financial position of the Corporation, and the manner in which these matters may be, or have been, disclosed in the financial statements;
- 4.13 meet separately with management, the external auditors and internal auditors from time to time, as it deems necessary, but not less than annually, and consider any matter that they recommend bringing to the attention of the Board;
- 4.14 review all related party transactions entered into by the Corporation;
- 4.15 review any business plans and operating and capital budgets of the Corporation;
- 4.16 establish procedures for: (i) the receipt, retention and treatment of complaints received by the Corporation regarding accounting, internal accounting controls, or auditing matters; and (ii) the confidential, anonymous submission by employees of the Corporation of concerns regarding questionable accounting or auditing matters;
- 4.17 review and discuss with the external auditors all significant relationships that the external auditors and their affiliates have with the Corporation and its affiliates in order to determine the external auditors' independence, including, without limitation: (i) requesting, receiving and reviewing, on a periodic basis, a formal written statement from the external auditors delineating all relationships that may reasonably be thought to bear on the independence of the external auditors with respect to the Corporation; (ii) discussing with the external auditors any disclosed relationships or services that the external auditors believe may affect the objectivity and independence of the external auditors; (iii) review and approve the Corporation's hiring policies regarding partners, employees and former partners and employees of the present and former external auditor of the Corporation; and (iv) recommending that the Board take appropriate action in

response to the external auditors' report to satisfy itself of the external auditors' independence;

- 4.18 annually prepare a report from the Committee to shareholders or others, concerning the Committee's activities in the discharge of its responsibilities, when and as required by applicable laws or regulations; and
- 4.19 at least annually, perform a self-evaluation to determine the Committee's effectiveness and performance, evaluate succession plans related to Committee membership and review this Charter and, if required, recommend changes to the Board.

## **5 OTHER**

The Committee may, at the request of the Board or on its own initiative, investigate such other matters as are considered necessary or appropriate in the circumstances and shall have the authority to (i) retain independent counsel and other advisors, as it determines necessary to carry out its duties, and (ii) set and pay the compensation for any advisors employed by the Committee.