



## **Sino-Forest Announces Findings of the Independent Committee**

- Independent Committee review verifies cash balances, timber assets, book values and revenues
- Final Independent Committee report expected to be submitted prior to year-end
- Q3 results delayed, pending resolution of outstanding issues
- A version of the Independent Committee's second interim report released online at [www.sedar.com](http://www.sedar.com) and [www.sinoforest.com](http://www.sinoforest.com).

**TORONTO, CANADA – November 15, 2011** - Sino-Forest Corporation (“Sino-Forest” or the “Company”) (TSX:TRE) today announced the findings of the Independent Committee of the Company’s Board of Directors (the “IC”). Sino-Forest also today announced that it is deferring the release of its third quarter financial 2011 results (“Q3 Results”). All references to \$ amounts contained in this press release are to United States Dollars.

Mr. Judson Martin, Vice-Chair and CEO of the Company stated “This has been an intense and challenging process and I am pleased that the Independent Committee has been able to refute the substance of the allegations made in the Muddy Waters report.

“The Independent Committee report verifies the Company’s stated cash balances, confirms registered title or contractual rights to the Company’s stated timber assets, as well as the book value of these assets, reconciles reported total revenue and refutes the allegation that Yuda Wood is a subsidiary of the Company. We can categorically say Sino-Forest is not the “*near total fraud*” and “*Ponzi scheme*” as alleged by Muddy Waters.”

“The Independent Committee and Audit Committee are verifying information regarding certain of the Company’s relationships with its suppliers and Authorized Intermediaries and addressing other issues that must be resolved before the Q3 Results can be released. We are confident this work will be carried out quickly and our current plan is to release our Q3 Results within the next 30 days. As the Independent Committee report notes, its work is substantially complete. We look forward to the Independent Committee’s final report which we expect to be released prior to year-end.”

“While the investigation has been difficult, we have also learned much through this process, including a better understanding of the way we need to communicate the operational and regulatory complexities of operating in our industry in China in order to give confidence to our international investor community. We also found that the Company’s internal processes, infrastructure and breadth of management team have not kept pace with the growth of its operations. These shortcomings will be addressed: we have a plan to improve our governance and processes going forward, and we plan

to add further qualified staff. We are also exploring ways to simplify our business structure, which we believe will provide greater comfort to our investors."

"To say that this has been a tough time for our employees, investors and our Company as a whole would be a huge understatement. A great deal of financial and reputational damage has been caused by unfounded accusations made by a short-seller, who we understand personally profited a great deal from the losses of others. Far from being a "near total fraud" and "Ponzi scheme" as alleged by Muddy Waters, Sino-Forest is a real company, with real assets and real revenue. We are reserving our rights to respond to this matter."

## **REPORTS OF THE INDEPENDENT COMMITTEE**

### **Establishment of Independent Committee**

On June 2, 2011, in response to a report issued by Muddy Waters, LLC (the "MW Report"), the Board of Directors of the Company appointed a committee of independent directors to examine the allegations in the MW Report, and report back to the Board of Directors. The IC retained independent legal counsel in Canada, Hong Kong and mainland China and independent accounting advisors.

### **The First Interim Report**

On August 11, 2011, the IC delivered its First Interim Report to the Board of Directors. In its First Interim Report, the IC's accounting advisors confirmed the Company's cash balances as of June 13, 2011 for accounts located inside and outside of mainland China. A total of 293 accounts controlled by Sino-Forest in Hong Kong were confirmed, representing 100% of the expected cash position. The Company had 267 accounts in China. The logistics and requirements of in person/in branch verification led the IC to confirm 28 accounts, representing approximately 81% of the expected cash position in China. The IC was satisfied based on this verification that the Company's expected cash position in China existed as at the date of confirmation.

### **Work of the Independent Committee Leading to its Second Interim Report**

Since delivering its First Interim Report, the IC's focus has been principally on (i) the ownership structure of timber assets on Sino-Forest's balance sheet, (ii) verifying the Company's holdings of standing timber and plantation land use/lease rights, (iii) interviewing suppliers and authorized intermediaries ("AIs") with a view to verifying the existence and nature of the Company's relationship with its commercial counterparties, and (iv) examining the Company's relationship with Yuda Wood, historically one of the largest suppliers of standing timber to Sino-Forest.

### **Sino-Forest's Business Segments and Business Models**

Sino-Forest's business encompasses several different activities: (i) plantation fibre operations (sometimes also referred to as the tree plantation business), (ii) wood log

and wood products trading operations (both import and domestic in China) and (iii) manufacturing and other operations. Sino-Forest also owns a majority interest in Greenheart Group Limited.

The plantation fibre operations use two principal business models, a “purchased plantation” model and a “planted plantation” model. Purchased plantations are comprised of standing timber without underlying leases of land use rights. The purchased plantation model operates through two legal structures: a British Virgin Islands (“BVI”)/AI legal structure and, to a lesser but growing extent, a China-incorporated Wholly Foreign Owned Enterprise (“WFOE”) legal structure. The planted plantation model is operated exclusively through the WFOE legal structure, although the WFOEs are typically also held indirectly through a BVI holding structure. The planted plantation model involves the planting of seedlings on land for which Sino-Forest has plantation land use rights through leases or other similar legal instruments. As at December 31, 2010, Sino-Forest disclosed approximately 711,000 hectares of purchased plantations under management in China, with 467,000 hectares recorded as held by BVIs and approximately 244,000 hectares recorded as held by WFOEs at December 31, 2010. Sino-Forest disclosed approximately 77,700 hectares of planted plantation under management in China at December 31, 2010.

### **Property Rights to Plantations / Timber in China**

Property rights are relatively new in China and the system for recording them continues to evolve, in the IC's experience, at different rates in different parts of the country.

There are four separate types of rights associated with plantations in China, being (i) plantation land ownership, (ii) plantation land use rights, (iii) timber ownership and (iv) timber use rights. Private enterprises cannot legally hold plantation land ownership but may hold plantation land use rights for a specified duration of up to 70 years, although in certain provinces foreign enterprises cannot acquire land use rights. Private enterprises also may hold timber ownership and timber use rights. This is important to clarify, because Sino-Forest has never claimed to ‘own the land’ on which it has standing timber.

A plantation rights certificate (“PRC”) reflects plantation land ownership and plantation land use rights as registered in the registration system and is the ultimate proof of ownership. There is a nationally mandated registration system for PRCs, although there are some locations where PRCs are not yet issued. There is no system in place to record the sale and purchase of standing timber when that transaction does not also accompany the sale and purchase of land ownership or land use rights. As described above, in China, the right to own or use land is different from the right to own or use the timber on that land.

In circumstances where a PRC was not available, the Company's general practice was (and is) to require suppliers to seek and obtain “confirmation letters” or “approvals” from local forestry bureaus relating to the standing timber purchase contracts entered into by

its BVIs. These confirmation letters, although not title documents in the Western sense of that term, provide significant support as to the Company's contractual rights. The Company views these confirmations as letters of comfort which indicate that the relevant forestry bureaus do not dispute the Company's claims to the standing timber to which they relate. These confirmations are not publicly available for review at relevant forestry bureaus and, as a result, the entirety of the Company's plantation assets in China cannot be verified from publicly available sources. However, forestry bureau confirmations have been reviewed in the course of the IC work.

While confirmations provide significant comfort as to the Company's contractual rights, the purchase contracts should be regarded as the primary evidence of the Company's interest in timber assets.

## **Second Interim Report**

On November 14, 2011 the IC delivered its Second Interim Report to the Board of Directors. The executive summary of the report is attached to this release. The principal findings in the Second Interim Report are set out below.

### **(a) Timber Ownership**

Subject to the comments in its Second Interim Report, the IC has confirmed to its satisfaction that the Company has registered title to approximately 151,000 hectares of plantations, being 17.9% of its disclosed timber holdings by area, and additional contractual rights to approximately 683,000 hectares of plantations, being 81.3% of its disclosed timber holdings by area. The IC reported that it has reviewed originals or copies of purchase contracts for the acquisition by the Company of virtually all of its disclosed timber holdings as at December 31, 2010.

The following is a chart showing the percentage of timber assets under each type of ownership that has been verified by the type of documentation that is available:

<b>Summary of Timber Assets By Verification Source</b>					
<b>(in hectares, rounded)</b>					
	<b>Company Reported December 31, 2010 Timber Holdings <sup>(1)</sup></b>	<b>Purchase Contracts Provided by Company &amp; Reviewed by IC <sup>(2)</sup></b>	<b>% of 12/31/10 Timber Holdings</b>	<b>Acquisition Confirmations Provided by Forestry Bureaus <sup>(4)</sup></b>	<b>% of 12/31/10 Timber Holdings</b>
Purchased Plantations (BVI)	467,000	467,000	100%	467,000	100%
Purchased Plantations (WFOE)	244,000	237,000	97%	89,000	36%
Planted Plantations (WFOE)	77,700	129,000 <sup>(3)</sup>	166%	50,000	64%
<b>Total</b>	<b>788,700</b>	<b>833,000</b>	<b>106%</b>	<b>606,000</b>	<b>77%</b>

*(1) Company reported timber holdings (rounded to the nearest thousand) as per Company's 2010 annual report*

*(2) Originals or copies of purchase contracts (and the corresponding set-off documentation confirming payment) for the acquisitions made by the Company*

*(3) Includes approximately 51,000 hectares of plantation land on which timber had not been planted as at December 31, 2010*

*(4) Company has original or copies of forestry bureau confirmations relating to the acquisition of this hectareage*

*Note: Plantation Rights Certificates issued by forestry bureaus are not available for BVI assets, however approximately 95,000 are available for Purchased Plantation (WFOE) and approximately 55,000 for Planted Plantation (WFOE)*

The IC has verified that the Company has registered title to approximately 151,000 hectares, as at December 31, 2010, as follows, (a) via original PRCs in the Company's name, to approximately 86,000 hectares of WFOE purchased plantations and approximately 43,000 hectares of WFOE planted plantations; and (b) via copies of PRCs in the Company's name supporting the acquisition of approximately 9,000 hectares of WFOE purchased plantations and approximately 12,000 hectares of WFOE planted plantations.

Additionally, as at December 31, 2010, the IC has determined that the Company has original or copies of forestry bureau confirmations relating to the acquisition of approximately 467,000 hectares of BVIs purchased plantations, 89,000 hectares of WFOE purchased plantations, and approximately 50,000 hectares of WFOE planted plantations.

As indicated above, a system of registered title through PRCs has not been implemented in the jurisdictions examined by the IC Advisors for standing timber that is held without land use/lease rights. In these circumstances, the Company sought confirmations from the relevant local forestry bureaus acknowledging its rights to the standing timber. In meetings organized by management, the IC Advisors met with a sample of forestry bureaus with a view to obtaining further verification of the Company's rights to standing timber in those jurisdictions. Such meetings to date have concluded with the forestry bureaus having issued new confirmations as to the Company's contractual rights in respect of 111,177 hectares as at December 31, 2010 and 133,040 hectares as at March 31, 2011. These forestry bureaus also have acknowledged

existing confirmations in respect of 113,058 hectares as at December 31, 2010.

The IC Advisors did not obtain significant insight into the internal authorization or diligence processes undertaken by the forestry bureaus in issuing confirmations nor did the IC have independent verification of the methods by which those confirmations were obtained. In areas where Sino-Forest has reported large timber holdings, the relevant forestry bureau has confirmed to the IC that the Company is a significant player in the forestry industry.

The Company is continuing its efforts to obtain new confirmations and/or verification of old confirmations from forestry bureaus for the balance of its inventory in those areas where such confirmations can be made available.

In summary, the IC has reviewed to its satisfaction the purchase contracts for approximately 100% of disclosed timber assets, PRCs for 17.9% of timber assets, and forestry bureau confirmations of 77% of timber assets.

**(b) Book Value of Timber**

The IC reported that it is satisfied that the book value of the BVIs timber assets of \$2.476 billion reflected on its 2010 Audited Financial Statements and of WFOE standing timber assets of \$298.6 million reflected in its 2010 Audited Financial Statements reflects the purchase prices for such assets as set out in the BVIs and WFOE standing timber purchase contracts reviewed by the IC Advisors. Further, the purchase prices for such BVIs timber assets have been reconciled to the Company's financial statements based on set-off documentation relating to such contracts that were reviewed by the IC.

The IC's Advisors reviewed documentation acknowledging the execution of the set-off arrangements between the suppliers, the Company and the AIs for the 2006-2010 period. However, due to a lack of cooperation from suppliers and AIs, the IC Advisors were unable to review any documentation belonging to suppliers or AIs which independently verified movements of cash in connection with such set-off arrangements between suppliers, the Company and the AIs used to settle purchase prices paid to suppliers by AIs on behalf of Sino-Forest. Suppliers and AIs were under no legal obligation to provide such verification.

**(c) Revenue Reconciliation**

The IC has reconciled reported 2010 total revenue to the sales prices in BVIs timber sales contracts, together with macro customer level data from other businesses. However, due to the unwillingness of suppliers and AIs to share detailed financial information, the IC was unable to review any documentation of suppliers or AIs which independently verified movements of cash in connection with set-off arrangements used to settle purchase prices paid, or sale proceeds received by, or on behalf of Sino-Forest.

#### **(d) Relationships**

The IC is satisfied that Mr. Huang Ran, a Yuda Wood employee, is not currently an employee of the Company and that Yuda Wood is not a subsidiary of the Company. However, there is evidence suggesting close cooperation between the Company and Yuda Wood. Management has offered explanations for these arrangements. Further, Mr. Ran has an ownership interest and/or directorship in a number of other suppliers.

The IC's review has identified other situations which require further review to determine the extent and particulars of the relationship between the Company and certain other suppliers. Certain suppliers and AIs may have cross-ownership and other relationships with each other, which the IC continues to investigate to determine their relevance, if any. In the interviews conducted by the IC Advisors with selected AIs and suppliers, all such parties represented that they were independent of Sino-Forest.

Management has very recently provided information and analysis to the IC intended to resolve the question around related party relationships. The IC is reviewing this material from management and intends to report its findings in this regard in its final report. Some of such information and explanations may not be capable of independent verification.

If any of Sino-Forest's material purchase and sale transactions are found to have been with related parties, the value of these transactions, as recorded on the books and records of the Company, may be impacted.

#### **Independent Committee Reports Available For Review**

A version of the Second Interim Report of the IC and the Process Schedule have been redacted for commercial sensitivity and filed on SEDAR ([www.sedar.com](http://www.sedar.com)) and made available on the Company's website ([www.sinoforest.com](http://www.sinoforest.com)). A version of the First Interim Report of the IC and certain schedules to the Second Interim Report of the IC will be redacted for commercial sensitivity and will be filed on SEDAR ([www.sedar.com](http://www.sedar.com)) and made available on the Company's website ([www.sinoforest.com](http://www.sinoforest.com)) within two days.

#### **Completion of the Work of the Independent Committee**

The Independent Committee has worked diligently over five months to complete its two reports. Taking into account advisor costs, the Company has incurred costs of approximately \$35 million to date on the work of the Independent Committee and matters arising as a result of the MW Report.

With the delivery of its Second Interim Report to the Board, the IC has largely completed its mandate. The remaining outstanding items are identified in the Second Interim Report. The IC expects to complete its work and deliver a final report to the Board, prior to the end of 2011.

## **ACTIONS OF THE COMPANY TO PRESERVE STAKEHOLDER VALUE**

In parallel with the appointment of the IC, the Company also instituted a series of measures designed to preserve value at the Company during the IC review process for the benefit of its stakeholders. Such measures included:

- a) The substantial curtailment of further cash investment activities in the plantation fibre business; and
- b) The institution of strict cash controls by management to ensure tighter controls over the Company's cash balances.

These measures were instituted to ensure that the Company's assets were protected for the benefit of all stakeholders pending the outcome of the IC's enquiries.

## **DEFERRAL OF Q3 RESULTS**

The Board of Directors has concluded that it is not currently in a position to authorize the release of the Company's Q3 Results by November 14, 2011 but is continuing its work on the Q3 Results and hopes to be in a position to issue them soon. Before the Q3 Results can be released, certain issues must be resolved to the satisfaction of the Board.

Although the Company is not in a position to issue its Q3 Results at this time, the Company is able to release the cash balance, and cash flow information attached to this release and can therefore confirm that as at November 4, 2011, the Company had a cash balance of \$571.1 million.

As a result of the Company's failure to file its Q3 Results on a timely basis in accordance with applicable law, it has breached certain covenants under its senior and convertible note indentures. An event of default under the note indentures will have occurred if the Company fails to cure that breach within 30 days in the case of the senior notes, and 60 days in the case of the convertible notes, after having received written notice of such default from the relevant indenture trustee or the holders of 25% or more in aggregate principal amount of a given series of notes, thereby subsequently potentially entitling noteholders, through the trustees, to enforce certain rights.

In addition to its outstanding senior and convertible notes, as of October 31, 2011, the Company has loan facilities in China totaling \$67.1 million.

Mr. William Ardell, Non-Executive Chairman of the Company and Chair of the Independent Committee said, "We understand the frustration that our stakeholders are feeling. We are working diligently to address outstanding issues and allow the Q3 Results to be released. We appreciate your patience and we will continue to move forward as quickly and thoroughly as we can."

## **Ontario Securities Commission Investigation**



The Ontario Securities Commission's investigation is ongoing and its cease trade order on the Company's securities remains in effect.

## About Sino-Forest Corporation

Sino-Forest Corporation is a leading commercial forest plantation operator in China. Its principal businesses include the ownership and management of tree plantations, the sale of standing timber and wood logs, and the complementary manufacturing of downstream engineered-wood products. Sino-Forest also holds a majority interest in Greenheart Group Limited (HKSE:00094), a Hong-Kong listed investment holding company with assets in Suriname (South America) and New Zealand and involved in sustainable harvesting, processing and sales of its logs and lumber to China and other markets around the world. Sino-Forest's common shares have been listed on the Toronto Stock Exchange under the symbol TRE since 1995. Learn more at [www.sinoforest.com](http://www.sinoforest.com).

Cautionary notes: No stock exchange or regulatory authority has approved or disapproved of information contained herein. Certain information included in this news release is forward-looking and is subject to important risks and uncertainties. When used in this news release, the words "believe", "intend", "estimate", "expect", "plan" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain such words. These forward-looking statements are based on current expectations. The results or events predicted in these statements may differ materially from actual results or events and are no guarantees of future performance of Sino-Forest. Factors which could cause results or events to differ from current expectations include, among other things: our ability to cure our default under our notes, actions taken by noteholders or other lenders to enforce their rights, the outcome of examinations currently underway by the Independent Committee and securities regulatory authorities, the outcome of class action proceedings initiated against the Company as a result of allegations made in the MW Report, 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 the relationship with local plantation land owners and/or plantation land use rights holders, 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, the evaluation of our provision for income and related taxes, economic, political and social conditions and government policy in China, the Republic of Suriname and New Zealand, and stock market volatility, and other factors not currently viewed as material that could cause actual results to differ materially from those described in the forwarding-looking statements. For additional information with respect to certain of these and other factors, see the reports filed by Sino-Forest Corporation with applicable Canadian securities administrators. Sino-Forest Corporation disclaims any intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law.

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**Appendix A**

**SECOND INTERIM REPORT OF  
THE INDEPENDENT COMMITTEE OF THE BOARD OF DIRECTORS OF  
SINO-FOREST CORPORATION**

**EXECUTIVE SUMMARY**

**November 13, 2011**

## EXECUTIVE SUMMARY

### A. Introduction

The IC was established by the Board on June 2, 2011, immediately following the release by Muddy Waters of the MW Report regarding SF. The members of the IC are William Ardell (Chair), James Bowland, and James Hyde. At the invitation of the IC, Mr. Garry West, an independent director of SF, attends virtually all IC meetings and participates in its process. Following the delivery to the Board of the IC's draft of the Second Interim Report on November 3, 2011, Mr. James Bowland resigned as a director and therefore from the IC. The mandate of the IC, in general terms, is to independently examine and review the serious and wide-ranging allegations made in the MW Report and report back to and, if appropriate, make recommendations to the Board. To date, the IC has met approximately 48 times.

The IC Advisors' role is to support the IC in its mandate to review the allegations made in the MW Report and related matters. The IC Advisors have conducted various investigative and review processes, all at the direction of, and subject to such scope limitations as the IC, in its judgment, deemed appropriate. The Second Interim Report to the Board, while based on the work of such advisors, is the report of the IC and (other than Schedule IV) not the report of the IC Advisors.

The IC's First Interim Report to the Board dated August 10, 2011 outlined the nature and scope of the IC's activities (principally data collection) to that date and the planned next steps. The purpose of the Second Interim Report is to report to the Board on the activities undertaken by the IC since mid-August, the outcomes and findings from such activities and further next steps.

While the MW Report took a scatter gun approach in its allegations, the IC determined to address the issues raised in three core areas: (i) timber asset verification; (ii) timber asset value; and (iii) revenue recognition. Overlaying the latter two areas are the issues raised by the MW allegations relating to related party transactions. The IC also determined to focus on the years 2006 to 2010. Using this framework for its review, the IC's focus since its last report has been principally on:

- the ownership structure of timber assets on SF's balance sheet;
- verifying the Company's holdings of standing timber ("purchased plantations" as referred to in the 2010 AIF) and plantation land use/lease rights ("planted plantations" as referred to in the 2010 AIF, though some plantation land use/lease rights, such as the Mandra holdings, are classified as "purchased plantations" in the 2010 AIF), held through BVIs and WFOEs and the nature of its interests in such assets;
- interviewing Suppliers and AIs with a view to verifying the existence and nature of SF's relationship with such third parties and seeking to obtain financial

particulars about purchase and sale transactions between such third parties and SF; and

- examining and assessing the relationship with Yuda Wood, historically one of the largest Suppliers of standing timber to SF supplying approximately 21.5% of BVI timber purchases from 2008 through 2011.

The IC's work has also included:

- examining a number of specific situations which are the subject of MW allegations or critical newspaper articles;
- engaging with and assisting E&Y in its examination of various issues relevant to its reports on the Company's financial statements;
- responding to questions and requests for documents and information from the OSC, including enquiries made through the Hong Kong securities authorities, in connection with its publicly announced investigation;
- meeting with and responding to requests for information from BJ and FTI;
- conducting interviews of certain members of Management;
- inspecting original versions of documents issued to the WFOEs and BVIs on letterheads with forestry bureau names and featuring Chops (the seal typically used in place of signatures) that indicate that they had been issued by the corresponding forestry bureau (the "**forestry bureau confirmations**"), and attending meetings with forestry bureaus in an attempt to verify the Company's holdings of standing timber;
- attending interviews of AIs and Suppliers, examining SF employee and other relationships with AIs and Suppliers; and
- meeting with and responding to requests for information from the RCMP.

In addition to the IC review, the MW Report has spawned various actions by public and private parties. These actions, which have affected the IC's activities and processes, include:

- an OSC investigation of matters related to SF;
- a review by E&Y of various matters relating to its 2010 and prior years' audits;
- three class action lawsuits in Ontario (one of which has a companion action in Quebec) by securities holders against the Company, its officers, E&Y and others;
- a threatened derivative claim against E&Y and certain officers and employees of the Company;

- extensive newspaper and analyst reporting of the Company, including several in-depth investigative reports; and
- an enquiry by the RCMP through IMET.

While the IC believes its work is substantially complete, there remain certain further steps which it intends to undertake as follows:

- review the information and analysis very recently provided by Management intended to respond to certain issues regarding relationships of the Company with AIs and Suppliers and between AIs and Suppliers identified in the Second Interim Report;
- engage an independent valuator;
- such other steps as the IC, in its judgement, deems advisable in the discharge of its mandate; and
- submit its final report and recommendations to the Board.

The IC expects to be able to deliver its final report to the Board prior to the end of 2011.

## **B. Overview of Principal Findings**

The following sets out a very high level overview of the IC's principal findings and should be read in conjunction with the balance of the report.

### **Timber Ownership**

Based on its review and subject to its comments herein, the IC has confirmed to its satisfaction that the Company has:

- registered title to approximately 151,000 Ha. of SW and SP planted plantations and Mandra plantations. This constitutes approximately 17.9% of its timber holdings by area as at December 31, 2010;<sup>1</sup> and
- contractual or other rights to approximately 683,000 Ha. of plantations, being 81.3% of its timber holdings by area as at December 31, 2010 (of these, the Company holds original Plantation Rights Certificates, issued in the name of the Supplier, representing approximately 15,000 Ha., which the IC believes gives the Company a demonstrable chain of title).

In connection with such confirmation, the IC has reviewed originals or copies of purchase contracts (and the corresponding set-off documentation confirming payment, in the case of the BVI purchased plantations) for the acquisition by the Company of:

- approximately 467,000 Ha. of BVIs purchased plantations;<sup>2</sup>
- approximately 237,000 Ha. of WFOE purchased plantations;<sup>3</sup> and
- approximately 129,000 Ha. of planted plantations<sup>4</sup>

representing approximately 106%<sup>5</sup> of SF's disclosed timber holdings of 788,700 Ha. as at December 31, 2010. With respect to these holdings, the IC has verified to its satisfaction that the Company has registered title:

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<sup>1</sup> Timber holdings by area as at December 31, 2010 have been calculated by adding approximately 51,000 Ha. of planted plantation land for which the Company has contracts but has yet to classify as plantations under management for the purposes of its annual disclosure, to the Company's disclosed plantation holdings in China of 788,700 Ha.

<sup>2</sup> BVI purchased plantations are comprised of standing timber without underlying leases of land use rights.

<sup>3</sup> The Company classifies this as being comprised of all WFOE (SP) standing timber and all Mandra leased plantations. Mandra leased plantations are considered to be "purchased" plantations in the Company's public disclosure because they were acquired through the 2010 acquisition of Mandra.

<sup>4</sup> The Company classifies this as being comprised of all WFOE (SW and SP) leased plantations.

<sup>5</sup> The Company's explanation for this figure being approximately 106% of its disclosed timber holdings as at December 31, 2010 is that the IC reviewed leases for approximately 51,000 Ha. of plantation land which were

- via original Plantation Rights Certificates in the Company's name, to approximately 86,000 Ha. of WFOE purchased plantations,<sup>6</sup> and approximately 43,000 Ha. of WFOE planted plantations;<sup>7</sup> and
- via copies of Plantation Rights Certificates in the Company's name, to approximately 9,000 Ha. of WFOE purchased plantations, and approximately 12,000 Ha. of WFOE planted plantations.

In addition, as at December 31, 2010, the IC has determined that the Company has original or copies of forestry bureau confirmations relating to the acquisition of:

- approximately 467,000 Ha. of BVIs purchased plantations;
- approximately 89,000 Ha. of WFOE (SP) purchased plantations; and
- approximately 50,000 Ha. of WFOE (SP only) planted plantations.

The Company does not obtain registered title to BVI purchased plantations. In the case of the BVIs' plantations, the IC has visited forestry bureaus, Suppliers and AIs to seek independent evidence to establish a chain of title or payment transactions to verify such acquisitions. The purchase contracts, set-off arrangement documentation and forestry bureau confirmations constitute the documentary evidence as to the Company's contractual or other rights. The IC has been advised that the Company's rights to such plantations could be open to challenge. However, Management has advised that, to date, it is unaware of any such challenges that have not been resolved with the Suppliers in a manner satisfactory to the Company.

### **Forestry Bureau Confirmations and Plantation Rights Certificates**

Registered title, through Plantation Rights Certificates is not available in the jurisdictions (i.e. cities and counties) examined by the IC Advisors for standing timber that is held without land use/lease rights. Therefore the Company was not able to obtain Plantation Rights Certificates for its BVIs standing timber assets in those areas. In these circumstances, the Company sought confirmations from the relevant local forestry bureau acknowledging its rights to the standing timber.

The IC Advisors reviewed forestry bureau confirmations for virtually all BVIs assets and non-Mandra WFOE purchased plantations held as at December 31, 2010. The IC Advisors, in meetings organized by Management, met with a sample of forestry bureaus with a view to obtaining verification of the Company's rights to standing timber in those jurisdictions. The

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not included in the disclosed total of planted plantations of 77,700 Ha. as of December 31, 2010, due to a number of reasons, primarily because these lands had not yet been planted.

<sup>6</sup> These 86,000 Ha. of WFOE purchased plantations are composed of approximately 84,000 Ha. of leases under Mandra and approximately 2,000 Ha. of standing timber under SP.

<sup>7</sup> These 43,000 Ha. of WFOE planted plantations are composed approximately of 31,000 Ha. of leases under SW and approximately 12,000 Ha. of leases under SP.

result of such meetings to date have concluded with the forestry bureaus or related entities having issued new confirmations as to the Company's contractual rights to the Company in respect of 111,177 Ha. as of December 31, 2010<sup>8</sup> and 133,040 Ha. as of March 31, 2011,<sup>9</sup> and have acknowledged the issuance of existing confirmations issued to the Company as to certain rights, among other things, in respect of 113,058 Ha. as of December 31, 2010.<sup>10</sup>

Forestry bureau confirmations are not officially recognized documents and are not issued pursuant to a legislative mandate or, to the knowledge of the IC, a published policy. It appears they were issued at the request of the Company or its Suppliers. The confirmations are not title documents, in the Western sense of that term, although the IC believes they should be viewed as comfort indicating the relevant forestry bureau does not dispute SF's claims to the standing timber to which they relate and might provide comfort in case of disputes. The purchase contracts are the primary evidence of the Company's interest in timber assets.

In the meetings with forestry bureaus, the IC Advisors did not obtain significant insight into the internal authorization or diligence processes undertaken by the forestry bureaus in issuing confirmations and, as reflected elsewhere in the report, the IC did not have visibility into or complete comfort regarding the methods by which those confirmations were obtained. It should be noted that several Suppliers observed that SF was more demanding than other buyers in requiring forestry bureau confirmations.

### **Book Value of Timber**

Based on its review to date, the IC is satisfied that the book value of the BVIs timber assets of \$2.476 billion reflected on its 2010 Financial Statements and of SP WFOE standing timber assets of \$298.6 million reflected in its 2010 Financial Statements reflects the purchase prices for such assets as set out in the BVIs and WFOE standing timber purchase contracts reviewed by the IC Advisors. Further, the purchase prices for such BVIs timber assets have been reconciled to the Company's financial statements based on set-off documentation relating to such contracts that were reviewed by the IC. However, these comments are also subject to the conclusions set out above under "Timber Ownership" on title and other rights to plantation assets.

The IC Advisors reviewed documentation acknowledging the execution of the set-off arrangements between Suppliers, the Company and AIs for the 2006-2010 period. However, the IC Advisors were unable to review any documentation of AIs or Suppliers which independently verified movements of cash in connection with such set-off arrangements between Suppliers, the Company and the AIs used to settle purchase prices paid to Suppliers by AIs on behalf of SF. We

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<sup>8</sup> Composed of 106,446 Ha. of BVI plantations and 4,731 Ha. of WFOE planted plantations, of which 60,707 Ha. were confirmed in the Hunan Forestry Entity #1 Confirmation. This amount is, however, different from the total 60,696 Ha. shown on the confirmation, which appears to arise from an addition error.

<sup>9</sup> Composed of 128,309 Ha. of BVI plantations and 4,731 Ha. of WFOE planted plantations, of which 60,707 Ha. were confirmed in the Hunan Forestry Entity #1 Confirmation. This amount is however different from the total hectare of 60,696 shown on the confirmation, which appears to arise from an addition error.

<sup>10</sup> Composed of 90,905 Ha. of BVI plantations and 22,153 Ha. of WFOE planted plantations.



note also that the independent valuation referred to in the Second Interim Report has not yet been completed.

### **Revenue Reconciliation**

As reported in its First Interim Report, the IC has reconciled reported 2010 total revenue to the sales prices in BVIs timber sales contracts, together with macro customer level data from other businesses. However, the IC was unable to review any documentation of AIs or Suppliers which independently verified movements of cash in connection with set-off arrangements used to settle purchase prices paid, or sale proceeds received by, or on behalf of SF.

### **Relationships**

- **Yuda Wood**: The IC is satisfied that Mr. Huang Ran is not currently an employee of the Company and that Yuda Wood is not a subsidiary of the Company. However, there is evidence suggesting close cooperation (including administrative assistance, possible payment of capital at the time of establishment, joint control of certain of Yuda Wood's RMB bank accounts and the numerous emails indicating coordination of funding and other business activities). Management has explained these arrangements were mechanisms that allowed the Company to monitor its interest in the timber transactions. Further, Huang Ran (a Yuda Wood employee) has an ownership and/or directorship in a number of Suppliers. The IC Advisors have been introduced to persons identified as influential backers of Yuda Wood but were unable to determine the relationships, if any, of such persons with Yuda Wood, the Company or other Suppliers or AIs. Management explanations of a number of Yuda Wood-related emails and answers to E&Y's questions are being reviewed by the IC and may not be capable of independent verification.
- **Other**: The IC's review has identified other situations which require further review. These situations suggest that the Company may have close relationships with certain Suppliers, and certain Suppliers and AIs may have cross-ownership and other relationships with each other. The IC notes that in the interviews conducted by the IC with selected AIs and Suppliers, all such parties represented that they were independent of SF. Management has very recently provided information and analysis intended to explain these situations. The IC is reviewing this material from Management and intends to report its findings in this regard in its final report to the Board. Some of such information and explanations may not be capable of independent verification.
- **Accounting Considerations**: To the extent that any of SF's purchase and sale transactions are with related parties for accounting purposes, the value of these transactions as recorded on the books and records of the Company may be impacted.

### **Cash**

As reported in the IC's First Interim Report, as a precautionary measure, the IC requested that PwC confirm SF's cash balances. PwC did this as of June 13, 2011 for both China accounts and "offshore" accounts. A total of 293 accounts controlled by SF in Hong Kong were confirmed, representing 100% of the expected cash position. There are a very significant number of accounts held by SF in China (in excess of 260) and the logistics and requirements of in-person/in-branch verification in that country led the IC to confirm only a portion of the China accounts (28 accounts, representing approximately 81% of the expected China cash position). The IC was satisfied that SF's expected cash position existed as at the date of the confirmation. The Board should be aware that at the time of the cash confirmation process, SF only updated the details of its cash position quarterly, so the confirmation results must be considered in that context. The IC has instituted certain additional controls over cash movements in excess of \$1 million held in SF Hong Kong bank accounts in order to provide the IC with some precautionary comfort during the examination process. Further, Management has advised that cash balances are now updated on a more frequent basis.

### **BVI Structure**

The BVI structure used by SF to purchase and sell standing timber assets could be challenged by the relevant Chinese authorities as the undertaking of "business activities" within China by foreign companies, which may only be undertaken by entities established within China with the requisite approvals. However, there is no clear definition of what constitutes "business activities" under Chinese law and there are different views among the IC's Chinese counsel and the Company's Chinese counsel as to whether the purchase and sale of timber in China as undertaken by the BVIs could be considered to constitute "business activities" within China. In the event that the relevant Chinese authorities consider the BVIs to be undertaking "business activities" within China, they may be required to cease such activities and could be subject to other regulatory action. As regularization of foreign businesses in China is an ongoing process, the government has in the past tended to allow foreign companies time to restructure their operations in accordance with regulatory requirements (the cost of which is uncertain), rather than enforcing the laws strictly and imposing penalties without notice.

## C. Challenges

Throughout its process, the IC has encountered numerous challenges in its attempts to implement a robust independent process which would yield reliable results. Among those challenges are the following:

(a) Chinese Legal Regime for Forestry:

- national laws and policies appear not yet to be implemented at all local levels;
- in practice, none of the local jurisdictions tested in which BVIs hold standing timber appears to have instituted a government registry and documentation system for the ownership of standing timber as distinct from a government registry system for the ownership of plantation land use rights;
- the registration of plantation land use rights, the issue of Plantation Rights Certificates and the establishment of registries, is incomplete in some jurisdictions based on the information available to the IC;
- as a result, title to standing timber, when not held in conjunction with a land use right, cannot be definitively proven by reference to a government maintained register; and
- Sino-Forest has requested confirmations from forestry bureaus of its acquisition of timber holdings (excluding land leases) as additional evidence of ownership. Certain forestry bureaus and Suppliers have indicated the confirmation was beyond the typical diligence practice in China for acquisition of timber holdings.

(b) Obtaining Information from Third Parties: For a variety of reasons, all of them outside the control of the IC, it is very difficult to obtain information from third parties in China. These reasons include the following:

- many of the third parties from whom the IC wanted information (e.g., AIs, Suppliers and forestry bureaus) are not compellable by the Company or Canadian legal processes;
- third parties appeared to have concerns relating to disclosure of information regarding their operations that could become public or fall into the hands of Chinese government authorities: many third parties explained their reluctance to provide requested documentation and information as being “for tax reasons” but declined to elaborate; and
- awareness of MW allegations, investigations and information gathering by the OSC and other parties, and court proceedings; while not often

explicitly articulated, third parties had an awareness of the controversy surrounding SF and a reluctance to be associated with any of these allegations or drawn into any of these processes.

(c) Small Management Team: The Company has a very small executive management team and it is stretched by:

- demands from the IC, the OSC and E&Y;
- the placement on administrative leave in late August 2011 of certain members of Management by the Company, based upon the advice of BJ. These employees remained available to assist Management upon request on a supervised basis, which further stretched the remaining management;
- the appointment of a new Chief Executive Officer part way through the IC process; and
- the fact that Management is dispersed among Canada, Hong Kong and various parts of China.

(d) Cultural/Language/Geographic Issues:

- vast majority of operational documents are in Chinese;
- most Asia-based Management employees' first language is Chinese;
- business practices in China and the SF business model:
  - rely heavily on personal relationships; and
  - documentation of contractual arrangements is not as comprehensive as would be typical in Western jurisdictions, is often not done until after the transaction is agreed and is frequently incomplete;
- geographic and time distances for the North American-based teams;
- SF's operations in China are widely and remotely geographically dispersed, a number of plantations are close to sensitive border areas and some are accessible only by overland vehicle travel; and
- public records in China are more limited than in Western jurisdictions and are often not complete, accessible, up to date or accurate.

(e) Corporate Governance/Operational Weaknesses: Management has asserted that business in China is based upon relationships. The IC and the IC Advisors have observed this through their efforts to obtain meetings with forestry bureaus, Suppliers and AIs and their other experience in China. The importance of

relationships appears to have resulted in dependence on a relatively small group of Management who are integral to maintaining customer relationships, negotiating and finalizing the purchase and sale of plantation fibre contracts and the settlement of accounts receivable and accounts payable associated with plantation fibre contracts. This concentration of authority or lack of segregation of duties has been previously disclosed by the Company as a control weakness. As a result and as disclosed in the 2010 MD&A, senior Management in their ongoing evaluation of disclosure controls and procedures and internal controls over financial reporting, recognizing the disclosed weakness, determined that the design and controls were ineffective. The Chairman and Chief Financial Officer provided annual and quarterly certifications of their regulatory filings. Related to this weakness the following challenges presented themselves in the examination by the IC and the IC Advisors:

- operational and administration systems that are generally not sophisticated having regard to the size and complexity of the Company's business and in relation to North American practices; including:
  - incomplete or inadequate record creation and retention practices;
  - contracts not maintained in a central location;
  - significant volumes of data maintained across multiple locations on decentralized servers;
  - data on some servers in China appearing to have been deleted on an irregular basis, and there is no back-up system;
  - no integrated accounting system: accounting data is not maintained on a single, consolidated application, which can require extensive manual procedures to produce reports; and
  - a treasury function that was centralized for certain major financial accounts, but was not actively involved in the control or management of numerous local operations bank accounts;
- no internal audit function although there is evidence the Company has undertaken and continues to assess its disclosure controls and procedures and internal controls over financial reporting using senior Management and independent control consultants;
- SF employees conduct Company affairs from time to time using personal devices and non-corporate email addresses which have been observed to be shared across groups of staff and changed on a periodic and organized basis; this complicated and delayed the examination of email data by the IC Advisors; and

- lack of full cooperation/openness in the ICs examination from certain members of Management.
- (f) Complexity, Lack of Visibility into, and Limitations of BVIs Model: The use of AIs and Suppliers as an essential feature of the BVIs standing timber business model contributes to the lack of visibility into title documentation, cash movements and tax liability since cash settlement in respect of the BVIs standing timber transactions takes place outside of the Company's books.
- (g) Cooperation and openess of the Company's executives throughout the process: From the outset, the IC Advisors sought the full cooperation and support of Allen Chan and the executive management team. Initially, the executive management team appeared ill-prepared to address the IC's concerns in an organized fashion and there was perhaps a degree of culture shock as Management adjusted to the IC Advisors' examination. In any event, significant amounts of material information, particularly with respect to the relationship with Yuda Wood, interrelationships between AIs and/or Suppliers, were not provided to the IC Advisors as requested. In late August 2011 on the instructions of the IC, interviews of Management were conducted by the IC Advisors in which documents evidencing these connections were put to the Management for explanation. As a result of these interviews (which were also attended by BJ) the Company placed certain members of Management on administrative leave upon the advice of Company counsel. At the same time the OSC made allegations in the CTO of Management misconduct.

Following the implementation of these administrative leaves and the subsequent appointment of Judson Martin as the new Chief Executive Officer of the company on August 26, 2011, the cooperation received by the IC Advisors from the Company improved significantly. As a result of Mr. Martin's direction, meetings have been arranged and held with Suppliers, AI's and additional forestry bureaus. In addition, as noted above, very recently, Management presented information regarding AIs and Suppliers and relationships among the Company and such parties. The IC is reviewing this material from Management and intends to report its findings in this regard in its final report to the Board.

- (h) Independence of the IC Process: The cooperation and collaboration of the IC with Management (operating under the direction of the new Chief Executive Officer) and with Company counsel in completing certain aspects of the IC's mandate has been noted by the OSC and by E&Y. Both have questioned the degree of independence of the IC from Management as a result of this interaction. The IC has explained the practical impediments to its work in the context of the distinct business culture (and associated issues of privacy) in the forestry sector in China in which the Company operates. Cooperation of third parties in Hong Kong and China, including employees, depends heavily on relationships and trust. As noted above, the Company's placing certain members of Management on administrative leave, as well as the OSC's allegations in the CTO, further hampered the IC's ability to conduct its process. As a result, the work of the IC was frequently done

with the assistance of, or in reliance on, the new Chief Executive Officer and his Management team and Company counsel. Given that Mr. Martin was, in effect, selected by the IC and BJ was appointed in late June 2011, the IC concluded that, while not ideal, this was a practical and appropriate way to proceed in the circumstances. As evidenced by the increased number of scheduled meetings with forestry bureaus, Suppliers and AIs, and, very recently, the delivery to the IC of information regarding AIs and Suppliers and relationships among the Company and such parties, it is acknowledged that Mr. Martin's involvement in the process has been beneficial. It is also acknowledged that in executing his role and assisting the IC he has had to rely on certain of the members of Management who had been placed on administrative leave.

## GLOSSARY

“\$” means, unless otherwise specified, U.S. dollars;

“**2010 AIF**” means the Company’s annual information form for the year ending December 31, 2010;

“**2010 Financial Statements**” means the Company’s audited consolidated financial statements and the notes thereto as at and for the year ended December 31, 2010;

“**2010 MD&A**” means the Company’s management discussion and analysis for the year ending December 31, 2010;

“**AI**” means an authorized intermediary, an entity through which a BVI conducts its sales;

“**BJ**” means Bennett Jones LLP, Canadian counsel to the Company;

“**Board**” means the Board of Directors of SF;

“**BVI**” means a subsidiary of the Company incorporated in the British Virgin Islands;

“**China**” means The People’s Republic of China;

“**Chop**” means the seal typically used in place of signatures in China;

“**Company**” or “**SF**” or “**Sino-Forest**” means Sino-Forest Corporation and, where the context requires, its consolidated subsidiaries;

“**CTO**” means the cease trade order of the OSC dated August 26, 2010;

“**E&Y**” means Ernst & Young LLP, the auditor of the Company;

“**forestry bureau confirmations**” or “**confirmations**” means documents issued to the WFOEs and BVIs on letterheads with forestry bureau names and featuring Chops (the seal typically used in place of signatures) that indicate that they had been issued by the corresponding forestry bureau, but does not include new confirmations;

“**FTI**” means FTI Consulting, a consulting firm advising the Company;

“**Ha.**” means hectares, which is equivalent to 15 mu (statements of Ha. herein are approximate, given the rounding associated with the conversion of mu to Ha.);

“**Hunan Forestry Entity #1 Confirmation**” means the new forestry bureau confirmation issued by Hunan Forestry Entity #1;

“**IC**” means the Independent Committee to the Board;

“**IC Advisors**” means one or more of PwC, Osler, Malleons and JH;



“**IMET**” means an Integrated Market Enforcement Team of the RCMP;

“**JH**” or “**Chinese counsel to the IC**” means Jun He Law Offices, independent Chinese IC counsel;

“**Mallesons**” means Mallesons Stephen Jaques, independent Hong Kong counsel to the IC;

“**Management**” means, at any time, the management of SF at that time;

“**Mandra**” means Mandra Forestry Holdings Limited, a wholly-owned subsidiary of SF;

“**MD&A**” means management discussion and analysis;

“**mu**” means a Chinese unit of measure for area, which is equivalent to 0.067 Ha;

“**Muddy Waters**” or “**MW**” means Muddy Waters, L.L.C.;

“**MW Report**” means the initial “research report” issued by Muddy Waters dated June 2, 2011;

“**OSC**” means Ontario Securities Commission;

“**Osler**” means Osler, Hoskin & Harcourt LLP, independent Canadian counsel to the IC;

“**Plantation Rights Certificate**” means a governmental registered certification of ownership issued by a forestry bureau in China to evidence certain forestry-related rights;

“**PwC**” means PricewaterhouseCoopers LLP, forensic accounting advisors to the IC;

“**RCMP**” means Royal Canadian Mounted Police;

“**RMB**” means Renminbi, the official currency of China;

“**SP**” means Sino-Panel (Asia) Inc. (BVI), a BVI;

“**Supplier**” means a supplier to the Company of plantation assets, either rights to standing timber or plantation/land use rights or both;

“**WFOE**” means a subsidiary of the Company incorporated in China as a “Wholly Foreign Owned Enterprise”; and

“**Yuda Wood**” means Huaihua City Yuda Wood Co. Ltd, a Supplier.

## Appendix B

Summary Cash Flow July 1, 2011 to November 4, 2011 (US\$ in millions)			
<b>Cash Balance as of June 30, 2011<sup>(1)</sup></b>			<b>\$835.8</b>
Less: Scheduled Senior Note Repayment			(87.7)
Less: Scheduled Senior / Convertible Note Interest Payments			(61.6)
Less: Other Offshore Bank Loan Repayments			(35.9)
Less: China Bank Loan Repayments			(29.9)
Less: Operating Cash Flows - China			(36.6)
Less: Operating Cash Flows - Outside China			(12.4)
Less: Professional Fees <sup>(2)</sup>			(24.5)
Plus: New Onshore Bank Loans (China)			24.0
<b>Total Cash Flow July 1, 2011 to November 4, 2011</b>			<b>(264.7)</b>
<i>Cash Flow Excluding Financing Items &amp; Professional Fees</i>			<i>(49.0)</i>
<b>Total Cash Balance as of November 4, 2011</b>			<b>\$571.1</b>
<b>Cash Balance by Geography - November 4, 2011 (US\$ in millions)</b>			
	<b>Restricted<sup>(3)</sup></b>	<b>Unrestricted</b>	<b>Total</b>
China Entities - Accounts in China	\$223.9	\$30.3	\$254.2
China Entities - Offshore Accounts	28.0	15.0	43.1
Hong Kong	83.0	38.6	121.6
Canada	0.0	152.0	152.0
Barbados	0.0	0.1	0.1
<b>Total Cash Balance as of November 4, 2011</b>	<b>\$335.0</b>	<b>\$236.1</b>	<b>\$571.1</b>
<i>Note: Totals may not sum due to rounding</i>			
<i>(1) Total cash balance does not include cash of US\$63.1 million at Greenheart Group Limited as of June 30, 2011</i>			
<i>(2) Primarily related to the Independent Committee investigation</i>			
<i>(3) Restricted balances include funds currently held by SAFE and funds used for cash collateralization of credit facilities</i>			