SINO-FOREST
嘉漢林業

ANNUAL REPORT 2006

SINO-FOREST CORPORATION

GROWING IN STATURE

SINO-FOREST CORPORATION is a leading foreign-owned commercial forestry plantation operator in China. The Canadian corporation began operations in 1994 as the first foreign and privately managed company involved in forest products in the People's Republic of China ("PRC"). Its principal businesses include the ownership and management of forestry plantation trees and sales of standing timber, wood chips and logs, and complementary manufacturing of downstream engineered-wood products. Its executive offices are in Hong Kong and Toronto, and its common shares trade on the Toronto Stock Exchange under the symbol TRE.

Note: All amounts are expressed in U.S. dollars, unless otherwise indicated.

Why Invest In Sino-Forest ?

China Needs Wood
Growing Demand

China's wood fibre deficit is increasing. Currently, 35% is imported and the figure is set to rise to 50%. Sino-Forest is well positioned to help sustain China's rising consumption of timber logs and downstream engineered products.

Competitive Advantage
Growing Proficiency

Sino-Forest is an industry leader, deploying scientific silviculture techniques and forest-management methodologies that maximise harvest yields and ensure long-term sustainability.

Strong Track Record
Growth through Experience

Sino-Forest has a proven twelve-year track record operating in China. The Company's sizeable operations and its accumulated forestry expertise serve as a solid foundation for exceptional growth in the years to come.

China Encourages Forestry
Growth Plan

China's eleventh Five-year Plan (2006-2010) aims to protect and restore the environment with particular emphasis on forestry development. As a leading foreign-owned plantation operator, Sino-Forest aims to play a vital role.

Broad Reach
Geographical and Vertical Growth

Sino-Forest has nearly doubled its plantation base and expanded its geographical coverage during the past three years. It now operates in ten provinces, deploying integrated operations – ranging from standing timber and wood chip supply to downstream product manufacturing to capture margins along the value chain.

Benefits to Shareholders
Growing in Value

Driven by a strong management team and solid demand for wood fibre, Sino-Forest's net income and earnings per share achieved a compound annual growth rate of 35% (net income) and 21% (diluted EPS) respectively over the past twelve years.

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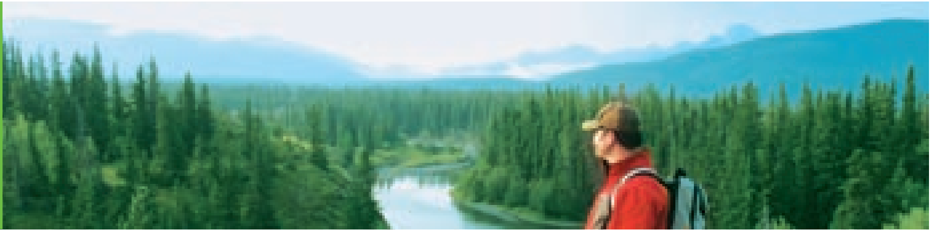
SINO-FOREST 2006 PERFORMANCE



- Delivered record earnings for the twelfth consecutive year with net income exceeding the $100 million mark, driven by solid sales in standing timber
- Total asset base exceeded $1 billion with timber holdings accounting for over $750 million at cost, compared to Pöyry's valuation of $919 million based on a single rotation
- Topline key performance indicators achieved double-digit compound average growth over the past five years

SUMMARY OF FINANCIAL DATA

U.S. dollars (in millions, unless otherwise indicated)	2006	2005	Change (%)	5-year CAGR* (%)
Revenue	**645.0**	493.3	30.7	36.3
Gross profit	**194.5**	136.9	42.1	45.1
Gross profit margin	**30.2%**	27.7%	2.5 pts	—
EBITDA	**334.3**	255.9	30.6	71.4
Net income	**111.5**	81.7	36.4	43.1
Diluted earnings per share	**0.80**	0.59	34.4	30.7
Cash flow from operating activities	**289.3**	196.5	47.3	86.4
Cash and cash equivalents, end of year	**152.9**	108.4	41.0	145.9
Capital expenditures	**416.8**	299.7	39.1	55.9
Total assets	**1,207.3**	895.3	34.8	33.8
Return on equity	**18.4%**	17.5%	0.9 pts	—
Shareholders' equity	**605.7**	468.0	29.4	28.5
Share price at year end (Canadian dollars)	**7.83**	4.94	58.5	47.3
Market capitalization at year end (millions of Canadian dollars)	**1,080.0**	681.0	58.6	62.4
Hectares of trees acquired	**129,276**	175,214	(26.2)	—
Hectares of trees sold	**111,367**	108,013	3.1	—
Hectares of trees under management at year end	**352,000**	324,000	8.6	—

* Compound average annual growth rate from 2001 to 2006

YEARLY FOREST ASSETS VALUATION BY INDEPENDENT CONSULTANTS

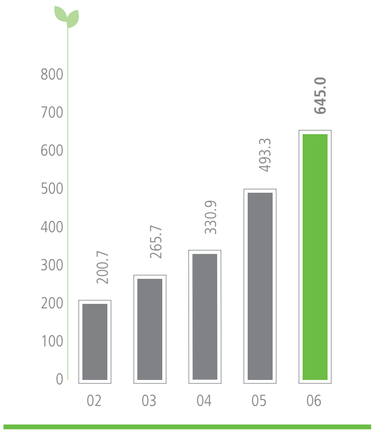
	2006	2005	2004
Trees inventory under management (in hectares)	**352,000**	324,000	242,000
Value of existing forest assets** (millions)	**919**	729	566
Value with perpetual rotation*** (millions)	**1,428**	968	774
Total volume (m^3 in millions)	**27.4**	23.8	16.4
Average yield (m^3 per hectare)	**87**	78	73

Source: Pöyry

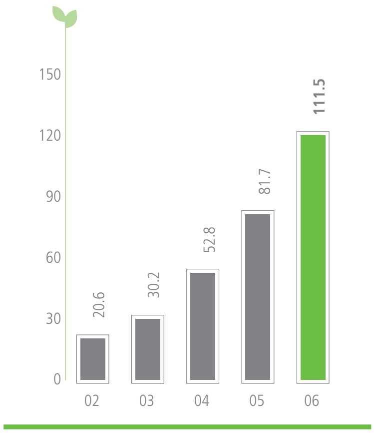
** Based on single rotation, a one-off harvesting of standing timber

*** Based on perpetual re-planting and cultivation of plantation land after harvesting through many rotations over a fifty-year period, including 400,000 hecares in Hunan Province

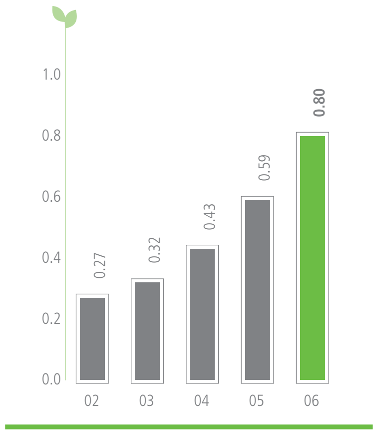
REVENUE (millions)



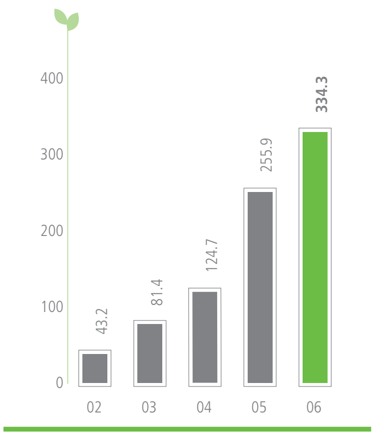
NET INCOME (millions)



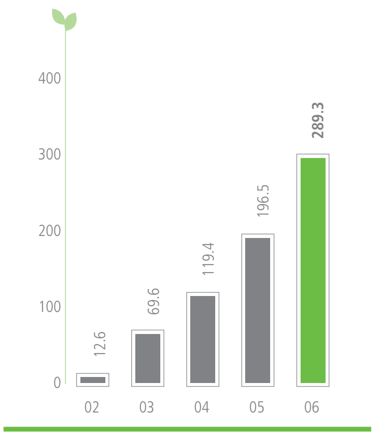
DILUTED EPS



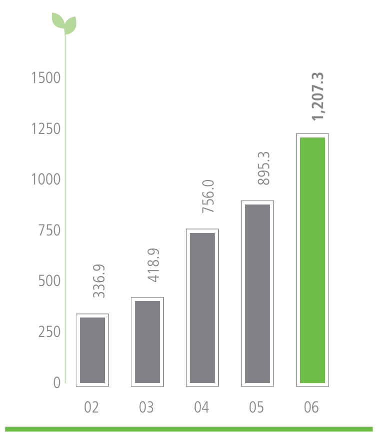
EBITDA (millions)



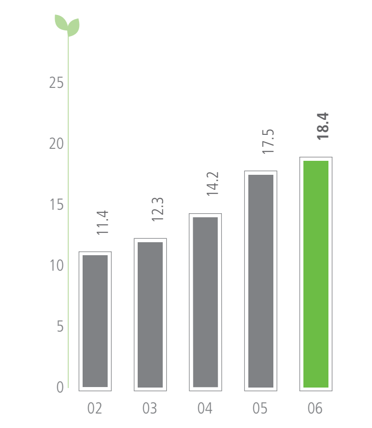
CFFO (millions)



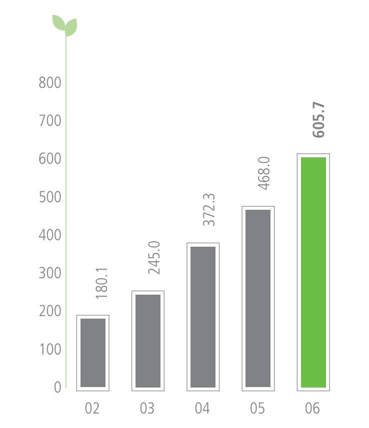
TOTAL ASSETS (millions)



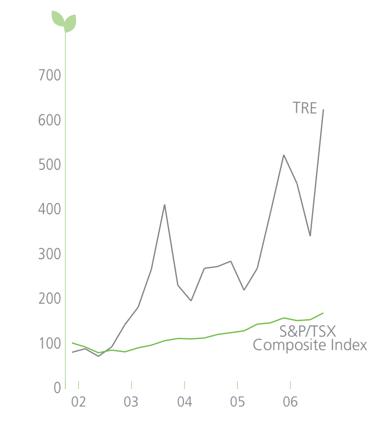
RETURN ON EQUITY (%)



SHAREHOLDERS' EQUITY (millions)

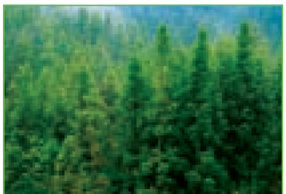


TRE VERSUS S&P/TSX COMPOSITE INDEX



OPERATIONS AT A GLANCE

Revenue Contributor



STANDING TIMBER

we acquire, cultivate and sell standing timber at both purchased and planted plantations

54.7%

WOOD CHIPS & LOGS

we source wood logs from PRC suppliers and sell them as wood chips through an intermediary after processing

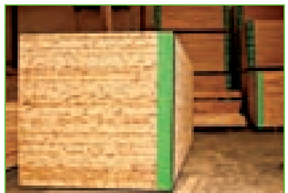
14.0%

IMPORTED WOOD PRODUCTS

we import logs, veneer, sawn timber and other wood-based products, and sell them to domestic customers

27.6%

Wood Fibre Operations



MANUFACTURING & OTHER OPERATIONS

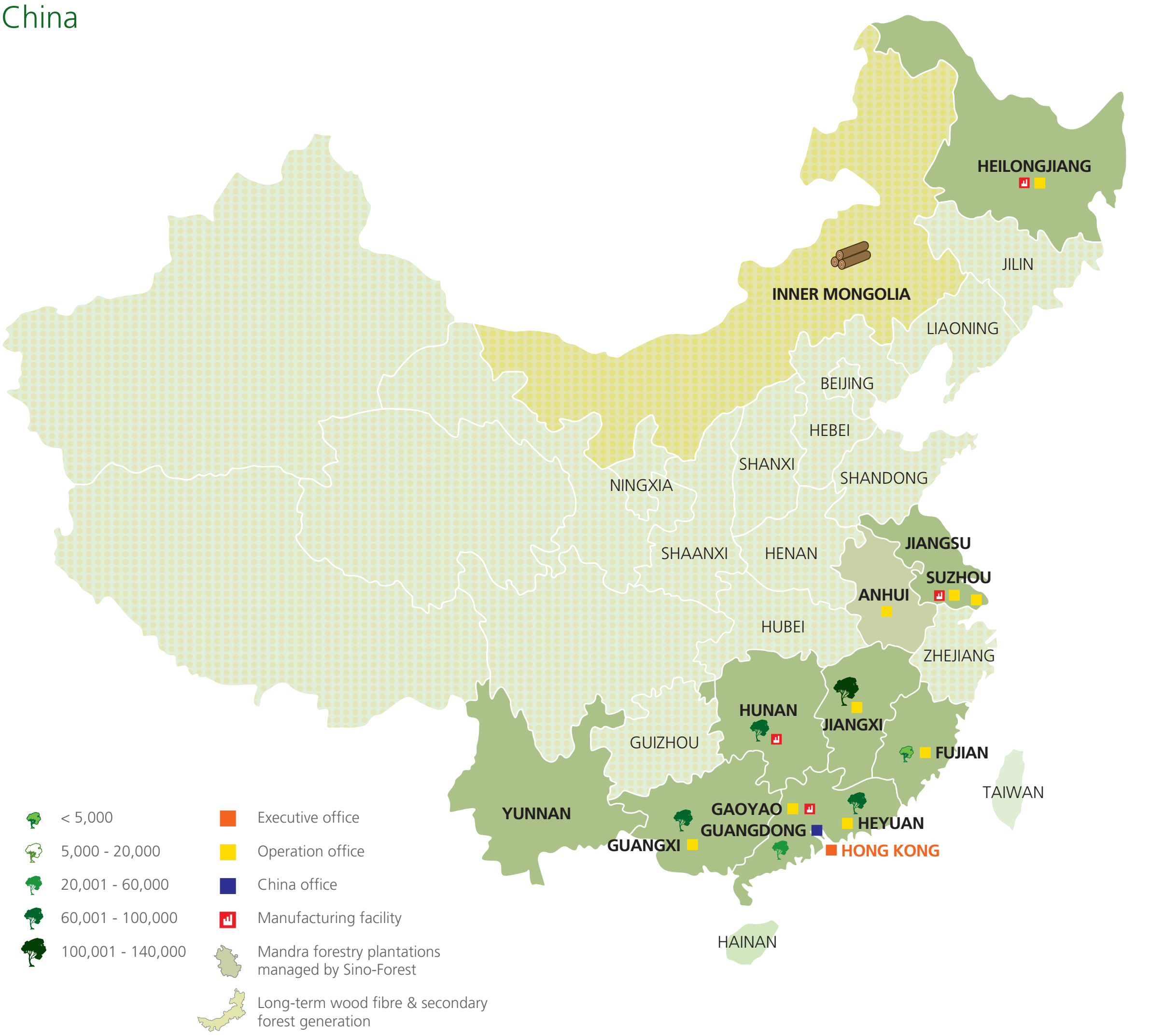
we produce particleboard, engineered wood flooring, oriented strand board, and operate nurseries and greenery business

3.7%

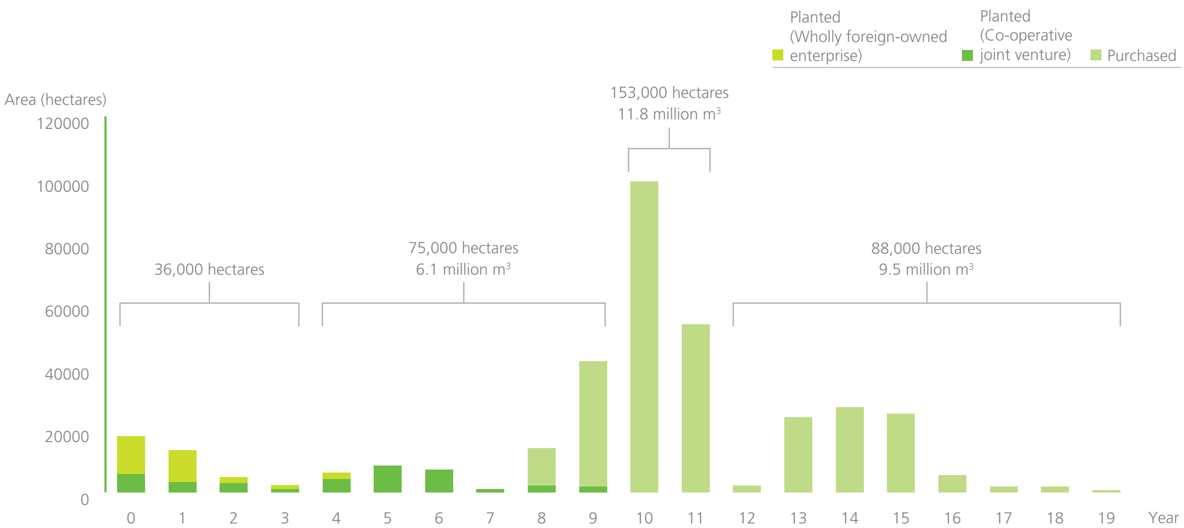
Manufacturing & Other Operations

U.S. dollars (millions)	**2006**	2005	Annual change %
Wood Fibre Operations			
Standing timber	**352.6**	240.8	46.4
Imported wood products	**178.4**	84.1	112.0
Wood chips & logs	**90.0**	155.9	(42.3)
Manufacturing & Other Operations	**24.0**	12.5	92.8
Total Revenue	**645.0**	493.3	30.7

China



DISTRIBUTION BY PLANTATION TYPE & AGE



Source: Pöyry

Notes: 1. Based on 352,000 hectares of trees under management as of Dec 31, 2006
2. 36,000 hectares trees age less than four years have minimal fibre output
3. Includes eucalyptus, pine, poplar and other species

Building Awareness

Sino-Forest's mission is to generate and sustain awareness that environmentally friendly policies are not only viable but also economically rewarding. By being at the forefront of such strategies, Sino-Forest positions itself for inclusion into any environmental initiatives that evolve.

CHAIRMAN'S MESSAGE

Sino-Forest celebrated several significant milestones in 2006. In our twelfth successful year in operation, we achieved revenue of $640 million and our market capitalization exceeded $1 billion.

Even more impressive are some of our compound annual growth rates over those first twelve years: revenue 33%, net income 35% and diluted earnings per share 21%.

Sino-Forest has achieved a formidable market position in a relatively short time. **We are growing in size, strength and stature.**

Allen Chan, Chairman and CEO

TAKING A LONG-TERM APPROACH

We were an early foreign-owned entrant into China's forestry sector. Since then, our long-term perspective, sustainable business strategy and innovative business practices have firmly placed Sino-Forest as one of the leading commercial wood fibre suppliers in the country.

While we can be proud of our strong track record, we are a forward-looking company with ambitious yet realistic goals. We will continue to operate at the forefront of our industry and make investments that increase the value of our business.

We remain committed to developing a sustainable wood fibre supply while diversifying our sources of income as we grow. We believe in satisfying the needs of today without compromising the environmental resources needed by future generations. Our goal is to own a critical mass of fast-growing, high-yield plantation trees that will allow us to develop a perpetual harvesting model. We intend to remain leaders in the sustainable development of commercial plantations and eventually have a critical mass of trees in our inventory from which we can harvest annually.

At year-end 2006, we had accumulated over 352,000 hectares of forestry plantation area under management, up 9% from 2005. During the year, we invested approximately $383 million to acquire 129,276 hectares of trees, and we sold 111,367 hectares of standing timber, generated $353 million in revenue, which represented 55% of total revenue.

GROWING RAPIDLY WITH CHINA

There is massive growth potential for our operations in China and many opportunities lie ahead.

The country has experienced an average economic growth rate of 10% over the past five years. With its fast-growing regional economies, extensive infrastructure development, mounting direct foreign investment, increasing urbanization, growing middle class and rising home ownership, the PRC is the fastest-growing timber marketplace in the world and the third-largest consumer of timber products. However, China faces a substantial and growing wood fibre deficit.

As China's economy continues to heat up in coastal areas and economic development gradually moves inland, we are adjusting our expansion plans accordingly. Last year, we saw higher coastal land prices raise the cost of acquiring trees there. With a sizeable plantation operation already established on the coast, we turned our attention inland to find attractively priced fibre.

- Sino-Forest's forest protection crew conduct routine patrol

CHAIRMAN'S MESSAGE

• Densely populated Chinese fir in Hunan

In line with our strategy, we signed a number of significant long-term fibre supply agreements. This enables us to acquire a total of 600,000 hectares of pine and fir plantation trees in Hunan and Yunnan Province, and to secure 1.5 million cubic metres ("m^3") of wood fibre in the Inner Mongolia Autonomous Region through managing a regeneration program of secondary forests.

MOVING AHEAD STRATEGICALLY

The commercial forestry plantation industry in the PRC is relatively underdeveloped with only a limited number of large-scale plantations currently using modern silviculture management practices. Our successful twelve-year track record demonstrates that we have developed key competitive advantages in that area.

To keep up with increased market demand and retain our leadership position as a preferred wood fibre supplier, we will continue to execute our proven strategy. In addition to increasing our plantation holdings, we expect to develop them to their full potential by deploying our strong research and development capabilities and professional forestry practices, and through our commitment to operating in an environmentally sustainable manner.

We are also committed to utilising advance technology and processing to maximise the value of our wood resources. This will enable us to minimise waste, create more employment and contribute to modernising China's burgeoning forestry industry.

Our strategic initiatives are aligned with China's eleventh Five-year Plan, whereby the central government aims to reduce poverty in rural areas and improve community livelihoods by accelerating regional economic development in inner and northern regions of the country.

We will develop our wood fibre operations in strategic locations, seeking to secure plantation land with long-term leases, both inland and in south-western and northern provinces. This will give us a critical mass of trees, geographically diversify our plantation holdings in areas where wood fibre can be obtained at attractive economic returns, and help develop regional markets that could produce consistent quality forest-related products.

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.

> “If you are planning for a year,
> **sow rice**;
> If you are planning for a decade,
> **plant trees**;
> If you are planning for a lifetime,
> **educate people**.”

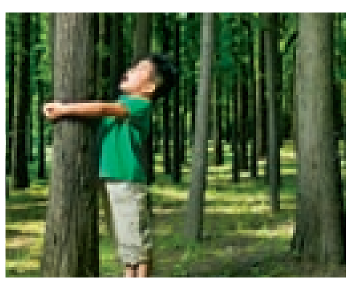
To achieve our vision, we strive to be at the forefront of our industry by creating regional “wood baskets” that ensure a sustainable and quality supply of wood fibre to downstream manufacturing operations. We also plan to introduce new technologies to improve productivity, quality and economic viability of China’s engineered wood products. In addition to increasing the value of harvested fibre, we will also continue to create employment, thus improving livelihoods in rural areas.

Sino-Forest has truly grown in stature. Our financial success and growth have caught the attention of many institutional and individual investors around the world who have seen our inventory of trees and earnings per share increase dramatically.

These institutional investors include Temasek Holdings, which agreed to take up a strategic stake of approximately 25 million common shares at Cdn.$9.15 per share, representing approximately 16% of the total diluted shares outstanding. When completed (expected in early April), the strategic placement will raise US$200 million of gross proceeds which will be used for the acquisition of 200,000 hectares standing timber in Yunnan Province and beyond, and for the development of downstream facilities to maximise the value of the wood fibre to be harvested. This is all exciting news for Sino-Forest and its shareholders as we believe we have the strategic plan, management capabilities and financial resources to achieve our next billion-dollar milestone, in total revenue this decade.

In closing, we would like to extend our gratitude to all our employees, business partners and stakeholders who contributed to the corporation’s success in 2006, and we look forward to continuing to build sustainable value with you in 2007.

Allen Chan
Chairman and CEO
March 31, 2007

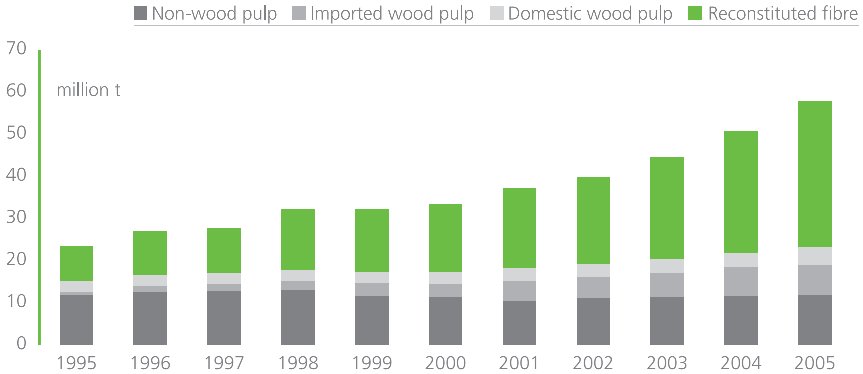


MARKET FACTORS

With a population of 1.3 billion people, the PRC is an enormous market. The economy has been growing by 10% per year since 2001. Economic reforms, foreign investment, capital spending on infrastructure, urbanisation, and a fast-emerging middle class are all contributing to the stellar growth in demand for wood fibre. China, however, has a large wood fibre deficit and must import wood from abroad.

Key drivers accelerating demand for our products include construction, investment in infrastructure, manufacturing of furniture and other finished wood-based products, interior decoration and the pulp and paper industries.

CHINA PULP CONSUMPTION: 1995-2005

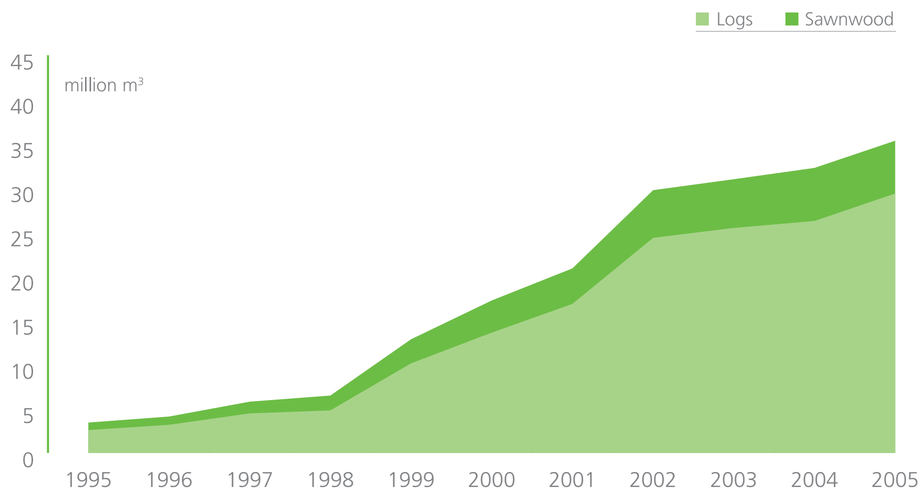


Source: Pöyry and The China Paper Association

With cities experiencing an influx of people from the rural areas, building of commercial and residential space persists unabated. Escalating urbanisation has seen the middle class grow to at least 100 million, creating voracious markets for household furniture, flooring and wood fixtures.

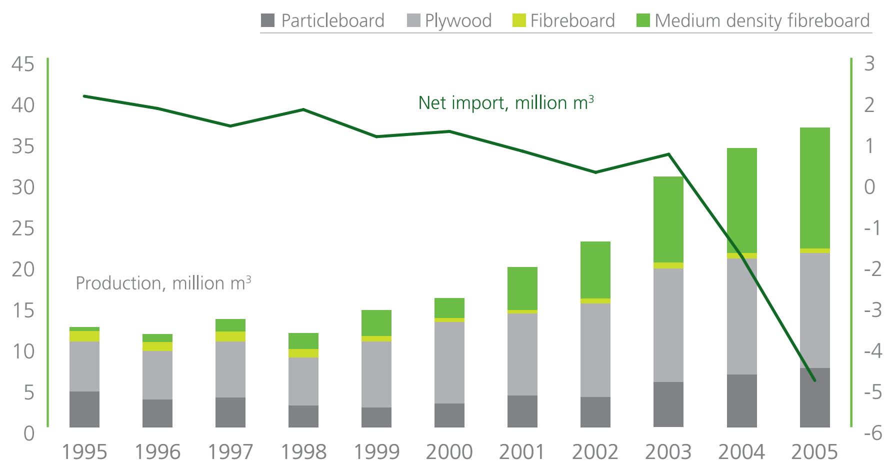
In 1998, China prohibited logging of natural forests, which had caused severe soil erosion and flooding. Elsewhere in Asia, restrictions on logging of natural forests have exacerbated shortages of harvested wood. To compensate for its shortfall, in addition to importing timber from neighboring countries, China has been encouraging commercial forestry plantation programs and has increased natural forest coverage. In 2006, the central government launched its eleventh Five-year Plan, placing forestry development firmly on the agenda. The Plan encourages expansion of sustainable plantations along with a greater focus on regional economic development and enhanced job creation.

WOOD IMPORTS INTO CHINA: 1995-2005



Source: Pöyry and World Trade Atlas

WOOD BASED PANEL PRODUCTION AND NET IMPORTS IN CHINA: 1995-2005



Source: Pöyry and The State Forestry Administration and World Trade Atlas

Given China's continue growth in panel board and pulp productions, Sino-Forest, as a leading foreign-owned, commercial forestry plantation operator in the PRC, is strategically positioned to make a significant contribution to supply the increasing demand and realising value in this exciting market.

Cultivating Quality

Sino-Forest carefully considers the thinking of governments and local communities when developing its strategy for growth. By engaging and working alongside these partners, Sino-Forest is able to make important contributions to primary, secondary and tertiary levels of eco-business developments.

STRATEGY AND BUSINESS OPERATIONS

(From left to right)
Zhao Weimao, Chen Hua, Dave Horsley, Allen Chan, Albert Ip, KK Poon

Our successful twelve-year track record represents a significant competitive advantage in the PRC, where the commercial forestry plantation industry is relatively underdeveloped and where few large-scale plantations use professional forestry management practices.

We have successfully executed our business strategy of acquiring and cultivating fast-growing trees at both purchased and planted plantations.

Further enhancing our competitiveness, we have forged valuable relationships with forestry bureaus, plantation farmers, service providers and wood traders.

We maximise plantation output by applying advanced plantation management and silviculture practices focused on the development of sustainable commercial plantations. We will continue to improve yields at our plantations through investing in research and development.

Moreover, Sino-Forest is strategically engaged in integrated downstream operations and forest-related businesses, including product trading, manufacturing and nurseries. These operations provide meaningful synergies that enable us to reap additional value from China's vast market potential.

OUR STRATEGIC BUSINESS SEGMENTS

Sino-Forest's operations are comprised of two core business segments. Our Wood Fibre Operations segment is the major revenue contributor (96% in 2006) while our Manufacturing & Other Operations segment (4% in 2006) enables us to create extra value from downstream synergies.

Wood Fibre Operations

At our annual shareholders meeting held last year, we announced that our strategic goal for the next three to five years is to increase our wood fibre output to 15-20 million m^3 from 8 million m^3 annually, and our long-term goal is to create "wood baskets" in several regional markets, allowing us to have a significant and sustainable supply of wood fibre in our portfolio. This goal is challenging but realistic given our proven track record of accumulating plantation land, combined with our other competitive strengths.

In 2006, our wood fibre output reached 10 million m^3 excluding fibre from the Hunan trees acquisition and from logs to be harvested selectively in Inner Mongolia. Meanwhile, our merchantable standing volume (i.e. immediately harvestable fibre) per Pöyry's valuation report increased 15% to 27.4 million m^3 from 23.8 million m^3 in 2005. This is attributable to the addition of plantation trees under management and improvement of average yield from 78 per m^3 per hectare to 87 per m^3 per hectare.

We will remain at the forefront of the industry, moving into inner and northern PRC provinces to lock in strategic locations and seize opportunities for diversification and growth.

STRATEGY AND BUSINESS OPERATIONS

- Top: Nursery in Gaoyao preparing for next re-planting season
- Bottom: Needle pine leaves from the Chinese fir family (Cunninghamia aceolata)

Standing Timber

At year-end 2006, Sino-Forest had 352,000 hectares of plantations under management, comprised of both mature and premature trees — mainly fast-growing eucalyptus, poplar, pine and fir — in either "planted" or "purchased" plantations. Our plantations are located primarily in southern and eastern China in the wealthier provinces of Guangdong, Guangxi, Jiangxi, Fujian and Hunan.

One of Sino-Forest's business objectives is to be creative in sourcing and accessing timber resources, and to expand our plantations geographically. In the second quarter of 2006, we entered the Inner Mongolia Autonomous Region through an agreement to secure long-term supply of birch and larch wood fibre over the next twelve years by assisting in a regeneration programme of secondary forests.

In addition, Sino-Forest signed two sizeable standing timber acquisition agreements, one in Hunan and the other in Yunnan, that will run over a period of fourteen years and ten years respectively. Our overall goal is to deploy our silviculture best practices to optimize the usage and value of wood fibre through a vertically integrated operation. We will start by selling logs harvested from standing timber, obtaining competitive prices for various log sizes and residual timber. However, we see greater potential with subsequent phases of perpetual growth. Operating under the purchased plantation model, we will acquire trees and the rights to sell them, along with the first rights to lease the land for re-planting for periods of thirty to fifty years. These acquisitions will be made through privately-owned or collectively-owned entities with the endorsement of the local forestry bureaus where non-state-owned standing timber will be acquired.

Another initiative in progress is the conversion of our planted plantation co-operative joint ventures ("CJVs") to wholly foreign-owned enterprises ("WFOEs"). Our aim is to obtain greater control over plantation management through plantation land leasing rather than harvest profit sharing. To bring our margins at planted plantations on par or above those at purchased plantations, we will re-plant where land-lease terms are optimal.

Wood Chips and Logs

In 2006, this business segment produced approximately 763,000 bone dry metric tonnes ("BDMT") equivalent to 1.7 million m^3 of wood fibre output, and sales amounted to $90 million, down from $156 million last year. Logs are sourced locally through our PRC partners and are then processed by our business partner – an authorized intermediary with a licence to sell logs after processing.

We expect this segment will continue to decline during 2007 as the wood chipping capacity may not be available to us due to strong competition. However, Sino-Forest will retain the annual wood fibre volume quota sourced from PRC partners, and our plan is to shift those logs to our manufacturing facilities to maximise profitability of our downstream operations.

Imported Wood-based Products

We expect that China's substantial wood deficit will continue to increase due to rising domestic demand. To meet demand for large-diameter logs and wood-based products such as veneer, and to supplement sawn timber from our plantations portfolio, we import wood-based products from global suppliers in various countries, including New Zealand, Papua New Guinea and Russia. Recently, the Russian government announced plans to increase export tax on logs in three phases from the current level of 6.5% to 80% by 2009, effective from July 2007 onwards. Accordingly we plan to expand our global sourcing network to satisfy customers' growing demand for quality products at competitive prices.

Manufacturing & Other Operations

Our manufacturing and other wood-based operations complement our wood fibre operations through synergies that maximise usage and add value to our wood fibre.

Particleboard Manufacturing – Gaoyao, Guangdong Province

Our particleboard operations are located on a seventeen-hectare site within the Economic Development Zone in Gaoyao City, Guangdong Province. The manufacturing plant produces high-quality particleboard and a melamine-faced chipboard, targeting distributors and large end-users located in Guangdong.

We expect to complete upgrading our manufacturing facility in the second half of 2007. On completion, our particleboard capacity will increase from 100,000 m^3 to 275,000 m^3 and melamine capacity will grow from 2 million m^2 to 6.4 million m^2.

Engineered Wood Flooring – Suzhou, Jiangsu Province

We established our flooring business in 2004 with the objective of proving the feasibility of using small-diameter logs to manufacture quality products traditionally made from large-diameter logs. Using eucalyptus trees combined with other tree species, we produce over fifteen flooring patterns.

Our engineered flooring is available at over 200 Sino-Maple branded retail stores and large do-it-yourself shops nationwide. Sino-Maple is among the top five engineered-wood flooring brands in China.

We completed the first phase of construction of our manufacturing facilities in the third quarter 2006, and Sino-Forest is now well positioned to capture the potentially huge domestic demand for flooring products. The second phase is scheduled to be built in 2007, subject to production utilisation and profitability of the first phase. On completion of the second phase, the combined capacity will be approximately 8 million m^2.

Oriented Strand Board, Muling City, Heilongjiang Province

Oriented strand board ("OSB") is still a relatively new product in the PRC, although it is widely used in other countries as structural panel for houses, flooring and packaging material.

Located in Muling City, Heilongjiang, close to the Russian border, our new OSB plant has an annual capacity of approximately 12,000 m^3. The location enables the facility to obtain an abundant and cost-effective supply of wood fibre, both domestically and internationally from Russia.

Nurseries and greenery, Suzhou, Jiangsu Province

Our nurseries and landscaping business are creating a better living environment for Chinese citizens by providing greenery and improving air quality. Identifying the need for tree nursery products and urban landscape management, Sino-Forest is pursuing opportunities in this forest-product business segment. Utilising our plantation resources and expertise, we established Sinowin Plantings (Suzhou) Co. Ltd., which sources, supplies and manages landscaping products for property developers and other organisations.

- Top: Finger-joint board operation in Hunan Province acquired in Q1 2007
- Bottom: Logs of Chinese fir harvested, average diametre 18 cm

Branching Out

Sino-Forest's business dynamic enables it to participate in related lucrative fields of operation. Down-stream business models include processing and manufacturing.

CORPORATE GOVERNANCE

Sino-Forest's Board of Directors continues to implement a best-practice approach to corporate governance as recommended by Canadian securities regulators and by the Toronto Stock Exchange ("TSX"). Over the past few years, we have established mandates for our Directors, Chairman & CEO, and the three Committees chaired by the Board's independent Directors. Sino-Forest adopts commonly accepted governance policies and abides by public disclosure requirements.

As a company strongly rooted in China and listed on the TSX, Sino-Forest offers investors a China play that incorporates the transparency and sophistication of international corporate and accounting standards.

Most of our Directors are highly experienced and are independent as defined in Canadian securities legislation.

Sino-Forest continues to improve its corporate governance, public disclosure and communications with its current and potential investors in an efficient and open manner. Furthermore, we participated in a number of industry and institution-hosted conferences and conducted tours of our operations for the equity and credit analysts.

Meanwhile, our Board continues to review and fine-tune corporate governance policies and tools, including our Code of Business Conduct, Public Disclosure Policy, Insider Trading Policy, Whistle Blower Policy, and Board Effectiveness Survey.

The Board has three Committees and each has a defined mandate set out in its Charter, chaired and composed entirely of independent Directors:

The **Audit Committee** monitors the corporation's system of internal financial controls, evaluates and reports on the integrity of financial statements and oversees the accounting and financial reporting processes and audits of financial statements of the corporation.
Jamie Hyde, CA (chair), Edmund Mak, W. Judson Martin

Corporate Governance Committee develops and monitors the corporation's approach to matters of governance. This Committee is also responsible for the review and recommendation to the Board of reports on compliance with the governance guidelines and requirements of the TSX.
W. Judson Martin (Chair), Edmund Mak, Jamie Hyde, CA

Compensation and Nominating Committee develops and monitors the corporation's approach to the compensation of its Officers and to the nomination of Directors to the Board.
W. Judson Martin (Chair), Jamie Hyde, Simon Murray

The Corporation's report on Corporate Governance is set out in Sino-Forest's Management Information Circular for its most recent annual shareholders meeting which can be found on www.sedar.com.

Nurturing Sustainability

Sino-Forest's business model is both profitable and sustainable. At its root is the inherent wish to preserve the environment upon which our very lives depend. On the ground is a solution that enables us to do this in a financially rewarding way that is also environmentally friendly. Consumption without depletion is indeed possible.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management's Discussion and Analysis ("MD&A") relates to the financial condition and results of Sino-Forest's operations. Throughout this MD&A, unless otherwise specified, "Sino-Forest", "Company", "we", "us" and "our" refer to Sino-Forest Corporation and its subsidiaries. Except where otherwise indicated, all financial information reflected herein is determined on the basis of Canadian generally accepted accounting principles ("GAAP"). This MD&A should be read in conjunction with Sino-Forest's audited consolidated financial statements and notes thereto. The United States dollar is our reporting currency and all figures contained herein are in United States dollars unless otherwise indicated.

Additional information relating to our company, including our annual information form for the year ended December 31, 2006 and other statutory reports are available on SEDAR at www.sedar.com.

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements which reflect management's expectations regarding Sino-Forest's 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. 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 such as, but not limited to, our ability to acquire rights to additional standing timber, our ability to meet our expected plantation yields, the cyclical nature of the forest products industry and price fluctuation in and the demand and supply of logs, our reliance on joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers, our ability to operate our production facilities on a profitable basis, changes in currency exchange rates and interest rates, evaluation of our provision for income and related taxes and PRC economic, political and social conditions and government policy, 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. The Company 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.

OVERVIEW OF BUSINESS

About Sino-Forest

We are a leading, foreign owned, commercial forestry plantation operator in the PRC. As at December 31, 2006, we had approximately 352,000 hectares of forestry plantations located mainly in southern and eastern China.

We began operations in 1994 as the first, foreign and privately managed company involved in forest products in China. Our 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.

Strategic Business Units

Sino-Forest's operation is comprised of two core business segments – **Wood Fibre Operations** is the major revenue contributor, while our **Manufacturing & Other Operations** enable us to realise added value from downstream operation.

Revenue 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 Hongjiang City, Hunan Province;
- greenery & nurseries operation based in Suzhou, Jiangsu Province.

Our 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 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.

Other Key Factors Affecting Our Business

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 market 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;
- interest rates;
- government regulations and policies;
- population growth and changing demographics; and
- 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 decisions and abilities to develop and operate future forestry plantations are subject to various factors and uncertainties. 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.

The success of our business depends upon the productivity of our forestry plantations and our ability to realise our expected yields. 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 and improve our yields will depend on these factors and the results of our research and development efforts.

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 joint venture partners to, among other things, fulfill their obligations under the agreements. We rely on authorized intermediaries for our wood chips and trading activities. We rely on a few large customers for a significant percentage of our total revenue. We rely on a few large suppliers for a significant percentage of our timber supply. We rely to a significant extent on third party service providers for day-to-day operations of our plantations.

We are heavily dependent upon our senior management in relation to their expertise in the forest industry, research and development in forest plantation management practice, wood-based products manufacturing production processes and relationships cultivated by them with our PRC CJV partners, major customers and others.

We are subject to regulation under a variety of PRC national and local laws and regulations. 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.

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

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 and are subject to the risks inherent in establishing a new business, including competitive pressures, which could have a material adverse effect on our business, financial condition and results of operations.

We report our financial statements in United States dollars, while substantially all of our revenue is denominated in Renminbi. Any significant fluctuation in the exchange rates between the Renminbi and other currencies, such as the United States dollar, Canadian dollar, and Hong Kong dollar, or in the United States dollar against the Renminbi, the Canadian dollar 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 United States dollar, Canadian dollar or otherwise, of our revenue and net income.

Significant Accounting Policies and Interpretation

Cost of Sales

Our costs of sales consists of: (1) depletion of timber holdings as they are sold; (2) the costs of logs used as the raw materials in our sales of wood chips; (3) processing fees and administrative charges associated with wood chip sales; (4) the costs of imported logs and wood-based products acquired in our sales and trading activities of these products; and (5) the costs incurred at our manufacturing plants.

Depletion of Timber Holdings

Timber holdings include acquisition costs for young trees and standing timber, planting and maintenance costs, which are capitalised at cost in our financial statements until the trees are sold. Planting and maintenance costs include the following: planning, operations design, site preparation, terracing, fertilisation, planting, thinning, tending, protection, research and development, forestry bureau service charge, overhead and lease costs. Timber holdings from standing timber sales are depleted when the significant risks and rewards of ownership have been transferred to the buyer, which occurs when the contract for sale is entered into.

EBITDA

Defined as income from operations for the period after adding back depreciation and amortisation, impairment of capital assets as well as depletion of timber holdings from cost of sales, for the period. EBITDA is presented as additional information because we believe that it is a useful measure for certain investors to determine our operating cash flow and historical ability to meet debt service and capital expenditure requirements. EBITDA is not a measure of financial performance under Canadian GAAP and should not be considered as an alternative to cash flows from operating activities, a measure of liquidity or an alternative to net income as indicators of our operating performance or any other measures of performance derived in accordance with Canadian GAAP.

SIGNIFICANT BUSINESS ACTIVITIES

Significant activities that have occurred during the year ended December 31, 2006 and to the date of this report were as follows:

Appointment of Director

In February 2006, the Company announced the appointment of Mr. Judson Martin to its Board of Directors to replace Mr. David Horsley who resigned as a result of becoming the Company's Senior Vice President and Chief Financial Officer.

Syndicated Loan Facility

In February 2006, the Company announced the signing of a $150 million five-year and one day Loan Facility, bearing interest at LIBOR plus between 0.80% and 1.50% depending on consolidated debt to EBITDA. The facility will be primarily used for the acquisition of additional standing timber and logs and for general corporate purpose. The facility has been fully drawn down.

Long-Term Wood Fibre Supply

In July 2006, the Company entered into a master agreement with Inner Mongolia Forest and Timber Resources Company Limited and Erlianhot Lianhe Forestry Bureau to secure a long-term supply of wood fibre while managing a regeneration programme of secondary forests. Under the master agreement, the Company will acquire at least 1.5 million cubic meters of wood fibre annually for twelve years at a price which is RMB80 (or $10 equivalent) less than the lowest price at the timber trading market.

Opening of Flooring Facility in Suzhou

In September 2006, the Company announced the opening of its engineered wood flooring manufacturing facility in Suzhou. To be built in two phases, phase one of the project has been completed and is in commercial operation with an annual capacity of 4 million m^2. Construction of the second phase is expected to commence in 2007 which would increase the production capacity to 8 million m^2 when completed.

Acquisition of 400,000 hectares of Plantation Trees in Hunan

In September and December 2006, the Company entered into master agreements with Hongjiang City Forestry Technology Integrated Development Services Company to acquire approximately 400,000 hectares of plantation trees in Hongjiang City, Hunan Province for a total of approximately $1,291.3 million to $1,549.5 million over a fourteen-year period. The agreements also provide the Company the right of first refusal to lease the land for fifty years after harvesting.

Update Valuation of Forest Plantation Assets in China

In March 2007, the Company announced that it has received the updated, independent valuation of its commercial plantation assets as well as a prospective valuation of its proposed plantation development plans in China. Using a discounted cash flow methodology, Pöyry estimates that the existing forest plantation (single rotation only) as at December 31, 2006 had a value of approximately $919.0 million and on a perpetual rotation basis, a value of approximately $1,427.6 million.

SELECTED ANNUAL FINANCIAL INFORMATION

The following selected financial information has been derived from our consolidated financial statements for the three years ended December 31, 2006, 2005 and 2004.

Years ended December 31, (in thousands, except earnings per share and common shares outstanding)	**2006** **$**	2005 $	2004 $
OPERATING RESULTS			
Revenue	**644,979**	493,301	330,945
Cost of sales	**(450,481)**	(356,430)	(229,433)
Gross profit[1]	**194,498**	136,871	101,512
Net income from operations	**152,615**	112,607	73,389
Net income	**111,456**	81,687	52,774
EBITDA[2]	**334,320**	255,910	124,663
Basic earnings per share[3][4]	**0.81**	0.59	0.43
Diluted earnings per share[3][4]	**0.80**	0.59	0.43
FINANCIAL POSITION			
Current assets	**333,609**	277,340	320,660
Non-current assets	**873,646**	617,931	435,389
Total assets	**1,207,255**	895,271	756,049
Current liabilities (including current portion of long-term debt)	**151,596**	127,262	83,795
Long-term debts (net of current portion)	**450,000**	300,000	300,000
Total shareholders' equity (net assets)	**605,659**	468,009	372,254
Cash dividends declared per share	**nil**	nil	nil
Common shares outstanding	**137,999,548**	137,789,548	136,589,548

Over the past three fiscal years, we have focused on growing our standing timber plantation operations. Revenue has grown over these periods primarily due to increased sales of standing timber. Our revenue from standing timber increased from $105.1 million (sold 37,369 hectares, 31.8% of revenue) in 2004, to $240.8 million (sold 108,013 hectares, 48.8% of revenue) in 2005 to $352.6 million (sold 111,367 hectares, 54.7% of revenue) in 2006.

During these periods, our gross profit increased accordingly. Gross profit margin, being gross profit expressed as a percentage of revenue, increased to 30.2% in 2006 as sales of standing timber generated a higher gross profit margin than our other business segments. However, gross profit margin declined to 27.7% in 2005 compared to 30.7% in 2004 as sales of standing timber in 2005 included a higher proportion of lower margin sales of standing timber from the Heyuan Pine Undertaking.

Non-current assets, primarily standing timber, increased over the past three years as we continued to focus on developing our plantation hectares under management. As at December 31 of each year, we had the following plantation area under management:

2004 242,000 hectares

2005 324,000 hectares

2006 352,000 hectares

In 2004, we issued long-term debt in the amount of $300 million to fund the acquisition of mature pine plantations (Heyuan Pine Undertaking), and to repay existing debts. In 2006, we had obtained a five-year and one day $150 million syndicated loan for acquisition of additional standing timber and logs.

RESULTS OF OPERATIONS – 2006 VS 2005

Revenue

The following table sets forth the breakdown of our total revenue for the years ended December 31, 2006 and 2005:

	2006		2005	
	$'000	**%**	$'000	%
Wood Fibre Operations				
Standing timber	**352,574**	**54.7**	240,829	48.8
Imported wood products	**178,379**	**27.6**	84,136	17.1
Wood chips and logs	**89,994**	**14.0**	155,870	31.6
Manufacturing and Other Operations	**24,032**	**3.7**	12,466	2.5
Total Revenue	**644,979**	**100.0**	493,301	100.0

Our revenue increased 30.7% to $645.0 million in 2006. The increase in revenue was due primarily to the increase in sales of standing timber and imported wood products, offset by a decrease in the sales of wood chips and logs.

Wood Fibre Operations Revenue

Standing Timber

The following table sets forth revenue from standing timber sales for the years ended December 31, 2006 and 2005:

	2006			2005		
	Hectares	**Sales per hectare $**	**Total revenue $'000**	Hectares	Sales per hectare $	Total revenue $'000
Purchased plantations	**73,665**	**3,959**	**291,650**	40,718	3,302	134,458
Heyuan Pine Undertaking	**32,426**	**1,692**	**54,864**	64,189	1,602	102,833
Planted plantations	**5,276**	**1,149**	**6,060**	3,106	1,139	3,538
Total	**111,367**	**3,166**	**352,574**	108,013	2,230	240,829

Revenue from sales of standing timber increased 46.4% to $352.6 million in 2006. In 2006, we sold 111,367 hectares of standing timber, compared to 108,013 hectares the previous year. The increase was mainly due to the sales of an additional 35,117 hectares of purchased and planted plantations offset by a decrease of 31,763 hectares of standing timber sales from the Heyuan Pine Undertaking. The average selling price per hectare increased 42.0% from $2,230 in 2005 to $3,166 in 2006. The increase in the average selling price per hectare was primarily attributed to the higher proportion of sales of purchased plantations to total sales and sales of purchased plantations which had a higher yield and therefore higher selling price per hectare.

Standing timber sales comprised 54.7% of total revenue in 2006, compared to 48.8% in 2005.

Wood Chips and Logs

The following table sets forth revenue from wood chips and logs for the years ended December 31, 2006 and 2005.

	2006			2005		
	BDMT	**Average selling price $**	**Revenue $'000**	BDMT	Average selling price $	Revenue $'000
Wood chips	**763,440**	**109.9**	**83,894**	1,348,840	105.5	142,301
Wood logs			**495**			3,829
Commission	**368,640**	**15.2**	**5,605**	657,830	14.8	9,740
Total			**89,994**			155,870

Revenue from sales of wood chips decreased 41.0% to $83.9 million in 2006; this decrease was due to a decline of 43.4% in the volume of wood chips sold, partially offset by a 4.2% increase in the average selling price per bone dry metric ton ("BDMT") in 2006. Sales volume declined during the year for two reasons. Firstly, in Q4 2005, one of the two authorized intermediaries 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 authorized intermediary decreased as the authorized intermediary's wood chipping capacity was not available to us. 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 to the wood chipping capacity. We still retain the ability to acquire the same volume of fibre that was previously processed into wood chips and we plan to utilise the fibre in our own manufacturing facilities in the future.

Revenue from commission income, which is included in wood chips and logs, decreased 42.5% to $5.6 million in 2006 due to a decrease of approximately 44.0% of volume shipped to customers upon which agency fees are earned, from 657,830 BDMT in 2005 to 368,640 BDMT in 2006, despite an improvement in the agency fee rate of 2.7% from US$14.8 per BDMT in 2005 to US$15.2 per BDMT in 2006.

Wood chips and logs sales comprised 14.0% of total revenue in 2006, compared to 31.6% of total revenue in 2005.

Imported Wood Products

Revenue from sales of imported wood products increased 112.0%, from $84.1 million in 2005 to $178.4 million in 2006. This increase was primarily due to higher demand of imported logs.

Manufacturing and Other Operations Revenue

Revenue from our manufacturing and other operations increased 92.8% from $12.5 million in 2005 to $24.0 million in 2006 mainly due to higher revenue from flooring operations.

Cost of Sales

Cost of sales increased 26.4%, from $356.4 million in 2005 to $450.5 million in 2006. This increase was due primarily to higher sales volumes of standing timber, imported wood products and manufacturing products.

Wood Fibre Operations Cost of Sales

Standing timber cost of sales increased 31.5%, from $140.2 million in 2005 to $184.4 million in 2006. The increase reflected primarily the 27.6% increase in cost of sales per hectare of standing timber from $1,298 per hectare in 2005 to $1,656 per hectare in 2006, because we sold substantially more hectares of purchased plantations in 2006 compared to 2005, which had a higher average cost per hectare.

Wood chips and logs cost of sales decreased 42.7%, from $122.9 million in 2005 to $70.5 million in 2006. The decrease resulted primarily from lower sales volume, partially offset by an increase in the cost of wood chips.

Imported wood products cost of sales increased 111.7%, from $81.9 million in 2005 to $173.3 million in 2006, primarily reflecting an increase in the sales volumes of our imported log trading business.

Manufacturing and Other Operations Cost of Sales

The cost of sales of manufacturing and other operations increased 94.8% from $11.5 million in 2005 to $22.3 million in 2006, primarily due to an increase in the sales from the flooring operation.

Gross Profit

Gross profit increased 42.1%, from $136.9 million in 2005 to $194.5 million in 2006. Gross profit margin (gross profit as a percentage of total revenue) increased from 27.7% in 2005 to 30.2% in 2006 mainly due to the higher proportion of sales of standing timber which earn a higher gross profit margin than our other business segments.

Wood Fibre Operations Gross Profit

Gross profit margin from sales of standing timber increased from 41.8% in 2005 to 47.7% in 2006, as the sales mix of standing timber changed. In 2005 we sold more hectares from the Heyuan Pine Undertaking at lower margin compared to the hectares sold in 2006.

Gross profit margin from sales of wood chips and logs (excluding commission) increased from 15.9% in 2005 to 16.5% in 2006 as a result of higher selling prices, partially offset by higher average cost of wood chips.

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

Gross profit margin from sales of imported wood products increased slightly from 2.7% in 2005 to 2.9% in 2006.

Manufacturing and Other Operations Gross Profit
Gross margin from our manufacturing and other operations decreased from 8.0% in 2005 to 7.1% in 2006, primarily due to increased cost of production at our particleboard plant.

Selling, General and Administration Expenses
Our selling, general and administration expenses increased 79.1%, from $21.2 million in 2005 to $37.9 million in 2006, due primarily to increased compensation costs as a result of a $5.4 million termination payment made to an officer in December 2006 pursuant to his employment contract and additional staff compliment.

Depreciation and Amortisation
Depreciation and amortisation increased 28.3%, from $3.1 million in 2005 to $4.0 million in 2006, reflecting the increase in depreciation charges for our flooring manufacturing plant.

Income from Operations
Income from operations increased 35.5%, from $112.6 million in 2005 to $152.6 million in 2006, due to the factors explained above. Our income from operations as a percentage of revenue increased from 22.8% in 2005 to 23.7% in 2006.

Interest Expense
Interest expense increased 28.8%, from $29.0 million in 2005 to $37.3 million in 2006, due primarily to interest charged on the $150.0 million syndicated loans drawn down during 2006.

Amortisation of Deferred Financing Costs
Deferred financing costs increased 35.9%, from $1.3 million in 2005 to $1.8 million in 2006 due to higher amortisation of deferred financing costs for the syndicated loan obtained during the year.

Other Exchange Gains
Exchange gains increased from $1.3 million in 2005 to $3.7 million in 2006 due to appreciation of the Renminbi against the U.S. dollar in 2006.

Interest Income
Our interest income increased 55.2%, from $4.2 million in 2005 to $6.5 million in 2006, due to higher cash and cash equivalents and short-term deposits held throughout the year.

Provision for Income Taxes
In 2006, the provision for income taxes was $13.5 million compared to $7.3 million in 2005; the increase was due to the higher income earned.

Net Income
As a result of the foregoing, net income for 2006 increased 36.4%, from $81.7 million in 2005 to $111.5 million in 2006. And overall net profit margin increased from 16.6% in 2005 to 17.3% in 2006.

RESULTS OF OPERATIONS – Q4 2006 VS Q4 2005

The following table sets forth the selected financial information for the three months ended December 31, 2006 and 2005.

Three months ended December 31, (in thousands, except earnings per share)	2006 $	2005 $
Revenue	**250,306**	170,411
Cost of sales	**(165,370)**	(125,618)
Gross profit[1]	**84,936**	44,793
Net income from operations	**63,242**	35,071
Net income	**42,528**	27,535
EBITDA[2]	**148,703**	96,108
Basic earnings per share[3][4]	**0.31**	0.20
Diluted earnings per share[3][4]	**0.30**	0.20

The following table sets forth the breakdown of our revenue for the fourth quarter ended December 31, 2006 and 2005

Three months ended December 31,	2006 $'000	2005 $'000
Wood Fibre Operations		
Standing timber	**167,869**	95,824
Imported wood products	**55,528**	28,386
Wood chips and logs	**17,109**	39,016
Manufacturing and Other Operations	**9,800**	7,185
Total Revenue	**250,306**	170,411

Revenue for the fourth quarter ended December 31, 2006 increased by 46.9% to $250.3 million compared to $170.4 million in the fourth quarter of fiscal 2005. The increase was primarily due to higher sales of standing timber and imported wood-based products, partially offset by a decline in wood chips and logs revenue.

In the fourth quarters ended December 31, 2006 and 2005, standing timber sales were as follows:

	Three months ended December 31, 2006			Three months ended December 31, 2005		
	Hectare	**Sales per hectare $**	**Total revenue $'000**	Hectare	Sales per hectare $	Total revenue $'000
Purchased plantations	**40,987**	**3,923**	**160,811**	21,807	2,966	64,688
Heyuan Pine Undertaking	**2,768**	**1,756**	**4,861**	18,103	1,616	29,262
Planted plantations	**1,821**	**1,206**	**2,197**	1,634	1,147	1,874
Total	**45,576**	**3,683**	**167,869**	41,544	2,307	95,824

In the fourth quarter of 2006, sales of standing timber increased to 45,576 hectares, primarily due to increased sales of standing timber from our purchased plantations. The increase in the average selling price of standing timber was due to a higher proportion of sales from purchased plantations, which commanded a higher price due to a higher yield compared to 2005.

In the three months ended December 31, 2006, the decrease in revenue from wood chips and logs was mainly due to a 53.9% decrease in shipments to 151,490 BDMT for the reasons discussed above. This decrease was partially offset by an increase in price of wood chips; the average net wood chip price in the fourth quarter of 2006 was approximately $112.5 per BDMT compared to $106.4 per BDMT in the fourth quarter of 2005.

Revenue from commission income decreased 100.0% from $1.7 million in the fourth quarter of 2005 to nil in the fourth quarter of 2006 as a result of a decrease in shipments from 115,000 BDMT to nil BDMT.

In the fourth quarter of 2006, revenue from our imported wood products business amounted to $55.5 million, compared to $28.4 million in the fourth quarter of 2005. The increase was primarily attributable to the increase in sales of imported logs.

Costs and expenses were $187.1 million in the fourth quarter of 2006, an increase of 38.2% compared to $135.4 million in the fourth quarter of 2005. The increase in cost of sales was largely attributable to an increase in sales in the fourth quarter of 2006. Selling, general and administration expenses increased 130.0% to $20.6 million in the fourth quarter in 2006 primarily due to higher compensation costs as discussed above.

Net income increased 54.5% from $27.5 million to $42.5 million. Diluted earning per share increased 52.6% from $0.20 to $0.30.

LIQUIDITY AND CAPITAL RESOURCES

Our primary sources of funding have been short-term and long-term borrowings, equity offering and cash provided by operating activities. Our primary uses of funding have been to obtain new forestry plantations either in the form of standing timber or logs, to develop our existing forestry plantations, for imported logs trading, for working capital requirements, to service our short-term and long-term borrowings and to invest in and develop our manufacturing facilities.

Cash Flows

The following table sets forth a condensed summary of our statement of cash flows.

Years ended December 31, (in millions)	**2006** **$**	2005 $
Cash flows from operating activities		
Net cash provided by operations[5]	**298.5**	228.1
Net change in working capital[6]	**(9.2)**	(31.6)
Total	**289.3**	196.5
Cash flows used in investing activities	**(422.8)**	(301.4)
Cash flows from financing activities	**177.1**	11.5
Effect of exchange rate changes on cash and cash equivalents	**0.9**	0.7
Net increase (decrease) in cash and cash equivalents	**44.5**	(92.7)

Cash Flows from Operating Activities

Cash flows from operating activities increased 47.3% to $289.3 million in 2006. The increase was the result of an increase in cash provided by operations as a result of the stronger sales of standing timber.

Cash Flows Used in Investing Activities

In 2005 and 2006, cash flows used in investing activities were primarily used for capital expenditures to obtain additional forestry plantations and for investments in manufacturing facilities. Our cash outlays for our forestry plantations amounted to $265.2 million in 2005 and $415.1 million in 2006. Our cash outlays for our manufacturing facilities and other capital assets amounted to $16.6 million in 2005 and $9.6 million in 2006. Decrease in non-pledged short-term deposits in 2006 amounted to $11.9 million compared to an increase in non-pledged short-term deposits of $5.2 million in 2005. In addition, Sino-Forest provided a subordinated loan of $15.0 million to Mandra Forestry Holdings Limited in the second quarter of 2005.

Cash Flows From Financing Activities

In 2006, cash flows from financing activities consisted of an increase in bank indebtedness of $29.2 million and long-term debt of $150.0 million and decrease in pledged short-term deposits of $0.4 million offset by an increase in deferred financing costs of $3.0 million. In 2005, cash flows from financing activities consisted of an increase in bank indebtedness of $12.5 million offset by a decrease in pledged short-term deposits of $1.0 million.

Financing Arrangements and Contractual Obligations

As of December 31, 2006, we had secured and unsecured short-term liabilities of $71.0 million, comprised of $21.5 million of short-term bank loans and $49.5 million of trust receipt loans. We had long-term debts of $450.0 million. Our borrowings were denominated in US dollars and Renminbi.

Short-Term Borrowings

As of December 31, 2006, we had $90.6 million short-term credit facilities with banks in Hong Kong and the PRC to fund short-term working capital requirements of which $71.0 million was being utilised. Interest is payable on these short-term borrowings at rates ranging from 3.9% to 12.3% per annum, and the borrowings are either repayable on demand or due in less than one year. As of December 31, 2006, the short-term credit facilities were secured by certain of our land-use rights, buildings and timber holdings having an aggregate net book value of approximately $6.9 million and certain bank deposits of $6.1 million.

Other Contractual Obligations

As of December 31, 2006, we had other contractual obligations relating to: (1) approximately $25.0 million in respect of capital contributions to our WFOEs; (2) $12.3 million of capital commitments with respect to buildings, timber holdings, and plant and machinery; (3) $17.5 million of purchase commitments mainly regarding logs, (4) commitments under operating leases of approximately $41.4 million, and (5) $450.0 million non-convertible guaranteed senior notes and syndicated loans.

Scheduled Maturity of Contractual Obligations

The following table presents the scheduled maturities of our contractual obligations as of December 31, 2006.

			Anticipated Payment Dates				
	Total	2007	2008	2009	2010	2011	Thereafter
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
Long-term debts(7)	450,000	–	–	–	37,500	412,500	–
Capital contributions	25,000	25,000	–	–	–	–	–
Capital commitments(8)	12,305	12,305	–	–	–	–	–
Purchase commitments	17,538	17,538	–	–	–	–	–
Operating leases(9)	41,390	1,720	1,348	1,244	1,193	1,187	34,698
Total contractual cash obligations	546,233	56,563	1,348	1,244	38,693	413,687	34,698

Guarantees

We also periodically issue guarantees to third parties in relation to the debt of our subsidiaries. As of December 31, 2006, we had provided guarantees of approximately $77.0 million to banks in connection with credit facilities granted to our subsidiaries. These guarantees expire at the maturity of the underlying debt, which are for varying terms of less than one year, unless the underlying debt is renewed.

Historical and Planned Capital Expenditures

The following table sets forth the breakdown of our capital expenditures for the fourth quarter and year ended December 31, 2006.

	Three months ended December 31, 2006		**Twelve months ended December 31, 2006**	
(in millions)	**Hectares**	**$**	**Hectares**	**$**
Tree acquisition – Purchased plantations	**40,485**	**155.6**	**113,411**	**365.5**
Tree acquisition – Heyuan Pine Undertaking	**–**	**–**	**15,865**	**17.7**
Re-planting and maintenance of plantations		**4.9**		**24.0**
Panel manufacturing and other operations		**1.8**		**9.6**
Total		**162.3**		**416.8**

Capital expenditures incurred in relation to forestry plantations were for obtaining additional purchased-tree plantations and planted-tree plantations, and a variety of plantation management costs, including land lease costs, the costs of planting, developing seedlings, fertilisation, insecticide, labor and plantation maintenance service fees. Capital expenditures in relation to the manufacturing plants were for investing in manufacturing plants, including the costs of constructing the facilities and purchasing and installing production line equipment.

Forestry plantations capital expenditures for 2007 are expected to exceed $300 million.

Capital expenditures in 2007 relating to the manufacturing operations are expected to be approximately $30.0 million for the completion of the particleboard facility in Gaoyao, the flooring operation in Suzhou and additional value-added processing in Hunan province and Inner Mongolia.

Once completed, the manufacturing operations in Gaoyao will be one of the largest particleboard mills in China. Total production capacity will be 275,000m^3 of particleboard and 6,400,000m^2 of melamine lamination capacity.
The facility is expected to be completed by the end of the second quarter of 2007, and will be in production during the second half of 2007.

It is expected that 2007 capital expenditures will be funded primarily by cash flows from operations.

Independent Valuation of our Forest Assets by Pöyry

Pöyry Forest Industry Ltd ("Pöyry") has determined the valuation of our forest assets as at December 31, 2006 to be $919.0 million. This is the result of a valuation of the existing planted and purchased areas using a 11.5% discount rate applied to real, pre-tax cash flows. As at year end 2006, the book value of our timber holdings was $752.8 million.

Pöyry has also prepared an existing forest valuation that includes the revenues and costs of re-establishing and maintaining the plantation forests for a fifty-year period (perpetual rotation valuation). Sino-Forest has an option to lease the land at purchased–tree plantations for future rotations, the terms of which have yet to be agreed. Pöyry has determined the valuation of our forest assets based on a perpetual rotation (including the planned expansion in Hunan) using a pre-tax discount rate of 11.5% to be $1,427.6 million as at December 31, 2006.

The complete valuation report by Pöyry dated March 15, 2007 can be found on Sino-Forest website at www.sinoforest.com under 'Filings' or can be obtained on SEDAR at www.sedar.com.

Aging of Accounts Receivable

We recognise revenue from sales of standing timber when the buyer has signed the sales contract. The buyer is generally responsible for logging and hauling the timber from the plantations. After the buyer has entered into the sales contract, we generally give the buyers of our standing timber up to eighteen months to log and haul the timber from the plantations, and generally grant buyers a credit period of up to nine months from the date of the sales contract. We generally require a partial payment of approximately 20% of the purchase price within 60 days of the sales contract, and payment of 40% of the purchase price within 150 days of the sales contract and the remaining 40% within nine months of the sales contract. In addition, we have credit evaluation on customers as necessary and has monitoring processes intended to mitigate credit risk and maintain appropriate provisions for potential credit losses. We believe these measures mitigate our credit risks in our sales of standing timber. We generally grant our customers in our trading activities credit terms of 60 days for domestic sales of wood chips through authorized intermediaries, and 30 to 120 days with respect to domestic sales of imported logs and wood-based products. As a result, we may have large outstanding balances of accounts receivable with respect to sales of wood chips, wood-based products and standing timber. The following table sets forth an aging analysis of our accounts receivable for 2006 and 2005.

		Aging Analysis					
	Total Accounts Receivable $'000	0-30 Days $'000	31-60 Days $'000	61-90 Days $'000	91-180 Days $'000	181-360 Days $'000	Over One Year $'000
At December 31, 2006	**125,307**	**84,739**	**33,651**	**5,118**	**1,610**	**189**	**–**
At December 31, 2005	119,989	55,216	38,695	22,546	3,030	502	–

Inflation

Inflation in the PRC has not had a significant impact on Sino-Forest's results of operations in recent years. According to the National Bureau of Statistics in the PRC, the change in the Consumer Price Index in the PRC was 3.9%, 1.8% and 1.5% in 2004, 2005 and 2006, respectively.

Taxation

PRC WFOEs and CJVs are governed by the Income Tax Laws of China concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws ("Income Tax Laws"). Pursuant to the Income Tax Laws, WFOEs, Sino-foreign equity and CJV enterprises are subject to corporate income tax at an effective rate of 33% (30% state income taxes plus 3% local income taxes) on income as reported in their statutory financial statements. The PRC WFOEs and CJVs are eligible for an exemption from state and local income taxes for two years starting from the first profitable year of operations after offsetting losses carried forward from prior years, followed by a 50% exemption in the next three years. Subject to the approval of the relevant authorities, foreign invested enterprises categorised as forestry projects may be allowed a 15% to 30% reduction of the amount of income tax payable for a further period of 10 years after tax holidays.

Sino-Forest's tax charges for the years ended December 31, 2006 and 2005 were $13.5 million and $7.3 million, respectively, which represented effective tax rates of 10.8% and 8.2%, respectively. Such effective tax rates are significantly lower than applicable corporate income tax rates because the majority of income remitted to Sino-Forest from authorized intermediaries were already taxed. We believe we have made adequate tax provisions to meet Sino-Forest's tax liabilities as they become due.

OFF-BALANCE SHEET ARRANGEMENTS

Other than a currency swap agreement with respect to interest payable over the next five years on the non-convertible guaranteed senior notes, Sino-Forest does not have any outstanding derivative financial instruments or off-balance sheet guarantees. In addition, we are not otherwise engaged in hedging activities and had no forward exchange contracts outstanding as of December 31, 2006. In the ordinary course of business, we enter into operating lease commitments, capital commitments and other contractual obligations. These transactions are recognised in our financial statements in accordance with Canadian GAAP, and are more fully discussed above.

TRANSACTIONS WITH RELATED PARTIES

Pursuant to the respective service agreements, Sino-Forest pays the salaries of certain executive officers in the form of consultancy fees to companies controlled by the executive officers. The consultancy fees incurred in 2006 amounted to $4,136,000 [December 31, 2005 – $2,737,000].

In addition, as at December 31, 2006, we had an aggregate amount of $3,150,000 [December 31, 2005 – $2,129,000] owed to these related companies.

QUARTERLY FINANCIAL INFORMATION

Our business is seasonal. Generally, the third and fourth quarters together account for approximately 60% of annual revenue, while the first and second quarters together account for approximately 40% of annual revenue. This reflects the preference of timber companies to take advantage of the peak growing seasons in the spring and summer before harvesting the trees, and the difficulty in the logging and hauling of timber during the rainy season in the first half of the year.

The following table is a summary of our selected quarterly financial information for each of the eight quarters ended December 31, 2006.

			Earnings Per Share(3)(4)	
	Revenue	Net Income	Basic	Diluted
(in thousands, except per share amounts)	$	$	$	$
2006				
December 31	**250,306**	**42,528**	**0.31**	**0.30**
September 30	188,535	45,104	0.33	0.32
June 30	107,274	14,360	0.10	0.10
March 31	98,864	9,464	0.07	0.07
2005				
December 31	170,411	27,535	0.20	0.20
September 30	144,359	33,175	0.24	0.24
June 30	102,886	13,241	0.10	0.10
March 31	75,645	7,736	0.06	0.06

CRITICAL ACCOUNTING ESTIMATES

The preparation of financial statements in conformity with Canadian generally accepted accounting policies requires management to make estimates and assumptions that affect amounts reported in the consolidated financial statements and accompanying notes. Sino-Forest's significant accounting policies are described in Note 1 to the consolidated financial statements. Each policy involves a number of estimates and assumptions made by management. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable in the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities. On an on-going basis, the Company evaluates its estimates. Different accounting policies, or changes in estimates or assumptions, could potentially have a material impact, positive or negative, on Sino-Forest's financial position and results of operations. It is reasonably possible that circumstances may arise which cause actual results to differ from management estimates. The Company believes its most critical policies and estimates are those related to revenue recognition of standing timber and wood chips, asset impairment of timber holdings, and capital assets and income tax provision.

Asset Impairment

Timber Holdings

Timber holdings represented 62.4% of the Company's consolidated total assets as at December 31, 2006. Timber holdings are carried on the Company's consolidated balance sheet at cost which includes cost of young trees, standing timber, and planting and maintenance costs. The Company reviews the recoverability of the carrying value of its timber holdings on an annual basis or whenever events or changes in circumstances indicate that the carry amount may not be recoverable. If the sum of the future undiscounted cash flows expected to result from the asset is less than the asset's carrying value, asset impairment must be recognised. Impairment losses on timber holdings are measured as the amount by which the carrying value of the asset exceeds its fair value.

The Company believes that accounting estimates related to timber holding impairment assessments are critical accounting estimates because: (i) they are subject to significant measurement uncertainty and are susceptible to change as management is required to make forward-looking assumptions regarding timber market demand and pricing, cost of production such as harvesting costs, transportation costs, taxes and overhead costs, plantation risk such as fire, pest and disease, frost and typhoons, plantation growth and yield, future yield development and the Company's weighted average cost of capital, and (ii) any resulting impairment loss could have a material impact on the Company's consolidated income statement and the reported timber holdings amount in the Company's consolidated balance sheet.

To assist with its impairment assessments, the Company engages an outside consultant to help derive cash flow estimates and to estimate the fair value of its existing timber holdings using discounted cash flow valuation model.

If management's best estimate of key assumptions were to change significantly and the associated estimated future cash flows were to materially decrease, Sino-Forest could potentially experience future impairment charges and such charges could be material.

Capital Assets

The Company evaluates the recoverability of the carrying value of its capital assets on an annual basis or whenever indicators of impairment exist. Indicators of impairment include prolonged operating losses or a decision to dispose of, or otherwise change the use of, an existing capital asset. If the sum of the future undiscounted cash flows expected to result from the asset is less than the asset's carrying value, asset impairment must be recognised. Impairment losses on capital assets are measured as the amount by which the carrying value of the asset exceeds its fair value.

The Company believes that estimates related to capital assets impairment assessments are critical accounting estimates because: (i) they are subject to significant measurement uncertainty and are susceptible to change as management is required to make forward-looking assumptions regarding the impact of improvement plans on current operations, other new business opportunities, particleboard market demand and pricing, forecasted production volumes and cost of production assumptions on current and future business and (ii) any resulting impairment loss could have a material impact on the Company's consolidated financial statements and the reported capital asset amount in the consolidated balance sheet.

Revenue Recognition

Standing Timber

Sino-Forest sells standing timber at various stages of maturity to domestic wood dealers from its tree plantations. Standing timber revenue represents a significant portion of the Company's consolidated revenue. The timing or recognition of revenue from standing timber sales is dependent on the terms and conditions of the Company's contractual arrangements with its customers. To date, substantially all of the Company's standing timber revenue has been recognised when the Company and the buyer enter into a binding sales agreement. Typically, prior to entering into the agreement, the Company and the buyer will have negotiated the approximate timber volume and the expected harvest yield associated with a specified plantation area. The sales agreement typically provides the buyer with a fixed period of time over which the buyer is entitled to harvest the timber on the specified plantation area and amounts due from the buyer are fixed at the time of entering into the agreement and are not subject to adjustment based on the actual amount of timber harvested by the buyer. Harvesting and all related costs have to date been the responsibility of the buyer and the Company has not been responsible for any further significant acts of performance under the sales agreement. The buyer has borne all risks and rewards related to the timber on the specified plantation area over the harvest period.

A future change to the typical contractual arrangements for timber sales could materially impact the timing and manner in which revenue is recognised.

Wood Chips

We conduct our sales of wood chips from timber supplies sourced in the PRC through domestic wood dealers who act as our authorized intermediaries to purchase timber supplies and sell processed wood chips to customers. During most of 2006, we engaged one third-party wood dealer as our authorized intermediary. The suppliers 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.

Revenue from the sale of wood chips is recognised when the products are processed by the authorized intermediary on our behalf. We regularly evaluate the facts and circumstances in relation to the criteria within appropriate accounting guidelines and use our best judgment to determine whether to report on a gross or net basis for wood chips processed by authorized intermediaries. Currently, the facts and circumstances surrounding the wood chips business support the reporting of the sales on a gross basis as the Company acts as a principal to the transaction. The sales and cost of sales relating to this business reported on a gross basis in 2006 was $83,894,000 and $69,973,000 respectively [2005 – $142,301,000 and $119,208,000]. Commission income relating to wood chips sales represents transactions when the Company acts as an agent to the transaction and is recorded on a net basis. Commission income is recognised when the services are rendered.

Provision for Tax Related Liabilities

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 are not required to and therefore 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 recognised 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.

Included in accounts payable and accrued liabilities as at December 31, 2006 is the balance of the provision for these tax related liabilities amounting to $39,106,000 [2005 – $25,379,000] provided on the profits of the Authorized Sales Activities earned by the BVI Subsidiaries over the three previous years.

Contingencies for Tax Related Liabilities

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 and 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 recognised 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 evaluate the provision for tax related liabilities on an annual basis or as necessary and believe adequate but not excessive provision for tax related liabilities has been recognised in the financial statements.

CHANGE IN ACCOUNTING POLICIES

No changes in accounting policies during the year.

New Accounting Standards

Non-Monetary Transactions

In June 2005, the CICA replaced CICA Handbook Section 3830 "Non-Monetary Transactions" by Section 3831 "Non-Monetary Transactions". The revised standard replaced the criteria based on the culmination of earnings process with one based on commercial substance for the recognition of a non-monetary transaction at fair value. The revised standard is applied to all non-monetary transactions initiated in periods beginning on or after January 1, 2006. The adoption of this standard had no impact on the Company's consolidated financial statements.

Future Accounting Standards

Financial Instruments, Hedges and Comprehensive Income

In January 2005, the CICA issued three new standards: CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement", CICA Handbook Section 3865 "Hedging" and CICA Handbook Section 1530 "Comprehensive Income". These accounting standards introduce new requirements for recognition and measurement of financial instruments, the application of hedge accounting and the reporting and display of comprehensive income.

Financial Instrument – recognition and measurement section establishes guidance for recognising and measuring financial assets, financial liabilities and non-financial derivatives. The standard requires that financial instruments within scope, including derivatives, be included on the Company's balance sheet and measured, either at fair value or, in limited circumstances, at cost or amortised cost. All financial instruments must be classified into a defined category, namely, held-to-maturity investments, held-for-trading financial assets or financial liabilities, loans and receivables, available-for-sale financial assets, and other financial liabilities. This classification will determine how each instrument is measured and how gains and losses are recognised. Held-for-trading financial assets and financial liabilities are measured at fair value with gains and losses recognised in net income. Financial assets held-to-maturity, loans and receivables and financial liabilities, other than those held-for-trading, are measured at amortised cost using the effective interest rate method of amortisation. Available-for-sale financial assets are measured at fair value, with unrealised gains and losses, including changes in foreign exchange rates, being recognised in other comprehensive income. Investments in equity instruments classified as available-for-sale that do not have a quoted market price in an active market can be measured at cost. The recommendations further define derivatives to include non-financial derivatives and embedded derivatives which meet certain criteria. All derivatives must be classified as held-for-trading unless they are designated in a hedging relationship.

Hedging section establishes guidance addressing the accounting treatment of qualifying hedging relationships and necessary disclosures. The standard defines three specific hedging relationships, namely, fair value hedges, cash flow hedges, and hedges of a net investment in self-sustaining foreign operations, and defines how the accounting should be performed. Changes in the fair value of hedging derivatives in a fair value hedge are offset in the consolidated statement of income against the change in fair value of the asset, liability or cash flow being hedged. In cash flow hedges, the changes in fair value are recorded in other comprehensive income. To the extent the change in fair value of the derivative is not completely offset by the change in fair value of the item it is hedging, the ineffective portion of the hedging relationship is recorded immediately in the consolidated statement of income.

Comprehensive income section consists of net income and other comprehensive income ("OCI"). OCI includes unrealised gains and losses on financial assets classified as available-for-sale, unrealised foreign currency translation amounts net of hedging arising from self-sustaining foreign operations, and changes in the fair value of the effective portion of hedging instruments. The Company's consolidated financial statements will include a consolidated statement of other comprehensive income while the cumulative amount will be presented as a new category of shareholders' equity. The standards are to be applied to interim financial statements relating to fiscal years beginning on or after October 1, 2006. The Company does not expect that the adoption of these standards will result in a material impact on the Company's consolidated financial statements.

Equity

In 2005, the CICA reissued CICA Section 3251 "Equity" replacing CICA Handbook Section 3250 "Surplus". CICA 3251 establishes standards for the presentation of equity and changes in equity during the reporting period. The requirements set out in this standard are in addition to those established in Section 1530 and require that an enterprise present separately each of the changes in the equity during the period, including accumulated other comprehensive income, as well as components of equity at the end of the period. The standard is to be applied to interim financial statements relating to fiscal years beginning on or after October 1, 2006. Other than disclosure, this standard is not expected to have an effect on the Company's consolidated financial statements.

Accounting Changes

In July 2006, the CICA reissued CICA Handbook Section 1506 "Accounting changes". CICA 1506 requires that voluntary changes in accounting policy are only made if they result in the financial statements providing reliable and more relevant information. In addition, the standard establishes the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and correction of errors. The revised standard applies to interim and annual financial statements relating to fiscal years beginning on or after January 1, 2007.

Capital Disclosure, Financial Instruments Disclosure and Presentation

During the fourth quarter of 2006, the CICA issued three new accounting standards: CICA Handbook Section 1535 "Capital Disclosure", CICA Handbook Section 3863 "Financial Instruments – Presentation" and CICA Handbook Section 3862 "Financial Instruments – Disclosure".

Capital Disclosure section describes the standards for disclosing information about a Company's objectives, policies and processes for managing capital, quantitative data about what the Company regards as capital and whether the Company has complied with any capital requirements and, if not, the consequences of such non-compliance. Financial Instrument – Presentation carries forward the guidance under Section 3861 with little change and Financial Instrument – Disclosure requires disclosure on the face of the balance sheet of each of the financial instrument categories as well as additional disclosure regarding credit, market and liquidity risk faced by the Company. The standards are to be applied to interim financial statements relating to fiscal years beginning on or after October 1, 2007. The Company does not expect that the adoption of these standards will result in a material impact on the Company's consolidated financial statements.

RISK AND UNCERTAINTIES

For a complete list and description of additional risk factors which may affect our Company or its business, please refer to our annual information form for the year ended December 31, 2006 which is available on SEDAR at www.sedar.com.

Market Risks

We are exposed to various types of market risks, including changes in foreign exchange rates, interest rates and price of wood chips, wood-based products and standing timber, in the normal course of business.

We use financial instruments, including variable rate debts, to finance our operations and to manage risks associated with our interest rate risks. With respect to the non-convertible guaranteed senior notes, we have entered into a currency swap agreement to fix interest payments at $27.4 million per annum over the next five years. We do not otherwise engage in other hedging transactions with respect to our foreign exchange risks or interest rate risks.

Exchange Rate Risk

We conduct our business primarily in Renminbi, and partly in U.S. dollars and Hong Kong dollars. In 2006 and 2005, 73.1% and 82.7% of our sales were received in Renminbi respectively and 26.9% and 17.3% of our sales were received in U.S. dollars and Hong Kong dollars respectively. We translate our results of foreign operations in U.S. dollars. We expect in the future substantially all of our sales will be received in Renminbi. The majority of our operating expenses are denominated in Renminbi and Hong Kong dollars.

A portion of our revenue in Renminbi is converted into other currencies to meet foreign currency financial obligations denominated in currencies other than Renminbi. We have a substantial amount of indebtedness denominated in U.S. dollars. We cannot predict the effect that currency exchange rate fluctuations may have on our U.S. dollar operating results or cash flows.

Many foreign currency exchange transactions involving Renminbi, including foreign exchange transactions under our capital account, are subject to foreign exchange controls and require the approval of the PRC State Administration of Foreign Exchange. Developments relating to the PRC's economy and actions taken by the PRC government could cause future foreign exchange rates to vary significantly from current or historical rates. The Renminbi to U.S. dollar exchange rate has been relatively stable since 1994 until a revaluation against the U.S. dollar since July 2005. We cannot predict nor give any assurance of its future stability. Future fluctuations in exchange rates may adversely affect the value, translated or converted into U.S. dollars of our net assets, net profits and any declared dividends. We cannot give any assurance that any future movements in the exchange rates of Renminbi against the U.S. dollar and other foreign currencies will not adversely affect our results of operations, financial condition and cash flows.

As of December 31, 2006, we had Renminbi denominated bank accounts of RMB250.3 million (equivalent to $32.0 million) [2005 – RMB298.6 million, equivalent to $37.0 million], U.S. dollar denominated bank accounts of $127.6 million [2005 – $88.6 million], Canadian dollar denominated bank accounts of Cdn.$10.6 million (equivalent to $9.1 million) [2005 – Cdn.$12.2 million, equivalent to $10.5 million], Hong Kong dollar denominated bank accounts of HK$0.6 million (equivalent to $0.1 million) [2005 – HK$2.2 million, equivalent to $0.3 million] and Euro denominated bank accounts of €2.0 million (equivalent to $2.7 million) [2005 – €2.0 million, equivalent to $2.4 million]. We also had U.S. dollar and Renminbi denominated accounts receivable of $40.2 million [2005 – $31.3 million] and RMB665.6 million (equivalent to $85.1 million) [2005 – RMB717.7 million, equivalent to $88.7 million] respectively.

We incurred foreign currency denominated debts for capital expenditures primarily relating to the development and acquisition of our forestry plantations and investment in our manufacturing plants. If the U.S. dollar devalues against any of these currencies, it would correspondingly increase our acquisition costs.

Interest Rate Risk

We are exposed to interest rate risk resulting from fluctuations in interest rates on our debts, primarily on our bank indebtedness. Our debts consist of fixed and variable rate debt obligations with original maturities ranging from less than one to seven years. We undertake debt obligations to support general corporate purposes including capital expenditures and working capital needs. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding variable rate borrowings and financial instruments. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of our debt obligations carried at fixed rate. We do not currently use any derivative instruments to modify the nature of our debts so as to manage our interest rate risk.

Commodity Price Risk

We are exposed to fluctuations in the prices of standing timber, wood chips and wood-based products. We import wood-based products from suppliers outside of China. Such purchases are made at market prices. In addition, all our sales of standing timber, wood chips and wood-based products are made at market prices. Therefore, fluctuations in the prices of standing timber, wood chips and wood-based products have a significant effect on our business, results of operations and financial condition.

We do not enter into any futures contracts to hedge our sales of standing timber, wood chips and wood-based products.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures within the Company are designed to provide reasonable assurance that all relevant information required to be disclosed in its annual and interim filings and other reports is recorded, processed, summarised and reported on a timely basis and is accumulated and communicated to the Disclosure Committee and Sino-Forest management.

The Company's Chief Executive Officer ("CEO") and Senior Vice President and Chief Financial Officer ("CFO") are responsible for establishing and maintaining the Company's disclosure controls and procedures to provide reasonable assurance that all relevant information required to be disclosed is gathered and reported on a timely basis so that appropriate decisions can be made regarding public disclosure. An evaluation of the effectiveness of the Company's disclosure controls and procedures, as defined under Multilateral Instrument 52-109 was conducted as of December 31, 2006 by and under the Company's management, including the CEO and CFO. Based on that evaluation, the CEO and CFO concluded that the design and operation of Sino-Forest's disclosure controls and procedures are effective except as outlined below. It should be noted that while the CEO and CFO believe that disclosure controls and procedures can provide a reasonable level of assurance and they are effective, they do not expect disclosure controls and procedures can prevent all errors and fraud. A control system, no matter how well designed or operated can provide only reasonable, not absolute assurance that the objectives of the control system are met.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

Internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP focusing in particular on controls over information. Management is responsible for establishing and maintaining adequate internal controls over financial reporting. A control system, no matter how well conceived and operated, can provide only reasonable, and not absolute assurance that the objectives of the control system are met. Because of their inherent limitations, internal controls over financial reporting may not prevent or detect misstatements. These weaknesses in internal controls over financial reporting result in a more than remote likelihood that a material misstatement would not be prevented or detected on a timely basis.

The Company identified certain material weaknesses and the need for improvement of controls and procedures in areas such as: segregation of duties, Company does not have the optimum complement of financial personnel with the technical accounting knowledge in the foreign subsidiaries to address all complex and non-routine transactions that may arise, completeness and accuracy and timeliness of the period close process including reviewing and monitoring recording of reoccurring and non-reoccurring of journal entries and translation of foreign currency transactions and subsidiary company results and information systems are subject to general control deficiencies including lack of effective controls over spreadsheets.

As the Company continues to grow, management's plan is to address these deficiencies by the implementation of a new accounting system, retention of additional internal accounting personnel, continue to communicate and monitor applicable policies and procedure to more adequately manage internal controls and provide more timely information for analytical and decision making purposes.

There were no changes in internal control over financial reporting during the three months ended December 31, 2006, that have materially affected or are reasonably likely to materially affect Sino-Forest's internal control over financial reporting.

(1) Gross profit for any period is defined as total revenue less cost of sales. Gross profit is presented as additional information because we believe that it is a useful measure for certain investors to determine our operating performance. Gross profit is not a recognised term under Canadian GAAP and should not be considered as an alternative to net income as an indicator of our operating performance or any other measure of performance derived in accordance with Canadian GAAP. Because it is not a Canadian GAAP measure, gross profit may not be comparable to similar measures presented by other companies.

(2) EBITDA for any period is defined as income from operations for the period after adding back depreciation and amortisation, impairment of capital assets as well as depletion of timber holdings from cost of sales, for the period. EBITDA is presented as additional information because we believe that it is a useful measure for certain investors to determine our operating cash flow and historical ability to meet debt service and capital expenditure requirements. EBITDA is not a measure of financial performance under Canadian GAAP and should not be considered as an alternative to cash flows from operating activities, a measure of liquidity or an alternative to net income as indicators of our operating performance or any other measures of performance derived in accordance with Canadian GAAP.

EBITDA is calculated as follows:

		Years ended December 31,		Three months ended December 31,	
	2006	2005	2004	**2006**	2005
	$'000	$'000	$'000	**$'000**	$'000
Income from operations	**152,615**	112,607	73,389	**63,242**	35,071
Plus: depreciation	**3,975**	3,099	2,470	**1,103**	770
depletion of timber holdings	**177,730**	140,204	45,158	**84,358**	60,267
impairment of capital assets	**–**	–	3,646	**–**	–
	334,320	255,910	124,663	**148,703**	96,108

(3) On June 22, 2004, we filed articles of amendment whereby our Class A Subordinate-Voting Shares were reclassified as common shares and our Class B Multiple-Voting Shares were eliminated.

(4) Net Income per share is calculated using the weighted average number of common shares (formerly Class A Subordinate-Voting Shares) and Class B Multiple-Voting Shares outstanding during each period.

(5) Represents net income as adjusted for depletion of timber holdings, interest income from Mandra, exchange realignment, accretion of Exchangeable Notes, exchange gains/losses on long-term debt, depreciation and amortisation, amortisation and write-off of deferred financing costs, amortisation of redemption premium on long-term debt, stock-based compensation, impairment of capital assets and others.

(6) Represents decreases (increases) in accounts receivable, inventories, due from PRC CJV partners, prepaid expenses and other assets and increases (decreases) in accounts payable and accrued liabilities and income taxes payable.

(7) Represents the U.S. dollar equivalent of foreign currency denominated debts due in 2010 and 2011.

(8) Represents commitments to invest in buildings, plant and machinery for investments in the manufacturing plants and timber holdings.

(9) These represent mainly leases of plantation land.

MANAGEMENT'S REPORT

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

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

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

The consolidated financial statements have been reviewed by the Audit Committee prior to submission to the Board of Directors. The consolidated financial statements have also been audited by BDO McCabe Lo Limited, who have full access to the Audit Committee, with and without the presence of management.

Allen T. Y. Chan
Chairman and Chief Executive Officer
March 19, 2007

David J. Horsley
Senior Vice-President and Chief Financial Officer

AUDITORS' REPORT

To the Shareholders of
Sino-Forest Corporation

We have audited the consolidated balance sheets of **Sino-Forest Corporation** as at December 31, 2006 and 2005 and the consolidated statements of income and retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2006 and 2005 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Hong Kong
March 19, 2007

BDO McCabe Lo Limited
Certified Public Accountants

CONSOLIDATED BALANCE SHEETS

As at December 31, [Expressed in thousands of United States dollars]	2006 $	2005 $
ASSETS		
Current		
Cash and cash equivalents	**152,887**	108,418
Short-term deposits [note 2]	**18,550**	30,268
Accounts receivable [note 3]	**125,307**	119,989
Due from PRC CJV partners [note 4]	**2,771**	3,842
Inventories [note 5]	**15,178**	7,622
Prepaid expenses and other	**18,916**	7,201
Total current assets	**333,609**	277,340
Timber holdings	**752,783**	513,412
Capital assets, net [note 6]	**87,939**	81,077
Other assets [note 7]	**32,924**	23,442
	1,207,255	895,271
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness [note 2]	**70,958**	41,312
Accounts payable and accrued liabilities [note 11]	**79,517**	85,212
Income taxes payable	**1,121**	738
Total current liabilities	**151,596**	127,262
Long-term debts [note 8]	**450,000**	300,000
Total liabilities	**601,596**	427,262
Commitments and Contingencies [notes 16 and 17]		
Shareholders' equity		
Share capital [note 9]	**143,511**	142,815
Contributed surplus [note 10]	**4,726**	1,804
Cumulative translation adjustment	**33,972**	11,396
Retained earnings	**423,450**	311,994
Total shareholders' equity	**605,659**	468,009
	1,207,255	895,271

See accompanying notes

On behalf of the Board:

Allen T.Y. Chan
Director

James M.E. Hyde
Director

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Years ended December 31, [Expressed in thousands of United States dollars, except for earnings per share information]	**2006** **$**	2005 $
Revenue	**644,979**	493,301
Costs and expenses		
Cost of sales	**450,481**	356,430
Selling, general and administration	**37,908**	21,165
Depreciation and amortisation	**3,975**	3,099
	492,364	380,694
Income from operations before the undernoted	**152,615**	112,607
Interest expense	**(37,340)**	(28,994)
Interest income	**6,486**	4,179
Other exchange gains	**3,676**	1,253
Amortisation of deferred financing costs	**(1,819)**	(1,338)
Other income	**1,312**	1,236
Income before income taxes	**124,930**	88,943
Provision for income taxes [note 11]	**(13,474)**	(7,256)
Net income for the year	**111,456**	81,687
Retained earnings, beginning of year	**311,994**	230,307
Retained earnings, end of year	**423,450**	311,994
Earnings per share [note 12]		
Basic	**0.81**	0.59
Diluted	**0.80**	0.59

See accompanying notes

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years ended December 31, [Expressed in thousands of United States dollars]	2006 $	2005 $
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income for the year	**111,456**	81,687
Add (deduct) items not affecting cash		
Depletion of timber holdings included in cost of sales	**177,730**	140,204
Depreciation and amortisation	**3,975**	3,099
Stock-based compensation	**3,105**	2,672
Amortisation of deferred financing costs	**1,819**	1,338
Write-off of capital assets	**877**	–
Interest income from Mandra	**(300)**	(767)
Other	**(150)**	(153)
	298,512	228,080
Net change in non-cash working capital balances [note 13]	**(9,224)**	(31,625)
Cash flows from operating activities	**289,288**	196,455
CASH FLOWS USED IN INVESTING ACTIVITIES		
Additions to timber holdings	**(415,087)**	(265,158)
Increase in other assets	**(10,000)**	(14,501)
Additions to capital assets	**(9,649)**	(16,584)
Decrease (increase) in non-pledged short-term deposits	**11,912**	(5,155)
Cash flows used in investing activities	**(422,824)**	(301,398)
CASH FLOWS FROM FINANCING ACTIVITIES		
Increase in long-term debt	**150,000**	–
Increase in bank indebtedness	**29,175**	12,532
Issuance of shares, net of issue costs [note 9]	**513**	–
Decrease (increase) in pledged short-term deposits	**385**	(1,024)
Increase in deferred financing costs	**(3,001)**	–
Cash flows from financing activities	**177,072**	11,508
Effect of exchange rate changes on cash and cash equivalents	**933**	687
Net increase (decrease) in cash and cash equivalents	**44,469**	(92,748)
Cash and cash equivalents, beginning of year	**108,418**	201,166
Cash and cash equivalents, end of year	**152,887**	108,418
Supplemental cash flow information		
Cash payment for interest charged to income	**35,642**	28,994

See accompanying notes

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

1. SIGNIFICANT ACCOUNTING POLICIES

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

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries. The consolidated financial statements of the Company include the accounts of entities for which the Company is the primary beneficiary.

All significant intercompany accounts and transactions have been eliminated on consolidation.

Use of estimates

The preparation of consolidated financial statements in accordance with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of expenses for the periods reported. Areas where the nature of estimates makes it reasonably possible that the actual results could materially differ from amounts estimated include asset impairment of timber holdings and capital assets and provision for income taxes.

Revenue recognition

Revenue from standing timber is recognised when the contract for sale is entered into which establishes a fixed or determinable sales price with the customer whereby ultimate collection of the revenue is reasonably assured.

Revenue from the sale of wood chips is recognised when the products are processed by the authorized intermediaries on our behalf. We regularly evaluate the facts and circumstances in relation to the criteria within appropriate accounting guidelines and use our best judgment to determine whether to report on a gross or net basis for wood chips processed by authorized intermediaries. Currently, the facts and circumstances surrounding the wood chips business support the reporting of the sales on a gross basis as the Company acts as a principal to the transaction. The sales and cost of sales relating to this business reported on a gross basis was $83,894,000 and $69,973,000 respectively [2005 – $142,301,000 and $119,208,000].

Commission income relating to wood chips sales represents transactions when the Company acts as an agent to the transaction and is recorded on a net basis. Commission income is recognised when the services are rendered.

Revenue from the sale of logs and other products is recognised when the logs and other products are shipped to the customer.

Foreign currency translation

The Company's reporting currency is U.S. dollars. The assets and liabilities of subsidiaries denominated in their functional currencies other than U.S. dollars are translated into U.S. dollars at the year end exchange rate. Revenue and expense items are translated at average exchange rates for the year. The resulting net translation adjustment is included in the cumulative translation adjustment account in shareholders' equity.

Other foreign currency transactions are translated using the temporal method. Exchange gains or losses are included in the consolidated statement of income.

Derivative financial instruments

The Company through its subsidiaries operates substantially in the PRC with majority of transactions denominated in Renminbi, which gives rise to risks that its earnings and cash flows may be adversely impacted by fluctuations in exchange rates of Renminbi against other currencies. The Company uses derivative financial instruments such as foreign currency swaps to hedge its risk associated with fluctuations. Gains and losses arising from these contracts offset the foreign exchange losses or gains from the underlying hedged amount. The Company does not enter into derivative financial instruments for trading or speculative purposes.

Inventories

Inventories are stated at lower of cost and net realisable value. Cost is determined on the weighted average basis and, in the case of work in progress and finished goods, comprises direct materials, direct labour and an appropriate portion of overheads. Net realisable value is based on estimated selling prices less any estimated costs to be incurred to completion and disposal.

Timber holdings

Timber holdings comprise planted and purchased plantations which include acquisition costs of young trees and standing timber, planting and maintenance which are capitalised over a period of five to twelve years based on the growth cycle of the type of tree. Timber holdings are depleted when the trees are harvested on the basis of the area of timber cut. Timber holdings from standing timber sales are depleted based on the area of timber sold when the significant risks and rewards of ownership have been transferred to the buyer, which occurs when the contract for sale is entered into with the customer.

Investments

Investments where the Company does not have significant influence or control are accounted for on the cost basis. Investments are written down only when there is evidence that a decline in value that is other than temporary has occurred.

Income taxes

The Company uses the liability method of accounting for income taxes. Under this method, future tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the substantively enacted tax rates and laws that will be in effect when the differences are expected to reverse.

Capital assets

Capital assets are recorded at cost including interest capitalised on assets under construction. Repairs and maintenance expenditures are charged to income; major betterments and replacements are capitalised. Depreciation and amortisation are provided on a straight-line basis over the following estimated useful lives of capital assets:

Land-use rights	Over the term of the land-use rights
Buildings	20 years
Machinery and equipment	15 years
Office furniture and equipment	5 to 10 years
Vehicles	5 to 10 years

Impairment of long-lived assets

Timber holdings, capital assets and other assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Impairment losses on long-lived assets are measured as the amount by which the carrying amount of an asset group exceeds its fair value, as determined by the undiscounted future cash flows of the asset group.

Stock-based compensation plan

The Company has a stock option plan as described in note 9. Stock options are accounted for using the fair value method. Under this method, compensation expense is measured at fair value at the grant date using the Black-Scholes option pricing model and recognised as a charge to selling, general and administration expense on a straight-line basis over the vesting period with a corresponding credit to contributed surplus.

Earnings per share ("EPS")

Basic EPS is calculated by dividing the net income available to common shareholders by the weighted average number of common shares outstanding during the year. Diluted EPS is calculated using the treasury stock method, which assumes that all outstanding stock options grants are exercised, if dilutive, and the assumed proceeds are used to purchase the Company's common shares at the average market price during the year.

Deferred financing costs

Financing costs are deferred and amortised over the term of the related long-term debts on a straight-line basis.

Offsetting of financial assets and financial liabilities

Financial assets and financial liabilities are presented net when we have a legally enforceable right to set off the recognised amounts and intend to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cash and cash equivalents

Cash and cash equivalents consist of cash on hand and balances with banks and short-term deposits with original maturities of less than three months at the date of acquisition.

2. SHORT-TERM DEPOSITS AND BANK INDEBTEDNESS

[a] Short-term deposits

As at December 31, 2006, short-term deposits are made for varying periods of between one month to twelve months [2005 – one month to twelve months] depending on the immediate cash requirements of the Company, and earn interest at rates of 1.4% to 5.1% per annum [2005 – 1.2% to 4.3%].

[b] Bank indebtedness

Subsidiaries of the Company have established several credit facilities to a maximum of approximately $90,569,000 [2005 – $54,137,000]. These credit facilities bear interest at 3.9% to 12.3% per annum as at December 31, 2006 [2005 – 4.1% to 7.3%] and are repayable on demand or due in less than one year.

As at December 31, the following credit facilities were utilised:

	2006	2005
	$	$
Trust receipt loans	**49,482**	27,253
Bank loans	**21,476**	14,059
	70,958	41,312

Certain of the Company's banking facilities are collateralised by:

[a] charges over certain of the Company's land-use rights, buildings and timber holdings which have an aggregate net book value at December 31, 2006 of $6,940,000 [2005 – $3,713,000]; and

[b] certain short-term deposits at December 31, 2006 of $6,071,000 [2005 – $6,166,000].

3. ACCOUNTS RECEIVABLE

The Company reviews its outstanding accounts receivable and records an allowance for doubtful accounts when accounts are determined to be uncollectible. Accounts receivable are substantially from companies located in the PRC and denominated in Renminbi and U.S. dollars. Accounts receivable as at December 31, 2006 included $56,765,000 due from three customers [2005 – $45,731,000 due from three customers]. Included in accounts receivable is an amount due from an authorized intermediary of $3,158,000 [2005 – $25,881,000] which represents amounts receivable from the sale of wood chips by the authorized intermediary less amount payable to it for the purchase of timber on behalf of the Company and processing costs to convert the timber into wood chips by it on the Company's behalf totaling $2,635,000 [2005 – $21,607,000]. The Renminbi is not freely remittable out of the PRC and its conversion into other currencies is restricted under the current PRC foreign exchange regulations. As a result, the majority of the accounts receivable arising from sales of wood chips and standing timber are realised through instructing the debtors to settle the amounts payable on standing timber and other liabilities denominated in Renminbi.

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

4. DUE FROM PRC CJV PARTNERS

The amounts due from PRC CJV partners relate primarily to commission income and for reimbursement of office expenses. The amounts are unsecured and non-interest bearing. Amounts due from PRC CJV partners are expected to be settled in the next twelve months.

5. INVENTORIES

Inventories consist of the following:

	2006 $	2005 $
Raw materials	**1,169**	1,207
Work in progress	**6,685**	795
Finished goods	**2,240**	2,730
Timber logs	**2,360**	–
Nursery	**2,724**	2,890
	15,178	7,622

6. CAPITAL ASSETS

Capital assets consist of the following:

	2006		2005	
	Cost $	**Accumulated depreciation and amortisation $**	Cost $	Accumulated depreciation and amortisation $
Machinery and equipment	**81,161**	**10,458**	75,059	8,604
Buildings	**11,235**	**1,574**	8,760	1,079
Land-use rights	**5,148**	**679**	4,980	539
Office furniture and equipment	**1,577**	**899**	1,362	764
Vehicles	**3,425**	**997**	2,574	672
	102,546	**14,607**	92,735	11,658
Less: accumulated depreciation and amortisation	**(14,607)**		(11,658)	
Net book value	**87,939**		81,077	

Buildings, machinery and equipment of $31,427,000 [2005 – $42,034,000] are not being depreciated as the production facilities are under construction and have not yet been put into commercial operation. No interest was capitalised to capital assets in the current and prior period.

7. OTHER ASSETS

Other assets consist of the following:

	2006 $	2005 $
Investment in Mandra Holdings [a]	**2**	2
Subordinated loan and interest receivable [a]	**16,067**	15,767
Deferred financing costs, net	**8,713**	7,531
Deposit for purchase of logs [b]	**8,000**	–
Other	**142**	142
	32,924	23,442

[a] On May 11, 2005, the Company entered into a series of agreements with Mandra Resources Limited and certain of its subsidiaries (collectively, "Mandra") that are start-up companies formed to acquire, grow, harvest and replant standing timber on commercial forestry plantations (the "Plantations") located in Anhui province in the PRC (the "Mandra Project").

Mandra Forestry Finance Limited ("Mandra Finance") has raised third party debt financing to implement the Mandra Project (the "Financing"), which Mandra Finance is currently undertaking. The Financing was in the form of an international private placement consisting of $195 million of debt securities, together with warrants to subscribe for up to 20% (on a fully diluted basis) of the ordinary equity shares of Mandra Forestry Holdings Limited ("Mandra Holdings"), the parent corporation of Mandra Finance, for nominal consideration. In connection with the completion of the Financing, the parties entered into agreements pursuant to which the Company has made a $15 million subordinated loan (the "Subordinated Loan") to Mandra Holdings, acquired 15% equity in Mandra Holdings for nominal consideration, and will have the exclusive right and commitment to purchase the timber harvested from the Plantations at prevailing market prices less a 3% discount. In addition, the Company will provide an array of advisory services and technical expertise to assist Mandra Finance in identifying, acquiring and developing these resources. Subject to certain conditions, the Company will have an option to acquire all the other outstanding shares of Mandra Holdings at their then fair market value.

Mandra is a variable interest entity under AcG-15. Since the Company is not the primary beneficiary it does not include the assets, liabilities and results of activities of Mandra in its consolidated financial statements.

The Subordinated Loan carries an interest rate of 8% per annum and will be repaid 30 days after the full repayment of the $195 million of debt securities due in May 2013. The Subordinated Loan is secured on 75% equity interest in Mandra Holdings. Included in the balance of the subordinated loan and interest receivable is accrued interest of $1,067,000 [2005 – $767,000]. The Company's maximum exposure of loss from Mandra is limited to the Company's investment in and subordinated loan to Mandra Holdings and related interest receivable.

[b] The amount represents a refundable deposit of $10.0 million out of which $2.0 million has been reclassified to current assets, paid to a third party in connection with wood fibre to be purchased by the Company under the twelve-year wood fibre supply Master Agreement with Inner Mongolia Forest and Timber Resources Company Limited and Erlianhot Lianhe Forestry Bureau to secure an annual supply of at least 1.5 million cubic metres of wood fibre to the Company. The deposit will be refunded within five years after the first anniversary of signing the contract in July 2006.

8. LONG-TERM DEBTS

Long-term debts consist of the following:

	2006 $	2005 $
Senior Notes [a]	**300,000**	300,000
Syndicated Loans [b]	**150,000**	–
	450,000	300,000

[a] On August 17, 2004, the Company issued $300,000,000 non-convertible guaranteed senior notes. The notes bear interest at a rate of 9.125% per annum and payable semi-annually. The notes mature on August 17, 2011. The notes are:

- general obligations of the Company;
- guaranteed by the Subsidiary Guarantors (as defined in the indenture of the notes) on a senior basis subject to certain limitations;
- senior in right of payment to any existing and future obligations of the Company which are expressly subordinated in right of payment to the noteholders;
- at least pari passu in right of payment with all other unsecured, unsubordinated indebtedness of the Company subject to any priority rights of such unsubordinated indebtedness pursuant to applicable law; and
- pledge of the shares of the Subsidiary Guarantors.

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

On August 16, 2004, the Company entered into a currency swap contract. Under the terms of the contract, the Company hedged RMB113,290,070 on each of August 17 and February 17 in exchange for $13,687,500. The U.S. dollars will be used to fully pay the Company's interest payments on the $300,000,000 senior notes due on those dates. The term of the contract is five years. The Company received $750,000 from the counterparty to enter into this contract. This amount is amortised into income over the term of the contract on a straight-line basis.

The fair value of the non-convertible guaranteed senior notes and the currency swap contract as at December 31, 2006 were approximately $324,000,000 [2005 – $322,000,000] and $9,786,000 [2005 – $9,230,000] respectively.

Total interest expense on the notes for the year was $27,375,000 [2005 – $27,375,000].

[b] On February 24, 2006, the Company entered into a $150 million five-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 Company's ratio of consolidated total debt to consolidated EBITDA, with the current margin bearing 1.30% per annum. EBITDA is defined as consolidated net income plus consolidated interest expense, income taxes, depreciation expense, amortisation and all other non-cash items reducing consolidated net income (except depletion of timber holdings) less all non-cash items increasing consolidated net income. The facility is guaranteed by the Subsidiary Guarantors and rank at least pari passu with the claims of all other unsecured, unsubordinated creditors of the Company and the Subsidiary Guarantors, except for obligations mandatory preferred by law applying to companies generally. The facility will be primarily used for the acquisition of additional standing timber and logs, and for general corporate purposes. The facility has been fully drawn down during the year. Out of the $150,000,000, $37,500,000 will be repayable in 2010 and the remaining balance in 2011.

Total interest expense on the syndicated loans for the year was $6,714,000 [2005 – Nil].

The carrying amount of the syndicated loans approximates their fair value.

[c] Under the terms of the above debt agreements, the Company must meet certain financial and non-financial covenants including limitation on dividend and other payment restrictions affecting the Company and the restricted subsidiaries (as defined in the debt agreements).

9. SHARE CAPITAL

Share capital consists of the following:

	2006	2005
	$	$
Authorised		
Unlimited common shares, without par value		
Unlimited preference shares, issuable in series, without par value		
Issued		
137,999,548 common shares [2005 –137,789,548 common shares]	**143,511**	142,815
	143,511	142,815

The legal stated capital of the Company's common shares differs from the carrying value reflected in these consolidated financial statements. The legal stated capital as at December 31, 2006 is Cdn.$228,637,336 [2005 – Cdn.$227,820,790].

During the years ended December 31, 2005 and 2006, the movements in share capital were as follows:

[a] During the year ended December 31, 2006, 210,000 stock options were exercised for proceeds of $513,000.

[b] In conjunction with the completion of the equity offering in May 2004, the Company purchased from management certain rights to acquire shares in Sino-Wood Partners, Limited ("Sino-Wood") pursuant to securities purchase agreements for a pre-determined purchase price not to exceed Cdn.$12,000,000. The amount was settled by the

issuance of 2,400,000 common shares valued at Cdn.$2.65 per share based upon the offering price. One half of the shares vested 90 days following the completion of the offering and the remaining one half vested on the first anniversary of the completion of the offering. The Company has recorded the compensation expense of approximately $7,800,000 over the vesting period. The compensation expense recorded in 2005 and 2004 were $1,432,000 and $6,368,000 respectively. As a result, in August 2004 and May 2005, 1,200,000 common shares each were issued to management in settlement for the rights described above for $3,900,000 each [note 10].

Authorised

Each holder of common shares is entitled to one vote per common share at meetings of the Company's shareholders. Each holder of common shares is entitled to receive dividends if, as and when declared by the Company's board of directors. The holders of the common shares are entitled to receive the remaining property of the Company upon dissolution.

The preference shares may from time to time be issued in one or more series, each series of which will have the rights and other features determined by the board of directors of the Company. The preference shares of each series will rank equally with the preference shares of every other series with respect to priority in payment of dividends and return of capital in the event of the liquidation, dissolution or winding-up of the Company and have a preference over the common shares.

Stock options

The Company's Stock Option Plan provides for the issuance of up to a maximum of 10,000,000 common shares at an exercise price equal to the market price of the Company's common shares on the date of the grant. The option period for the Stock Option Plan is five years. Options granted may be vested over certain time periods within the option period, which will limit the number of options exercisable during each option year. Each stock option is exercisable into one common share of the Company at the price specified in the terms of the option. As at December 31, 2006, options to purchase 5,816,258 common shares have been granted and outstanding options to purchase 3,173,742 common shares remain available to be granted under the Stock Option Plan.

In the second quarter of 2005, options to acquire 450,000 common shares granted on May 11, 2004 were cancelled.

During the year ended December 31, 2006, options to acquire 1,589,258 common shares [2005 – 1,942,000] were granted to employees and directors at exercise prices ranging from Cdn.$4.36 to Cdn.$5.50 in accordance with the Company's Stock Option Plan. The options granted will vest over three years and expire in five years. The fair value of the stock options granted was estimated on the date of grant using the Black Scholes option-pricing model with the following assumptions:

	August 25, 2006	**August 15, 2006**
Number of options	**239,258**	**1,350,000**
Exercise Price (in Cdn.$)	**$4.36**	**$5.50**
Dividend Yield	**0.0%**	**0.0%**
Volatility	**51.0%**	**50.4%**
Risk-free interest rate	**4.07%**	**4.19%**
Expected option lives (in years)	**5.0**	**5.0**
Weighted average fair value of each option (in U.S. dollars)	**1.92**	**1.69**

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

	September 14, 2005	April 5, 2005	January 21, 2005
Number of options	292,000	1,350,000	300,000
Exercise price (in Cdn.$)	$2.70	$3.67	$3.90
Dividend Yield	0.0%	0.0%	0.0%
Volatility	53.9%	53.3%	54.3%
Risk-free interest rate	3.4%	3.6%	3.4%
Expected option lives (in years)	3.5	3.5	3.5
Weighted average fair value of each option (in U.S. dollars)	$0.98	$1.26	$1.35

The compensation expense recorded for the year 2006 with respect to the above options granted amounted to $3,105,000 [2005 – $1,240,000].

The following table summarises the changes in stock options outstanding during the years ended December 31, 2006 and 2005:

	2006		2005	
	Number of options	**Weighted average exercise price Cdn.$**	Number of options	Weighted average exercise price Cdn.$
Balance, beginning of year	**4,437,000**	**3.06**	2,945,000	2.68
Granted	**1,589,258**	**5.33**	1,942,000	3.56
Cancelled	**–**	**–**	(450,000)	2.72
Exercised	**(210,000)**	**2.72**	–	–
Balance, end of year	**5,816,258**	**3.69**	4,437,000	3.06
Exercisable at year-end	**3,277,147**	**3.50**	915,000	2.59

The following table summarises the weighted average exercise price and the weighted average remaining contractual life of the options outstanding and exercisable as at December 31, 2006:

Range of exercise prices	**Options outstanding**	**Weighted average remaining contractual life**	**Weighted average exercise price**	**Options exercisable**	**Options non-exercisable**	**Weighted average exercise price**
Cdn.$1.00 – Cdn.$2.00	**125,000**	**1.20 years**	**Cdn.$1.79**	**125,000**	**–**	**Cdn.$1.79**
Cdn.$2.00 – Cdn.$3.00	**2,452,000**	**2.52 years**	**Cdn.$2.72**	**1,537,333**	**914,667**	**Cdn.$2.72**
Cdn.$3.00 – Cdn.$4.00	**1,650,000**	**3.22 years**	**Cdn.$3.71**	**1,000,000**	**650,000**	**Cdn.$3.71**
Cdn.$4.00 – Cdn.$5.00	**239,258**	**4.65 years**	**Cdn.$4.36**	**14,814**	**224,444**	**Cdn.$4.36**
Cdn.$5.00 – Cdn.$6.00	**1,350,000**	**4.62 years**	**Cdn.$5.50**	**600,000**	**750,000**	**Cdn.$5.50**

10. CONTRIBUTED SURPLUS

The contributed surplus represents stock-based compensation and options granted over the vesting period which was charged to the income statement.

	2006	2005
	$	$
Balance, beginning of year	**1,804**	3,032
Stock-based compensation	**3,105**	2,672
Transfer to share capital [note 9]	**(183)**	(3,900)
Balance, end of year	**4,726**	1,804

11. PROVISION FOR INCOME TAXES

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

	2006	2005
	$	$
Income before income taxes	**124,930**	88,943
Expected statutory tax rate of Canada	**36.12%**	36.12%
Expected income tax expense	**45,125**	32,126
Increase (decrease) in income taxes resulting from:		
Unrecognised income tax losses arising from losses of the Company and its subsidiaries	**22,830**	16,043
Income tax at different rates in foreign jurisdictions	**(39,140)**	(22,045)
Profits not subject to taxation as the authorized intermediaries are responsible to pay applicable taxes therefrom on behalf of the Company [b]	**(28,426)**	(25,884)
	389	240
Additional tax reserves on Authorized Sales Activities [b]		
Provision for the year [b]	**18,796**	10,437
Reversal of prior years' provision [b]	**(5,711)**	(3,421)
	13,474	7,256

[a] Income tax rates of major tax jurisdictions in which the Company's subsidiaries operate

The PRC WFOEs and CJVs are governed by the Income Tax Laws of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws (the "Income Tax Laws"). Pursuant to the Income Tax Laws, WFOEs, Sino-foreign equity and co-operative joint venture enterprises are subject to corporate income tax at an effective rate of 33% [30% state income taxes plus 3% local income taxes] on income as reported in their statutory financial statements. The PRC WFOEs and CJVs are eligible for an exemption from state and local income taxes for two years starting from the first profitable year of operations after offsetting losses carried forward from prior years, followed by a 50% exemption for the next three years. Subject to the approval of the relevant authorities, foreign invested enterprises categorised as forestry projects may be allowed a 15% to 30% reduction of the amount of income tax payable for a further period of ten years after tax holidays.

Hong Kong profits tax has been provided at the rate of 17.5% [2005 – 17.5%] on the estimated assessable profits arising in Hong Kong during the year.

[b] Provision for tax related liabilities

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 recognised 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.

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

Included in accounts payable and accrued liabilities as at December 31, 2006 is the balance of the provision for these tax related liabilities amounting to $39,106,000 [2005 – $25,379,000] provided on the profits of the Authorized Sales Activities earned by the BVI Subsidiaries over the three previous years.

[c] Losses carry forward

As at December 31, 2006, the Company has income tax losses of approximately $54,594,000 which can be applied against future years' taxable income in Canada. Approximately $1,456,000 of these tax losses will expire in 2007, $1,267,000 in 2008, $984,000 in 2009, $852,000 in 2010, $874,000 in 2011, $12,218,000 in 2015, $18,581,000 in 2016 and $18,362,000 in 2017. In addition, as at December 31, 2006, the Company's PRC WFOEs and CJVs have incurred tax losses which can only be carried forward to a maximum of 5 years of approximately $28,499,000 [2005 – $18,451,000].

The benefit of these losses, has not been reflected in the financial statements as management does not consider it to be more likely than not that the related future income tax asset will be realised. There are no other material temporary differences.

12. EARNINGS PER SHARE

The following table sets forth the number of shares used in computation of basic and diluted earnings per share:

	2006	2005
Weighted average shares for basic earnings per share	**137,910,000**	137,359,000
Stock options	**1,751,000**	230,000
Adjusted weighted average shares and assumed conversions for diluted earnings per share	**139,661,000**	137,589,000

13. STATEMENTS OF CASH FLOWS

The net change in non-cash working capital balances comprises the following:

	2006 **$**	2005 $
Cash provided by (used for):		
Accounts receivable	**(4,162)**	(38,920)
Due from PRC CJV partners	**1,200**	143
Inventories	**(7,301)**	(4,819)
Prepaid expenses and other	**(9,494)**	(61)
Accounts payable and accrued liabilities [a]	**10,156**	11,862
Income taxes payable	**377**	170
	(9,224)	(31,625)

[a] As at December 31, 2006, the Company had an aggregate amount of $5,530,000 [2005 – $25,286,000] payable in respect of timber holdings acquired during the year which was included in accounts payable and accrued liabilities.

[b] During the year ended December 31, 2005, 1,200,000 common shares were issued to management as consideration for the purchase of certain rights to acquire shares in Sino-Wood [note 9b]. The corresponding contributed surplus of $3,900,000 was transferred to share capital.

14. FINANCIAL INSTRUMENTS

The Company is exposed to various types of market risks, including changes in foreign exchange rates, interest rates and price of wood chips, wood-based products and standing timber, in the normal course of business.

The Company uses financial instruments, including variable rate debts, to finance its operations and to manage risks associated with its interest rate risk. With respect to the non-convertible guaranteed senior notes, the Company has entered into a currency swap agreement to fix interest payments at $27.4 million per annum over the next five years. The Company does not otherwise engage in other hedging transactions with respect to our foreign exchange risk or interest rate risk.

Exchange Rate Risk

The Company conducts its business primarily in Renminbi, and partly in U.S. dollars and Hong Kong dollars. In 2006 and 2005, 73.1% and 82.7% of the sales were received in Renminbi respectively and 26.9% and 17.3% of the sales were received in U.S. dollars and Hong Kong dollars respectively. The Company translates its results of foreign operations in U.S. dollars. It is expected in the future substantially all of the sales will be received in Renminbi. The majority of the Company's operating expenses are denominated in Renminbi and Hong Kong dollars.

A portion of the Company's revenue in Renminbi is converted into other currencies to meet financial obligations denominated in currencies other than Renminbi. The Company has a substantial amount of indebtedness denominated in U.S. dollars. The Company cannot predict the effect that currency exchange rate fluctuations may have on its operating results or cash flows.

Many foreign currency exchange transactions involving Renminbi, including foreign exchange transactions under the Company's capital account, are subject to foreign exchange controls and require the approval of the PRC State Administration of Foreign Exchange. Developments relating to the PRC's economy and actions taken by the PRC government could cause future foreign exchange rates to vary significantly from current or historical rates. The Renminbi to U.S. dollar exchange rate has been relatively stable since 1994 until a revaluation against the U.S. dollar since July 2005. The Company cannot predict nor give any assurance of its future stability. Future fluctuations in exchange rates may adversely affect the value, translated or converted into U.S. dollars of the Company's net assets, net profits and any declared dividends. The Company cannot give any assurance that any future movements in the exchange rates of Renminbi against the U.S. dollar and other foreign currencies will not adversely affect its results of operations, financial condition and cash flows.

As of December 31, 2006, the Company had Renminbi denominated bank accounts of RMB250.3 million (equivalent to $32.0 million) [2005 – RMB298.6 million, equivalent to $37.0 million], U.S. dollar denominated bank accounts of $127.6 million [2005 – $88.6 million], Canadian dollar denominated bank accounts of Cdn.$10.6 million (equivalent to $9.1 million) [2005 – Cdn.$12.2 million, equivalent to $10.5 million], Hong Kong dollar denominated bank accounts of HK$0.6 million (equivalent to $0.1 million) [2005 – HK$2.2 million, equivalent to $0.3 million] and Euro denominated bank accounts of €2.0 million (equivalent to $2.7 million) [2005 – €2.0 million, equivalent to $2.4 million]. The Company also had U.S. dollar and Renminbi denominated accounts receivable of $40.2 million [2005 – $31.3 million] and RMB665.6 million (equivalent to $85.1 million) [2005 – RMB717.7 million, equivalent to $88.7 million] respectively.

The Company mainly incurred U.S. dollar denominated debts for capital expenditures primarily relating to the development and acquisition of its forestry plantations and investment in its manufacturing plants. If the U.S. dollar fluctuates against any of these currencies, it would correspondingly affect the repayment costs on these debts.

Credit Risk and Concentration of Sales and Economic Dependence

The Company is exposed to credit risk with respect to accounts receivable from customers. The Company has credit evaluation on customers as necessary and has monitoring processes intended to mitigate credit risks and maintains appropriate provisions for potential credit losses. Historically the Company has made arrangements with its debtors to settle amounts payable with respect to the purchase of standing timber on behalf of the Company.

During the year ended December 31, 2006, the purchase of timber supplies and sales of processed wood chips in the PRC has been conducted through one domestic wood dealer who act as authorized intermediary to facilitate the purchase of timber supplies and sales of processed wood chips. The Company's relationship with the authorized intermediary is governed by a master agreement as supplemented by certain operational procedures relating to the wood chips sales transaction. Since the fourth quarter of 2005, the Company only engaged one wood dealer as the Company's authorized intermediary.

Entering into derivative financial instruments can give rise to additional credit risks. Credit risks arise from the possibility that counterparty will default on its contractual obligations and it's limited to those contracts where the Company would incur a loss in replacing the instrument.

Interest Rate Risk

The Company is exposed to interest rate risk resulting from fluctuations in interest rates on its debts, primarily on its bank indebtedness. The debts consist of fixed and variable rate debt obligations with original maturities ranging from less than one to seven years. The Company undertakes debt obligations to support general corporate purposes including capital expenditures and working capital needs. Upward fluctuations in interest rates increase the cost of new debt and the interest cost of outstanding variable rate borrowings and financial instruments. Fluctuations in interest rates can also lead to significant fluctuations in the fair value of the debt obligations carried at fixed rate. The Company does not currently use any derivative instruments to modify the nature of its debts so as to manage its interest rate risk.

Commodity Price Risk

The Company is exposed to fluctuations in the prices of standing timber, wood chips and wood-based products. The Company imports wood-based products from suppliers outside of China. Such purchases are made at market prices. In addition, all the sales of standing timber, wood chips and wood-based products are made at market prices. Therefore, fluctuations in the prices of standing timber, wood chips and wood-based products have a significant effect on the Company's business, results of operations, financial condition and cash flows.

The Company does not enter into any futures contracts to hedge its sales of standing timber, wood chips and wood-based products.

Fair value of financial instruments

The fair value of financial instruments represents the amounts that would have been received from or paid to counterparties to settle these instruments. The carrying amount of all financial instruments classified as current approximates their fair value because of the short maturities and normal trade terms of these instruments. The fair value of other financial instruments disclosed in the financial statements are based on the Company's best estimates using present value and other valuation techniques that are significantly affected by the assumptions used concerning the amounts and timing of estimated cash flows and discounted rates which reflect varying degrees of risk.

15. SEGMENTED INFORMATION

Segmented information is presented by way of the Company's primary segment reporting basis, by industry segment. In determining the Company's geographical segments, revenues are attributed to the segments based on the location of the customers, and assets are attributed to the segments based on the location of the assets. No further geographical segment information is presented as over 90% of the Company's revenue is derived from customers based in the PRC, and 88% of the Company's assets are located in the PRC.

The Company's operating businesses are structured and managed separately, according to the nature of their operations and the products and services they provide. Each of the Company's industry segments represents a strategic business unit that offers products and services which are subject to risks and returns that are different from those of the other industry segment. The segments were re-organised to reflect the Company's role as a key wood fibre supplier and provider of value-added wood products through its manufacturing operations. Summary details of the industry segments are as follows:

[a] the wood fibre segment engages in the sale of wood chips, logs, standing timber, imported wood products and the provision of agency services in the sale of wood chips; and

[b] the manufacturing segment engages in the manufacturing of particleboard, melamine faced chipboard, sawn timber, flooring products and nursery products and services.

Corporate assets, corporate income and costs are included in the Company's corporate segment to differentiate its risks and returns from other business segments.

By Industry Segment

	2006				2005			
	Wood Fibre	**Manu- facturing**	**Cor- porate**	**Total**	Wood Fibre	Manufac- turing	Cor- porate	Total
	$	**$**	**$**	**$**	$	$	$	$
Revenue								
Sale of standing timber	**352,574**	**–**	**–**	**352,574**	240,829	–	–	240,829
Sale of imported wood products	**178,379**	**–**	**–**	**178,379**	84,136	–	–	84,136
Sale of wood chips and logs	**89,994**	**–**	**–**	**89,994**	155,870	–	–	155,870
Sale of manufacturing operation's products and other	**–**	**24,032**	**–**	**24,032**	–	12,466	–	12,466
	620,947	**24,032**	**–**	**644,979**	480,835	12,466	–	493,301
Income (loss) from operations before interest, other income, exchange gains and amortisation of deferred financing costs	**180,496**	**(9,148)**	**(18,733)**	**152,615**	132,823	(5,549)	(14,667)	112,607
Identifiable assets	**927,880**	**151,957**	**127,418**	**1,207,255**	690,787	122,408	82,076	895,271
Interest income	**918**	**154**	**5,414**	**6,486**	1,244	201	2,734	4,179
Interest expense	**2,788**	**457**	**34,095**	**37,340**	1,181	423	27,390	28,994
Depreciation and amortisation	**230**	**3,623**	**122**	**3,975**	171	2,823	105	3,099
Provision for income taxes	**13,392**	**82**	**–**	**13,474**	7,185	71	–	7,256
Depletion of timber holdings included in cost of sales	**177,730**	**–**	**–**	**177,730**	140,204	–	–	140,204
Additions to timber holdings and capital assets	**395,518**	**9,421**	**41**	**404,980**	283,569	15,844	238	299,651

Revenue from the Company's largest customer for the year amounted to approximately 13% [2005 – 18%] of total revenue. During the year, there were three [2005 – three] customers who each individually accounted for more than 10% of the Company's revenue and this revenue in aggregate represented approximately 35% [2005 – 42%] of total revenue.

Purchases from the Company's largest vendor for the year accounted for approximately 16% [2005 – 20%] of total purchases. During the year, two [2005 – four] vendors who each individually accounted for more than 10% of the Company's purchases and these purchases in aggregate represented approximately 26% [2005 – 64%] of total purchases.

By Geographic Segment

The Company conducts substantially all of its operations in PRC. During the year, revenue in the PRC and other countries amounted to approximately $643,934,000 [2005 – $491,940,000] and $1,045,000 [2005 – $1,361,000], respectively.

As at December 31, 2006, approximately $32,010,000 [2005 – $36,954,000] of the Company's cash and cash equivalents were denominated in Renminbi.

As at December 31, 2006, all of the Company's timber holdings and approximately $87,346,000 [2005 – $80,520,000] of the Company's capital assets were located in the PRC.

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

16. CAPITAL CONTRIBUTIONS AND COMMITMENTS

Capital contributions and commitments for the Company's principal business activities are as follows:

[a] Capital contributions

In November 2005, the Commission of Foreign Trade and Economic Co-operation has approved the registered capital of the Company's WFOE, Guangdong Jia Yao Wood Products Development Co. Ltd. to increase from $24,000,000 to $49,000,000. The increase in capital contribution will be in the form of machinery and 15% of the capital contribution to be contributed within three months and the remaining 85% within eighteen months. As of December 31, 2006, the capital contribution has not been contributed. In February 2007, $5,705,000 of machinery was contributed.

[b] Capital commitments

As at December 31, 2006, the Company has capital commitments with respect to buildings, timber holdings, and plant and machinery of $12,305,000 [2005 – $7,820,000].

[c] Operating leases

Commitments under operating leases for land and buildings are as follows:

	$
2007	1,720
2008	1,348
2009	1,244
2010	1,193
2011	1,187
2012 and thereafter	34,698
	41,390

17. CONTINGENCIES FOR TAX RELATED LIABILITIES

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, and 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 mightdo 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 recognised 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 evaluate the provision for tax related liabilities on an annual basis or as necessary and believe adequate but not excessive provision for tax related liabilities has been recognised in the financial statements.

18. RELATED PARTY TRANSACTIONS

[a] Pursuant to the respective service agreements, the Company pays the salaries of certain executive officers in the form of consultancy fees to companies controlled by the executive officers. The consultancy fees incurred for the year amounted to $4,136,000 [December 31, 2005 – $2,737,000].

[b] In addition, as at December 31, 2006, the Company had an aggregate amount of $3,150,000 [December 31, 2005 – $2,129,000] owed to these related companies.

19. COMPARATIVE CONSOLIDATED FINANCIAL STATEMENTS

The comparative consolidated financial statements have been reclassified from statements previously presented to conform to the presentation of the 2006 consolidated financial statements.

INDEPENDENT DIRECTORS

JAMES (JAMIE) M.E. HYDE

CA, Toronto 1 (chair), 2

Director since 2004; Executive Vice President & Chief Financial Officer, Resolve Business Outsourcing Income Fund; previously Vice President Finance and Chief Financial Officer, GSW Inc., Partner, Ernst & Young LLP and Senior Vice President, Ernst & Young Corporate Finance Inc.

EDMUND MAK

MBA, Vancouver 1, 2

Director since 1994; engaged in real estate marketing for Re/Max Select Properties; previously worked thirty years with public, multi-national and private corporations in North America and Hong Kong, in the real estate, computer and high technology equipment, transportation, construction, oil & gas, textile and China trade industries.

W. JUDSON MARTIN

Toronto 1, 2 (chair), 3 (chair)

Director since 2006 and appointed as Lead Director in March 2007; previously Senior Executive Vice President & Chief Financial Officer, Alliance Atlantis Communications Inc., Senior EVP, CFO & Chief Operating Officer, MDC Corporation, President & CEO, Trilon Securities Corporation, EVP & CFO, Brookfield Development Corporation, Vice President Finance, Trizec Corporation Ltd.

SIMON MURRAY

Hong Kong 3

Director since 1999; Chairman, GEMS (General Enterprise Management Services Limited); previously worked thirty-five years in Asia as founder Simon Murray & Associates, Executive Chairman, Asia Pacific, Deutsche Bank Group, co-founder, Distacom, and Group Managing Director, Hutchison Whampoa.

Note: 1. Audit Committee 2. Corporate Governance Committee 3. Compensation and Nominating Committee

DIRECTORS AND OFFICERS

ALLEN T.Y. CHAN

Chairman and Chief Executive Officer, Hong Kong

Director since 1994; after co-founding Sino-Forest in 1992; previously worked twelve years as a management consultant and project manager in China; previously worked for Hong Kong government in new town development and management programs.

KAI KIT (K. K.) POON

President, Hong Kong

Director since 1994; after co-founding Sino-Forest in 1992; previously worked fifteen years with Guangdong Forestry Bureau as engineer engaged in forest product trading and manufacturing.

OFFICERS AND EXECUTIVES

DAVID J. HORSLEY

CA, CBV, Senior Vice President and Chief Financial Officer, Toronto

Joined Sino-Forest in 2005; was Independent Director since 2004, member of Audit, Compensation, and Corporate Governance Committees and Senior Vice President and CFO, Cygnal Technologies Corporation; previously Senior Vice President and Corporate Secretary, Canadian General Capital Limited.

HUA CHEN

Senior Vice President, Administration & Finance, China

Joined Sino-Forest in 2002; previously board chair of Suzhou New-Development Area Economic Development Group, and managed large corporations and gained access to capital markets in China.

ALBERT IP

Senior Vice President, Development & Operations North-east & South-west China

Joined Sino-Forest in 1997; previously worked twenty years in marketing, production management, project management and corporate business development and operation, in the garment, electronics and wood-related industries.

WEI MAO ZHAO

Senior Vice President, Development & Operations, South & East China

Joined Sino-Forest in 2002; previously General Manager, Everbright Group Corp. with extensive experience in wood product manufacturing and knowledge of international wood material markets.

ALFRED C. T. HUNG

CFA, FRM, MSc Finance, Vice President, Corporate Planning, Banking and Sales, Hong Kong

Joined Sino-Forest in 1999; previously gained nine years experience in investment research and management for several international firms.

ALVIN LIM

CPA, Vice President, Finance and Group Financial Controller, Hong Kong

Joined Sino-Forest in 2002; previously worked ten years in finance and accounting for international audit and investment firms.

THOMAS M. MARADIN

CA, Vice President, Risk Management, Toronto

Joined Sino-Forest in 2005; previously worked five years for several multi-national corporations in financial reporting and internal control, regulatory compliance and system upgrading; previously worked fifteen years for Ernst & Young LLP, providing professional services in audit, taxation, risk management, strategic and business planning.

JAY LEFTON

LLB, Corporate Secretary, Toronto

Partner, Aird & Berlis LLP practicing in corporate and securities law since 1986, including financings, mergers & acquisitions, take-over bids, strategic alliances and shareholder agreements; previously member of the Ontario Securities Commission Securities Advisory Committee.

TEN-YEAR FINANCIAL HIGHLIGHTS

(in millions, except earnings per share and common shares outstanding)	**2006**	2005	2004	2003	2002	2001	2000	1999	1998	1997
Consolidated Income Statements and Cash Flows										
Revenue	**645.0**	493.3	330.9	265.7	200.7	137.3	126.7	141.6	92.7	41.8
Gross profit	**194.5**	136.9	101.5	64.9	42.7	30.2	38.6	39.8	30.0	24.4
Gross profit margin	**30.2%**	27.7%	30.7%	24.4%	21.3%	22.0%	30.5%	28.1%	32.4%	58.4%
Net income	**111.5**	81.7	52.8	30.2	20.6	18.6	28.6	28.2	21.4	15.3
Diluted earnings per share	**0.80**	0.59	0.43	0.32	0.27	0.21	0.31	0.31	0.26	0.19
Cash flow from operating activities	**289.3**	196.5	119.4	69.6	12.6	12.9	26.6	27.1	15.3	14.6
Capital Expenditures	**416.8**	299.7	178.6	96.6	44.2	45.3	54.4	37.7	30.7	31.7
Consolidated Balance Sheets										
Total assets	**1207.3**	895.3	756.0	418.9	336.9	281.6	220.2	178.3	100.5	72.8
Cash and cash equivalents	**152.9**	108.4	201.2	6.9	1.2	1.7	18.2	39.6	0.9	5.7
Working capital	**182.0**	150.1	236.9	(2.3)	26.1	5.5	13.3	38.8	5.2	13.6
Timber holdings	**752.8**	513.4	359.6	232.5	172.4	156.1	118.5	91.7	67.3	38.4
Long-term liabilities	**450.0**	300.0	300.0	56.0	82.3	47.2	28.7	30.2	3.3	6.7
Shareholders' equity	**605.7**	468.0	372.3	245.0	180.1	172.8	152.3	126.2	85.2	60.0
Shares										
Shares outstanding at year-end	**138.0**	137.8	136.6	96.2	80.3	80.3	80.3	80.8	80.7	73.6
– Common shares	**138.0**	137.8	136.6	–	–	–	–	–	–	–
– Class A Subordinate-Voting Shares*	**–**	–	–	96.2	74.3	74.3	74.3	74.8	74.7	67.6
– Class B Multiple-Voting Shares*	**–**	–	–	–	6.0	6.0	6.0	6.0	6.0	6.0

* Pursuant to articles of amendment filed by the Company on June 22, 2004, the Class A Subordinate-Voting Shares were reclassified as common shares and the Class B Multiple-Voting Shares were eliminated.

2006 QUARTERLY HIGHLIGHTS

		1st Q	2nd Q	3rd Q	4th Q	Total
Revenue	US$'000	98,864	107,274	188,535	250,306	644,979
Gross profit	US$'000	22,406	28,436	58,720	84,936	194,498
Gross profit margin		22.7%	26.5%	31.1%	33.9%	30.2%
EBITDA	US$'000	42,202	47,562	95,853	148,703	334,320
Net income	US$'000	9,464	14,360	45,104	42,528	111,456
Diluted earnings per share	US$	0.07	0.10	0.32	0.30	0.80
Cash flow from operating activities	US$'000	65,275	32,057	65,093	126,863	289,288
Standing Timber						
Hectares purchased		42,802	16,903	29,086	40,485	129,276
– Average purchased price/hectare	US$	1,699	2,455	3,899	3,843	2,964
Hectares sold		22,617	19,830	23,344	45,576	111,367
– Average selling price/ hectare	US$	1,923	2,335	4,066	3,683	3,166
Total Revenue	US$'000	43,492	46,307	94,906	167,869	352,574
Gross profit margin		41.2%	46.4%	51.8%	47.4%	47.7%
Wood Chips & Logs						
Bone dry metric tons sold		96,230	191,030	324,690	151,490	763,440
– Average price/BDMT	US$	107.7	109.3	109.6	112.5	109.9
Revenue – Wood chips	US$'000	10,360	20,889	35,600	17,045	83,894
Revenue – Wood logs	US$'000	–	79	352	64	495
Revenue – Commissions	US$'000	1,276	2,212	2,117	–	5,605
Total Revenue	US$'000	11,636	23,180	38,069	17,109	89,994
Gross profit margin		16.7%	17.0%	16.2%	16.3%	16.5%
Imported Wood Products						
Total Revenue	US$'000	39,723	32,064	51,064	55,528	178,379
Gross profit margin		2.8%	2.7%	3.0%	2.8%	2.9%
Manufacturing & Other Operations						
Total Revenue	US$'000	4,013	5,723	4,496	9,800	24,032
Gross profit margin		9.4%	5.3%	2.0%	9.4%	7.1%
Common Shares						
High	Cdn.$	7.00	6.59	6.01	7.97	7.97
Low	Cdn.$	4.65	4.76	3.60	4.22	3.60
Close	Cdn.$	6.55	5.75	4.27	7.83	7.83
Trading volume		35,102,343	29,022,026	21,030,620	40,106,202	125,261,191

CORPORATE AND SHAREHOLDER INFORMATION

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EXCHANGE LISTING

The common shares of the Company are listed on the Toronto Stock Exchange under the symbol TRE

ANNUAL SHAREDHOLDERS MEETING

4:00 p.m.
Monday, May 28, 2007
The Fairmont Royal York Hotel
The Imperial Room
100 Front Street West
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Please Note: This report contains projections and forward-looking statements regarding future events. Such forward-looking statements are not guarantees of future performance of Sino-Forest and are subject to risks and uncertainties that could cause actual results and company plans and objectives to differ materially from those expressed in the forward-looking statements. Such risks and uncertainties include, but are not limited to, changes in the PRC and international economies; changes in currency exchange rates; changes in worldwide demand for the Company's products; changes in worldwide production and production capacity in the forest products industry; competitive pricing pressures for the Company's products; and changes in wood and timber costs.

design and production Monopoly Design Limited

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