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This prospectus constitutes a public offering of these securities only in those jurisdictions where they may be lawfully offered for sale and therein only by persons permitted to sell such securities. No securities commission or similar authority in Canada has in any way passed upon the merits of the securities offered hereunder and any representation to the contrary is an offence. The securities qualified by this prospectus have not been and will not be registered under the United States Securities Act of 1933, as amended, and, except in limited circumstances, may not be offered or sold within the United States of America. See "Private Placement and Plan of Distribution". These securities are being issued to holders of Special Warrants of Sino-Forest Corporation in connection with the exercise of such Special Warrants and this prospectus does not constitute an offer to sell or a solicitation of an offer to buy any of these securities in the United States.



Sino-Forest Corporation

New Issue

January 28, 1997

SINO-FOREST CORPORATION

\$30,000,000

24,000,000 Class A Subordinate-Voting Shares

Issuable upon the exercise of 24,000,000 Special Warrants

This prospectus is being filed to qualify 24,000,000 Class A Subordinate-Voting Shares (the "Class A Subordinate-Voting Shares") of Sino-Forest Corporation ("Sino-Forest") to be issued without payment of any additional consideration upon the exercise of 24,000,000 special warrants (the "Special Warrants") previously issued by Sino-Forest. The Special Warrants were sold pursuant to prospectus exemptions under applicable securities legislation (the "Private Placement") pursuant to an agreement dated as of September 17, 1996 entered into by Sino-Forest with First Marathon Securities Limited, CIBC Wood Gundy Securities Inc., GTL Securities Inc. and Sprott Securities Limited (collectively, the "Underwriters") at a price of \$1.25 per Special Warrant. The Special Warrants were issued under a special warrant indenture (the "Special Warrant Indenture") dated as of October 2, 1996 between Sino-Forest and The R-M Trust Company, as warrant agent (the "Special Warrant Agent").

Each Special Warrant entitles the holder thereof to acquire, without payment of any additional consideration, one Class A Subordinate-Voting Share, subject to adjustment in certain circumstances. The Special Warrants may be exercised at any time prior to 5:00 p.m. (local time) on November 2, 1997, after which time they will expire. If a receipt for the (final) prospectus qualifying the Class A Subordinate-Voting Shares has not been

issued by each of the securities regulatory authorities of the provinces of Ontario and Manitoba and of the Northwest Territories prior to 5:00 p.m. (local time) on January 30, 1997, the holders of Special Warrants shall be entitled to receive 1.085 Class A Subordinate-Voting Shares (instead of one Class A Subordinate-Voting Share) in respect of each Special Warrant exercised. If receipts have been issued for the (final) prospectus on or before 5:00 p.m. (local time) on October 2, 1997 (the "Anniversary"), any unexercised Special Warrants will be exercised by the Special Warrant Agent on the fifth business day after the issuance of such receipts on behalf of the holders thereof without any further action on the holders' part. If receipts have not been issued for the (final) prospectus on or before the Anniversary, any unexercised Special Warrants will be exercised by the Special Warrant Agent on the Anniversary on behalf of the holders thereof without any further action on the holders' part. The Special Warrant Agent is holding \$15,000,000 of the proceeds of issue of the Special Warrants in escrow in accordance with the terms of the Special Warrant Indenture. For further terms of the Special Warrants, see "Private Placement and Plan of Distribution".

The price of \$1.25 for the Special Warrants was determined by negotiation between Sino-Forest and the Underwriters. The price of each Special Warrant exceeds the consolidated net tangible book value per Class A Subordinate-Voting Share after giving effect to this issue as at September 30, 1996 by \$0.46, representing a dilution of 36.8%. See "Dilution".

The currently outstanding Class A Subordinate-Voting Shares of Sino-Forest are listed on The Toronto Stock Exchange and trade under the symbol "TRE.A". On August 29, 1996, the trading day immediately preceding the announcement of the offering of the Special Warrants by Sino-Forest, the closing price of the Class A Subordinate-Voting Shares on The Toronto Stock Exchange was \$1.44 per share. On January 27, 1997, the closing price was \$1.45 per share. See "Price Range and Trading Volume of the Class A Subordinate-Voting Shares".

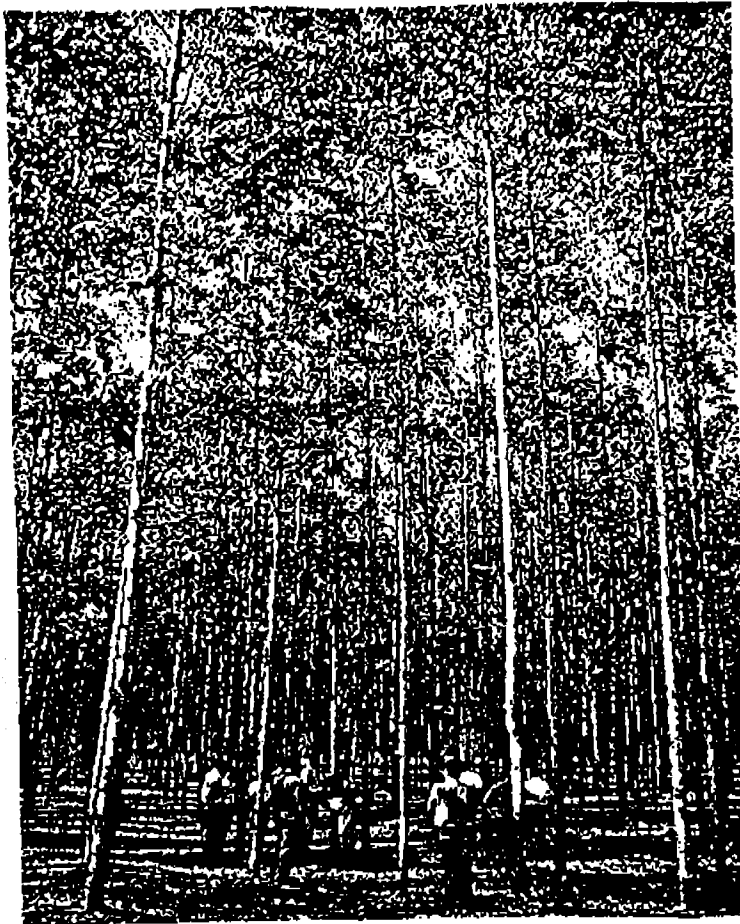
The principal assets of Sino-Forest are its interests in equity and co-operative joint venture enterprises operating in the People's Republic of China. There are certain risks associated with investment in the Class A Subordinate-Voting Shares. See "Enforcement of Civil Liabilities" and "Risk Factors".

	Price to the Public	Underwriters' Commission ⁽¹⁾	Net proceeds to Sino-Forest ⁽²⁾
Per Special Warrant	\$1.25	\$0.08125	\$1.16875
Total Offering	\$30,000,000	\$1,950,000	\$28,050,000

(1) Sino-Forest also granted to certain of the Underwriters broker special warrants to acquire non-assignable compensation options (the "Compensation Options") without payment of any additional consideration. The Compensation Options entitle the holders thereof to purchase an aggregate of 2,400,000 Class A Subordinate-Voting Shares at an exercise price of \$1.44 for each Class A Subordinate-Voting Share, subject to adjustment, at any time on or before October 2, 1998. Compensation Options to purchase up to 1,200,000 Class A Subordinate-Voting Shares are also being qualified for distribution under this prospectus. See "Private Placement and Plan of Distribution".

(2) Before deducting expenses of the issue estimated at \$550,000 which will be paid out of working capital of Sino-Forest.

Certain legal matters relating to the issuance of the Special Warrants and the Class A Subordinate-Voting Shares of Sino-Forest issuable upon the exercise thereof have been and will be passed upon on behalf of Sino-Forest by Aird & Berlis and on behalf of the Underwriters by Osler, Hoskin & Harcourt.



Five year old eucalyptus trees in southern China ready to be harvested.



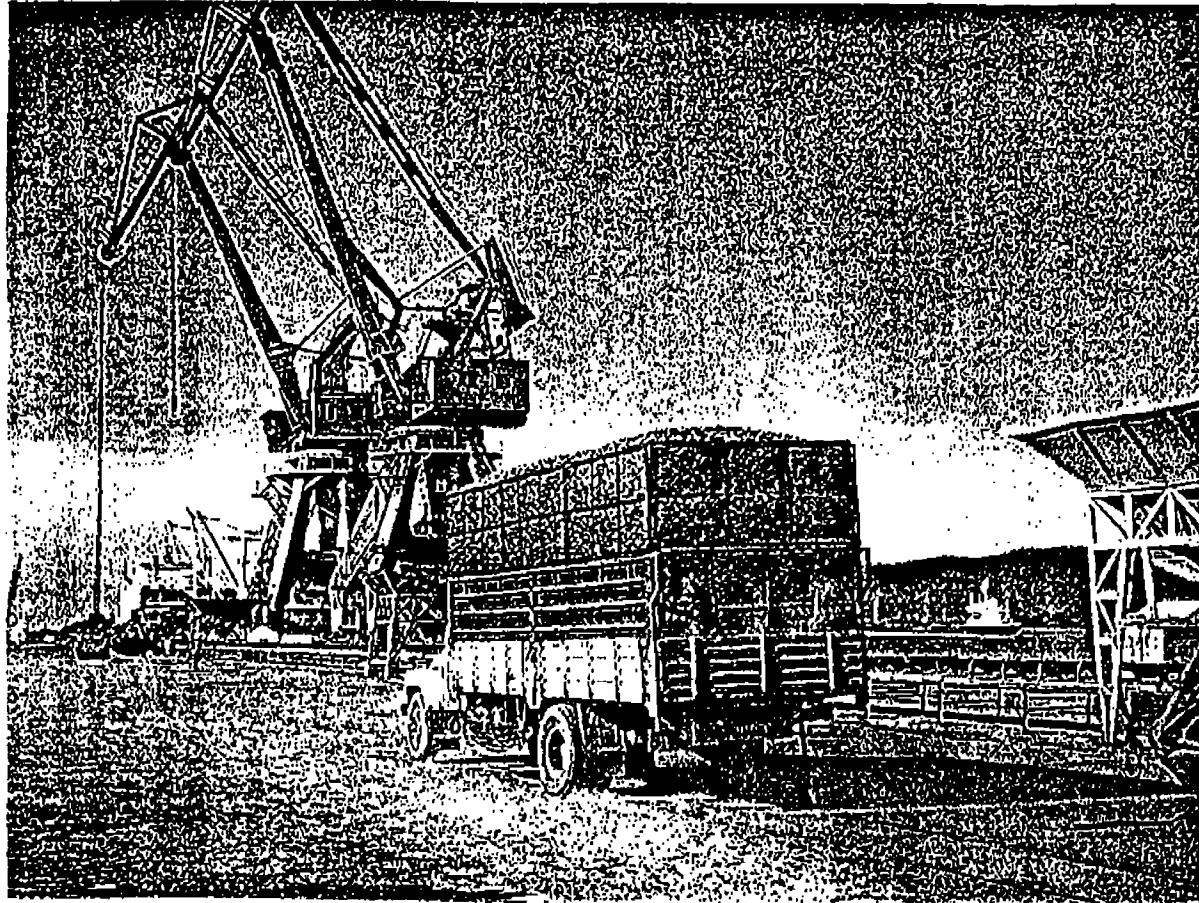
Wood chips produced from eucalyptus trees at the chipping plant.



Wood logs from eucalyptus trees harvested and ready to be chipped.



Wood chips produced from eucalyptus trees at the chipping plant.



Wood chips transported to the port for export to Japan, South Korea and Taiwan.

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GLOSSARY

Terms used in this prospectus are defined below:

"ADS" means ADS Holdings (BVI) Limited;

"Amalgamation" means the amalgamation of Mt. Kearsarge Minerals Inc. and 1028412 Ontario Inc. pursuant to which Sino-Forest was formed;

"ASE" means The Alberta Stock Exchange;

"BDMT" means bone dry metric tonnes;

"Broker Special Warrants" means the broker special warrants granted to certain of the Underwriters in connection with the Private Placement;

"CFETC" means the China Foreign Exchange Trading Centre of the PRC;

"CIETAC" means the China International Economics and Trade Arbitration Commission;

"CIF" means cargo, insurance and freight;

"CJV" means a co-operative joint venture established under CJV Law;

"CJV Agreement" means, with respect to a CJV, the CJV agreement between the Company and the CJV PRC partner;

"CJV Law" means the Law of the PRC on Sino-Foreign Co-operative Joint Ventures and the Detailed Implementing Rules for the Law of the PRC on Sino-Foreign Co-operative Joint Ventures promulgated by the Ministry of Foreign Trade and Economic Cooperation;

"China" or "PRC" means the People's Republic of China;

"Class A Subordinate-Voting Shares" means the Class A Subordinate-Voting Shares of the Company;

"Class B Multiple-Voting Shares" means the Class B Multiple-Voting Shares of the Company;

"Coattail Agreement" means the agreement dated September 11, 1995 between Sino-Forest, The R-M Trust Company and the holders of Class B Multiple-Voting Shares;

"Collectively-Owned Enterprises" means collective enterprises owned by local groups for which the Chinese government is not responsible for wages or similar operations;

"Company" refers to Sino-Forest and its subsidiaries, or any of them, as the context requires;

"Company's Joint Ventures" means the CJVs and the Leizhou EJV and **"Company's Joint Venture"** means one of them (and shall, unless otherwise specified or unless the context otherwise requires, means a CJV);

"Compensation Options" means the compensation options issuable upon the exercise of the Broker Special Warrants;

"cubic meter" equals 0.62 BDMT;

"EJV" means an equity joint venture established under EJV Law;

"EJV Law" means the Law of the PRC on Joint Venture Using Chinese and Foreign Investments and the regulations promulgated thereunder;

"Escrow Agreement" means the escrow agreement dated March 17, 1994 between Sino-Forest and NFL, ADS, FIP, Well Conduct Corporation, Equity Transfer Services Inc. and GTL Securities Inc.;

"Escrowed Funds" means \$15,000,000 of gross proceeds of the Private Placement deposited with the Special Warrant Agent;

"FERT" means the Department of Foreign Economic Relations and Trade;

"FIEs" means foreign-invested enterprises, being enterprises owned by foreign individuals or foreign companies in the PRC;

"FIP" means Forest Investment Partners, Ltd.;

"GDP" means gross domestic product;

"GNP" means gross national product;

"Hectare" means an area equal to 2.47 acres;

"Income Tax Law" means the Income Tax Law of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises promulgated by the NPC and the Detailed Implementing Rules for the Income Tax Law of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises;

"JPA Statistics" has the meaning ascribed thereto under "Wood Fibre Industry";

"Joint Venture" means, unless otherwise specified or unless the context otherwise requires, a CJV;

"Leizhou EJV" means the EJV subsidiary operating the eucalyptus tree plantation Zhanjiang Leizhou Eucalypt Resources Development Company Ltd. in Guangdong Province;

"Leizhou EJV Agreement" means the EJV agreement in respect of the Leizhou EJV;

"LFB" means the Leizhou Forestry Bureau;

"MOFTEC" means Ministry of Foreign Trade and Economic Co-operation in the PRC;

"NFL" means Natural Forest Limited;

"NPC" means the National People's Congress which is the supreme legislative body in China;

"Neilson/Flynn" has the meaning ascribed thereto under "Wood Fibre Industry";

"PBOC" means the People's Bank of China in the PRC;

"phase-in" means the act of accepting and taking control of certain lands for the purpose of management and operations under the terms of a CJV Agreement;

"Plan" means the stock option plan of Sino-Forest;

"Plantation" means a man-made forest which has been planted according to intended specifications, as opposed to a natural forest;

"Plantation Service Contract" means a plantation service contract between the Company's CJV and a Service Company of the PRC;

"PRC" means the People's Republic of China;

"Private Placement" means the private placement of Special Warrants;

"Privately-Owned Enterprises" means businesses operated by private individuals;

"RMB" means Renminbi Yuan, which is the legal currency in China;

"Service Companies" means the plantation service companies which are subsidiaries of the Company's CJV PRC partners;

"Sino-foreign" describes an enterprise in the PRC which has a foreign party holding at least 25% of the shares in the enterprise;

"Sino-Forest" means Sino-Forest Corporation;

"Sino-Wood" means Sino-Wood Partners, Limited, a wholly-owned subsidiary of Sino-Forest;

"Special Warrant Agent" means The R-M Trust Company;

"Special Warrant Indenture" means the special warrant indenture dated as of October 2, 1996 between Sino-Forest and the Special Warrant Agent;

"Special Warrants" means the special warrants issued by Sino-Forest, each of which entitles the holder thereof to acquire one Class A Subordinate-Voting Share, as described under "Private Placement and Plan of Distribution";

"State" means the government of China;

"State-Owned Enterprises" means enterprises wholly-owned by the people of China acting through the Chinese government;

"TSE" means The Toronto Stock Exchange;

"Trustee" means The R-M Trust Company, or any successor trustee appointed pursuant to the Coattail Agreement;

"tonne" means metric ton - 1,000 kilograms or 2,204.6 pounds;

"Underwriting Agreement" means an agreement dated as of September 17, 1996 between Sino-Forest and the Underwriters, as amended;

"Underwriters" means collectively, First Marathon Securities Limited, CIBC Wood Gundy Securities Inc., GTL Securities Inc. and Sprott Securities Limited;

"U.S. Securities Act" means the *United States Securities Act of 1933*, as amended; and

"wood chips" means small pieces of wood used to make pulp which are made from pulp wood harvested specifically for this purpose. Wood chips are generally somewhat uniform in size and are larger and coarser than sawdust.

In this Glossary, unless there is something in the subject matter or context inconsistent therewith, words in the singular shall be construed as if the plural has been used, and vice versa.

ENFORCEMENT OF CIVIL LIABILITIES

Sino-Forest is a Canadian company although substantially all of its assets are held by subsidiaries which are neither Canadian companies nor located in Canada and whose assets are not located in Canada. It may be difficult or not possible for investors to enforce outside of Canada judgments against Sino-Forest obtained in Canada in any actions, including actions predicated upon the civil liability provisions of the securities laws of Canada. In addition, certain directors and/or officers of Sino-Forest are residents of Hong Kong and all or a substantial portion of the assets of such persons are or may be located outside of Canada. As a result, it may be difficult for investors to effect service of process within Canada upon such persons or to enforce against them judgments obtained in Canadian courts, including judgments predicated upon the civil liability provisions of the securities laws of Canada. Sino-Forest has been advised by its Chinese counsel that there is uncertainty as to whether the courts of the PRC would enforce: (i) judgments of Canadian courts obtained against Sino-Forest or such persons predicated upon the civil liability provisions of the securities laws of Canada, and (ii) original actions brought in the PRC, in respect of judgments against Sino-Forest or such persons predicated upon the securities laws of Canada. Sino-Forest has been advised by its Hong Kong counsel that based upon the present law in Hong Kong, the courts of Hong Kong would generally endorse, and entertain original actions brought in Hong Kong in respect of, final judgments made by a superior court in Canada in civil proceedings against Sino-Forest or Canadian residents or those who have submitted to the jurisdiction of the Canadian courts, it being noted however that the law of Hong Kong relating to enforcement of foreign judgments made in Canada may be affected by Hong Kong ceasing to be part of the British Commonwealth and becoming a Special Administrative Region of China as from July 1, 1997. However, Sino-Forest has been advised by its British Virgin Islands counsel that the courts of the British Virgin Islands would generally enforce: (i) judgments of Canadian courts obtained against Sino-Forest or such persons predicated upon the civil liability provisions of the securities laws of Canada, and (ii) original actions brought in the British Virgin Islands in respect of judgments against Sino-Forest or such persons predicated upon the civil liability provisions of the securities laws of Canada.

CURRENCY AND EXCHANGE RATES

Unless otherwise indicated, references in this prospectus to "dollar" or "Cdn.\$" or the use of the symbol "\$" are to Canadian dollars; all references to "U.S. dollars" or "U.S.\$" are to United States dollars; and all references to "Renminbi" or "RMB" are to Renminbi Yuan which is the legal currency of the PRC. Sino-Forest's consolidated financial statements are expressed in U.S. dollars.

SUMMARY OF THE OFFERING

The following summary is qualified in its entirety by the more detailed information and financial statements appearing elsewhere in this prospectus.

The Offering

Offering:	24,000,000 Class A Subordinate-Voting Shares issuable upon the exercise of an equal number of previously issued Special Warrants.
Amount:	\$30,000,000
Price:	Sino-Forest will receive no additional consideration in respect of the exercise of any of the Special Warrants. The Special Warrants were issued at \$1.25 per Special Warrant.
Use of Proceeds:	The net proceeds of the offering of Special Warrants of approximately \$27.5 million will be used as to approximately \$15 million to fund the accelerated phase-in programme of the Company's CJV tree plantations in southern China, as to approximately \$7.5 million for the expansion of chipping plants, and as to approximately \$3.4 million for the expansion of port facilities, and the balance of approximately \$1.6 million will be used as working capital for general corporate purposes. See "Use of Proceeds".
Class A Subordinate-Voting Share Attributes:	Each Class A Subordinate-Voting Share has the same rights as, and is equal in all respects to, each Class B Multiple-Voting Share of Sino-Forest except with respect to voting, dividends and certain rights of conversion. At meetings of the holders of shares (other than separate meetings of the holders of shares of any other class of shares or of any series thereof), each holder of Class A Subordinate-Voting Shares is entitled to one vote for each share and each holder of Class B Multiple-Voting Shares is entitled to five votes per share. The Class A Subordinate-Voting Shares rank in priority to the Class B Multiple-Voting Shares as to the payment of dividends. Also, each holder of Class B Multiple-Voting Shares shall be entitled at any time and from time to time to have all or any part of the Class B Multiple-Voting Shares held converted into Class A Subordinate-Voting Shares on a share-for-share basis. Furthermore, the holders of the Class A Subordinate-Voting Shares are provided with certain rights relating to take-over bids. If a beneficial owner of Class B Multiple-Voting Shares transfers any of such shares to a purchaser who has made an offer for all the outstanding Class B Multiple-Voting Shares and who has not made an identical offer for all or substantially all of the Class A Subordinate-Voting Shares or transfers Class B Multiple-Voting Shares to a purchaser who is not otherwise a permitted transferee, then all of the Class B Multiple-Voting Shares so transferred shall, after notice is sent by the Trustee to the holders thereof, automatically be converted into Class A Subordinate-Voting Shares. A permitted transferee includes a person who at the time of transfer holds Class B Multiple-Voting Shares or a corporation which is wholly-owned, directly or indirectly, by a person who at the time of the transfer holds Class B Multiple-Voting Shares. See "Description of Share Capital - Authorized Capital".

The Company

Sino-Forest is a Canadian company with offices located in Toronto, Hong Kong and the PRC.

Sino-Forest commenced its current operations in 1994 as a result of the acquisition of Sino-Wood, a company incorporated under the laws of Hong Kong. The principal business of Sino-Wood has evolved through several phases and is now the management and operation of, and investment in, tree plantations in the PRC and the production of wood chips which are used to make pulp and engineered wood products. Management believes that the Company is the first, and continues to be the only, foreign-owned producer and exporter of wood chips in the PRC. The Company's current wood chip shipments are produced from eucalyptus trees grown in partnership with the local forestry bureaus or State-Owned Enterprises in the PRC. See "Business of the Company - Business Operations". The Company also has non-controlling interests in the forestry chemical business in the province of Jiangxi and earns commission income on lumber and wood chips trading.

The Company's joint venture tree plantations are all located in southern China where, in management's experience, the hot, humid, tropical and sub-tropical weather and soil conditions provide for short cycles (from planting to harvest) of five years for eucalyptus and aspen and 12 years for pine trees. Through its various existing agreements with several State-owned forestry bureaus, management of the Company expects that it will have, when fully phased-in, 623,000 hectares of tree plantation lands under its management and operation, thereby allowing the Company to produce an expected sustainable annual yield of approximately 4 million BDMT of wood chip fibre. In addition to the existing agreements with forestry bureaus in the provinces of Guangxi, Jiangxi and Guangdong, the Company intends to pursue the negotiation and establishment of CJVs in other neighbouring provinces, although there can be no assurance that it will be successful in doing so.

The table below sets out the provinces in the PRC in which the Company's joint venture plantations are located and the hectareage in each of these provinces when the plantation lands are fully phased-in.

Provinces	Hectares
Guangxi	250,000
Jiangxi	250,000
Guangdong	<u>123,000</u>
	<u>623,000</u>

Since the commencement of operations in 1994, the Company has grown rapidly, with wood chip shipments handled by the Company, as both principal and sales agent, increasing from 156,300 BDMT in 1994 to 336,744 BDMT in 1995. Wood chip shipments for the nine months ended September 30, 1996 were 389,600 BDMT. It is management's experience that wood chip production in the PRC is generally seasonal, with approximately 60% to 70% of the production occurring in the July to December period.

The Company's Joint Ventures' wood chips are currently sold in the export market, primarily to Japan, South Korea and Taiwan, and in the domestic PRC market. Export sales of the Company are all made in U.S. dollars, generally based on contract prices of Australian wood chips sold in Japan as pricing references.

With the proceeds of the offering, management expects that the Company's production will grow significantly over the next few years as a result of the acceleration of the planned annual phase-in of the plantation lands. The Company has phased-in approximately 30,000 hectares of plantations, or approximately 5% of the lands currently under contract. Given its proximity to the marketplace, especially Japan which imports approximately two-thirds of the world supply of pulpwood fibre, the Company believes it has an advantage as a low cost provider to key markets over its competitors in North America, South America and Australia. When all the hectarage of its tree plantations are fully phased-in, management believes that the Company will be a significant provider of wood chip fibre to the Asian market.

Risk Factors

The principal assets of Sino-Forest are its interests in equity and co-operative joint venture enterprises operating in the PRC. There are certain risks associated with investment in the Class A Subordinate-Voting Shares. Certain factors should be considered in evaluating the Company and its business including PRC political and economic considerations, the PRC legal system, PRC environmental considerations, the effect of a failure to make capital contributions, competition, fluctuations in the selling price of wood chips, dependence on key personnel, the limited operating history of the Company's Joint Ventures, joint venture arrangements, concentrated control of the Company, exchange rates, and reliability of information on the PRC. See "Risk Factors".

SUMMARY OF SELECTED FINANCIAL INFORMATION

The following table is a summary of selected consolidated financial information for Sino-Forest for the nine months ended September 30, 1996 and September 30, 1995 and each of the two years ended December 31, 1995 and December 31, 1994:

	Nine Months Ended September 30,		Year Ended December 31,	
	1996	1995 ⁽¹⁾	1995 ⁽¹⁾	1994
	[unaudited]			
<u>Income Statement Data</u>	(all amounts in thousands of U.S. dollars, except per share amounts)			
Revenue	<u>\$18,197</u>	<u>\$20,754</u>	<u>\$27,423</u>	<u>\$20,482</u>
Costs and expenses				
Cost of sales	8,657	11,580	15,191	12,971
Selling, general and administration	1,955	2,228	2,697	1,777
Depreciation, amortization and depletion	<u>556</u>	<u>667</u>	<u>793</u>	<u>1,426</u>
	<u>11,168</u>	<u>14,475</u>	<u>18,681</u>	<u>16,174</u>
Income from operations	7,029	6,279	8,742	4,308
Equity in losses of Jiangxi Investments	(250)	(121)	(262)	--
Interest income (expense)	(159)	22	(6)	58
Other income	--	<u>10</u>	<u>20</u>	<u>52</u>
Income before income taxes	6,620	6,190	8,494	4,418
Provision for income taxes - current	<u>797</u>	--	--	--
Income before non-controlling interests	5,823	6,190	8,494	4,418
Non-controlling interests	<u>(1,327)</u>	<u>(3,390)</u>	<u>(4,140)</u>	<u>(1,408)</u>
Net income for the period	<u>4,496</u>	<u>2,800</u>	<u>4,354</u>	<u>3,010</u>
Earnings per share				
Basic	<u>\$0.11</u>	<u>\$0.08</u>	<u>\$0.12</u>	<u>\$0.10</u>
Fully diluted	<u>\$0.09</u>	<u>\$0.08</u>	<u>\$0.12</u>	<u>\$0.08</u>

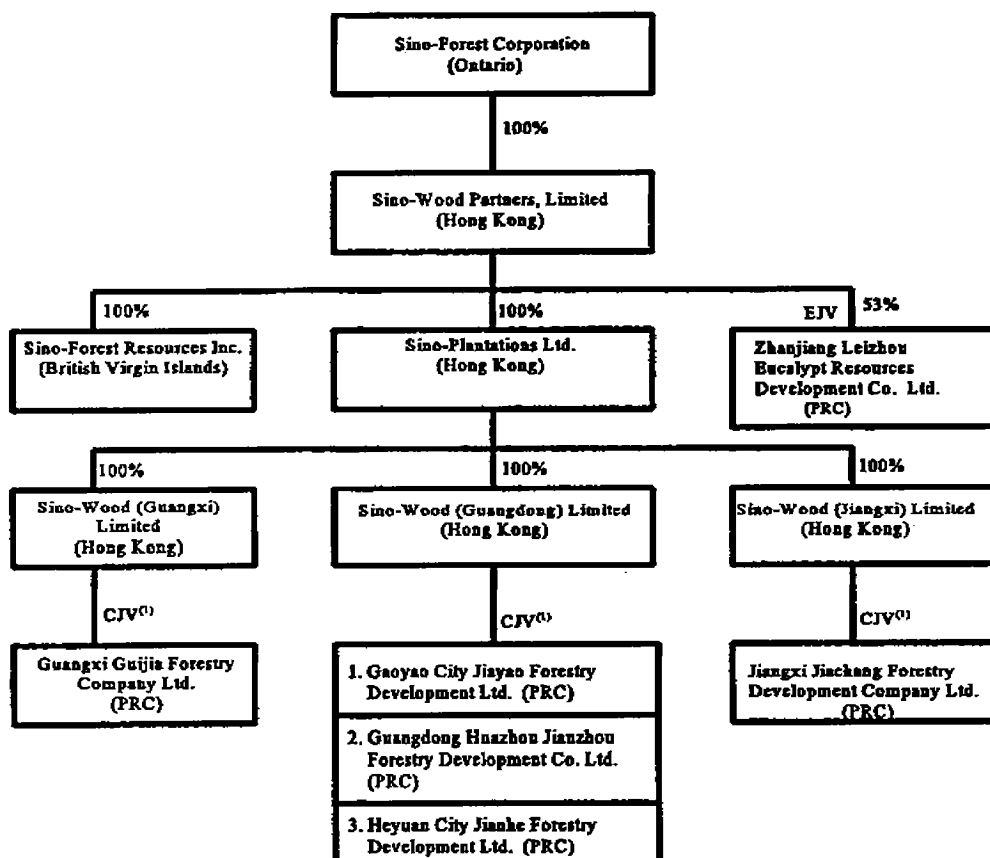
	As at September 30,	As at December 31,	
	1996	1995 ⁽¹⁾	1994
	[unaudited]		
<u>Balance Sheet Data</u>	(all amounts in thousands of U.S. dollars)		
Working capital	4,905	3,613	6,850
Total assets	42,050	31,549	30,610
Non-controlling interests	18,359	17,026	21,112
Shareholders' equity	18,906	13,689	8,482

Note:

(1) Reflects the reduction in equity interest in the chemical and board businesses from 55% to 30% at the end of the second quarter of 1995.

THE COMPANY

The following chart illustrates the corporate relationships between Sino-Forest, its subsidiaries and principal joint venture interests and identifies their respective jurisdictions of incorporation or organization and the appropriate percentage of ownership interest beneficially held by the Company:



(1) The Company has a 70% share in the timber the Company determines to cut in each of these CJVs.

The map below identifies the locations within certain provinces of the PRC in which the Company carries on plantation operations.



Sino-Forest Plantation

Forest Density:



High Density



Medium Density

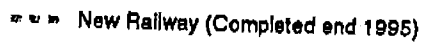


Low Density

Railway Route:



Existing Railway



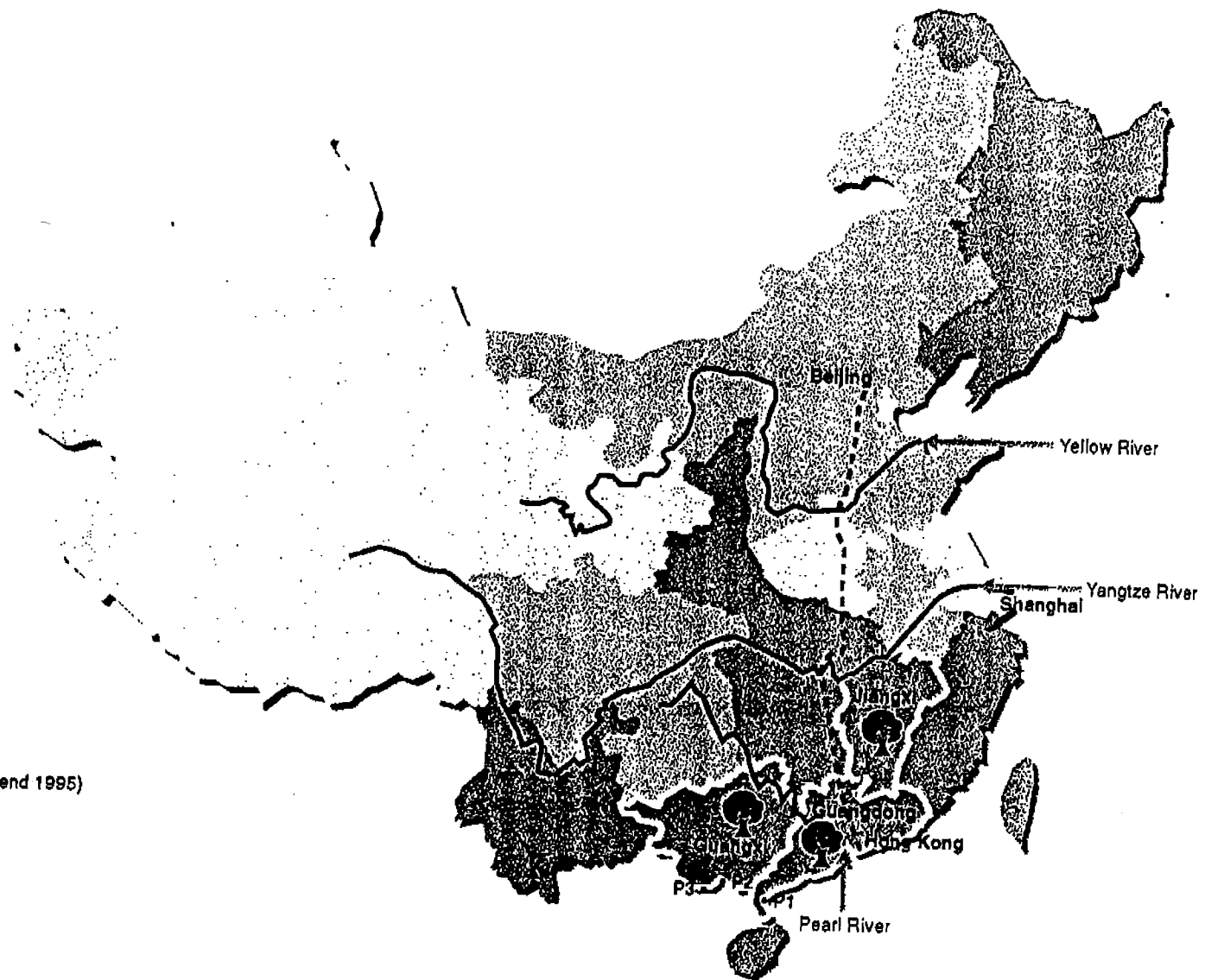
New Railway (Completed end 1995)

Port:

P1: Zhanjiang Port

P2: Qinzhou Port

P3: Fencheng Port



BUSINESS OF THE COMPANY

OVERVIEW

Sino-Forest is a Canadian company with offices located in Toronto, Hong Kong and the PRC.

Sino-Forest commenced its current operations in 1994 as a result of the acquisition of Sino-Wood, a company incorporated under the laws of Hong Kong. The principal business of Sino-Wood has evolved through several phases and is now the management and operation of, and investment in, tree plantations in the PRC and the production of wood chips which are used to make pulp and engineered wood products. Management believes that the Company is the first, and continues to be the only, foreign-owned producer and exporter of wood chips in the PRC. The Company's current wood chip shipments are produced from eucalyptus trees grown in partnership with the local forestry bureaus or State-owned Enterprises in the PRC. See "Business of the Company - Business Operations". The Company also has non-controlling interests in the forestry chemical business in the province of Jiangxi and earns commission income on lumber and wood chips trading.

The Company's joint venture tree plantations are all located in southern China where, in management's experience, the hot, humid, tropical and sub-tropical weather and soil conditions provide for short cycles (from planting to harvest) of five years for eucalyptus and aspen and 12 years for pine trees. Through its various existing agreements with several State-owned forestry bureaus, management of the Company expects that it will have, when fully phased-in, 623,000 hectares of tree plantation lands under its management and operation, thereby allowing the Company to produce an expected sustainable annual yield of approximately 4 million BDMT of wood chip fibre. In addition to the existing agreements with forestry bureaus in the provinces of Guangxi, Jiangxi and Guangdong, the Company intends to pursue the negotiation and establishment of CJVs in other neighbouring provinces, although there can be no assurance that it will be successful in doing so.

The table below sets out the provinces in the PRC in which the Company's joint venture plantations are located and the hectareage in each of these provinces when the plantation lands are fully phased-in.

Provinces	Hectares
Guangxi	250,000
Jiangxi	250,000
Guangdong	<u>123,000</u>
	<u>623,000</u>

Since the commencement of operations in 1994, the Company has grown rapidly, with wood chip shipments handled by the Company, as both principal and sales agent, increasing from 156,300 BDMT in 1994 to 336,744 BDMT in 1995. Wood chip shipments for the nine months ended September 30, 1996 were 389,600 BDMT. It is management's experience that wood chip production in the PRC is generally seasonal, with approximately 60% to 70% of the production occurring in the July to December period.

The Company's Joint Ventures' wood chips are currently sold in the export market, primarily to Japan, South Korea and Taiwan, and in the domestic PRC market. Export sales of the Company are all made in U.S. dollars, generally based on contract prices of Australian wood chips sold in Japan as pricing references.

With the proceeds of the offering, management expects that the Company's production will grow significantly over the next few years as a result of the acceleration of the planned annual phase-in of the plantation

lands. The Company has phased-in approximately 30,000 hectares of plantations, or approximately 5% of the lands currently under contract. Given its proximity to the marketplace, especially Japan which imports approximately two-thirds of the world supply of pulpwood fibre, the Company believes it has an advantage as a low cost provider to key markets over its competitors in North America, South America and Australia. When all the hectareage of its tree plantations are fully phased-in, management believes that the Company will be a significant provider of wood chip fibre to the Asian market.

WOOD FIBRE INDUSTRY

Unless otherwise indicated, the information in this section entitled "Wood Fibre Industry" is derived from "The International Woodchip and Pulplog Trade: Supply and Demand Trends and the Outlook for 1996" prepared by D.A. Neilson & Associates of Rotorua, New Zealand and Robert Flynn & Associates of Tacoma, Washington, U.S.A. (collectively "Neilson/Flynn") dated December 1995; from "1997 Edition of The International Woodchip and Pulplog Trade" by Neilson/Flynn dated January 1997; from the July 1996 edition of "Pulp and Paper International"; and from "Pulp & Paper Statistics 1996" prepared by the Japan Paper Association ("JPA Statistics").

Overview

Wood fibre is a primary raw material used for making paper and paperboard products. Wood fibre is derived from wood chips which are manufactured by shredding or dicing pieces of solid wood into small pieces which are then used to produce pulp through a variety of pulping processes depending on the nature of fibre required and the type of paper being produced.

Pulp characteristics vary significantly depending on the nature of wood fibre used. Northern softwood kraft pulp is a premium pulp recognized for its long wood fibres and the strength it adds to the paper's properties. It is management's experience that softwood species grown, for example, in northern climates, in the United States have growth cycles significantly longer than those being experienced by the Company on its PRC plantations.

Hardwood pulps are manufactured from a number of hardwood species including aspen, eucalyptus and beech and are recognized as being a short fibre pulp which does not impart the same strength in paper as a softwood fibre. Typically, however, hardwood species grow more rapidly and hardwood pulps have become increasingly used as a substitute for more expensive softwood pulps in many paper applications. Hardwood species, in particular eucalyptus, have been used in increasing quantities and this has led to the establishment of fast growing, high yielding hardwood plantations in southern climates. The Company believes that eucalyptus pulp has become well accepted due to the opacity it provides to printing/writing papers as well as the softness it provides in tissues. A major advantage of eucalyptus over softwood species is its efficiency at producing kraft pulp.

Plantation forests have a number of significant advantages over natural forests, including lower access costs and lower harvesting costs, fewer environmental concerns and better fire and disease protection.

The pulp market is international in nature, with large volumes of pulp moving between net-producing regions and net-consuming regions. The wood chip market is similar with different species of wood chips moving in large quantities from forested regions to pulp producing regions. Wood chips are transported short distances by truck and longer distances by ship. Access to port facilities is very important for export shipments, especially in the PRC.

Pulp and Paper Demand

Paper and paperboard production on a global basis drives the demand for wood pulp and wood fibre. While the trend to recycling and the use of non-wood fibre substitutes (such as bagasse) have reduced the percentage of virgin pulp used in the production of paper and paperboard, increasing paper consumption, particularly in the fast-growing Asian markets, will result in significant increases in global pulp requirements.

World pulp, paper and paperboard output continued to grow in 1995 and new record levels were set for the thirteenth consecutive year. After increasing by 6.7% in 1994, the rate of growth in paper and board production slowed to 3.4% in 1995 and is expected to show only marginal growth in 1996.

The United States remained the world's largest producer and consumer of paper and board in 1995 making 29.1% of the world's output. This was marginally down from the 30% recorded for 1994 as its output virtually stagnated at 81 million tons, an increase of just 0.2% over 1994. At approximately 30 million tons, Japan's consumption in 1995 was second to that of the United States.

Several of the world's fastest growing producing countries are in Asia. China produced approximately 2.6 million tons more paper and board in 1995, up from 21.4 million tons to 24 million tons in 1995, while Japan recorded a rise in paper and board production of more than one million tons. Other countries which have boosted production significantly include South Korea, Thailand and Indonesia. The total result was a 7.5% increase in paper and board production in Asia in 1995.

Paper Consumption in Selected Countries, 1995
(thousands of tons)

Country	Consumption	1995/1994 (% change)
USA	87.4	0.7
Japan	30.0	4.1
PRC	26.5	9.1
Canada	6.7	8.8
Germany	15.8	-3.1
Finland	1.6	14.4
Sweden	1.9	12.7
France	9.6	-1.1
Korea, Rep. of	6.6	8.9
Italy	8.1	-0.1
United Kingdom	11.3	-0.6
Brazil	5.4	18.0
CIS	3.6	8.9

Source: Pulp and Paper International, July 1996

In the late 1980's, Japan accounted for 50% of paper and board production in Asia, with an output of approximately 26 million tons. Japan still dominates the region but its share of paper and board production has fallen to approximately 38%, with an output of 29.6 million tons. Meanwhile, industry sources estimate that China has overtaken Japan as Asia's largest pulp producer.

The following chart shows the relative position of the PRC to Japan and certain other countries with respect to paper and board production and pulp production.

The World's Top 10 Paper and Board and Pulp Producers

Paper and Board Production			Pulp Production		
Paper and Board Producer	1995 (thousands of tons)	% change 95/94	Pulp Producer	1995 (thousands of tons)	% change 95/94
1. USA	81,000	0.2	1. USA	59,682	2.0
2. Japan	29,663	4.0	2. Canada	25,388	3.0
3. PRC	24,000	12.2	3. PRC	13,840	10.3
4. Canada	18,705	1.9	4. Japan	11,120	5.1
5. Germany	14,827	2.6	5. Sweden	10,187	0.9
6. Finland	10,942	0.3	6. Finland	10,089	1.3
7. Sweden	9,169	-1.2	7. Brazil	5,909	1.4
8. France	8,615	-0.8	8. CIS	5,220	29.7
9. Korea, Rep. of	6,877	6.9	9. Russia	5,067	29.6
10. Italy	6,802	1.4	10. France	2,819	1.1

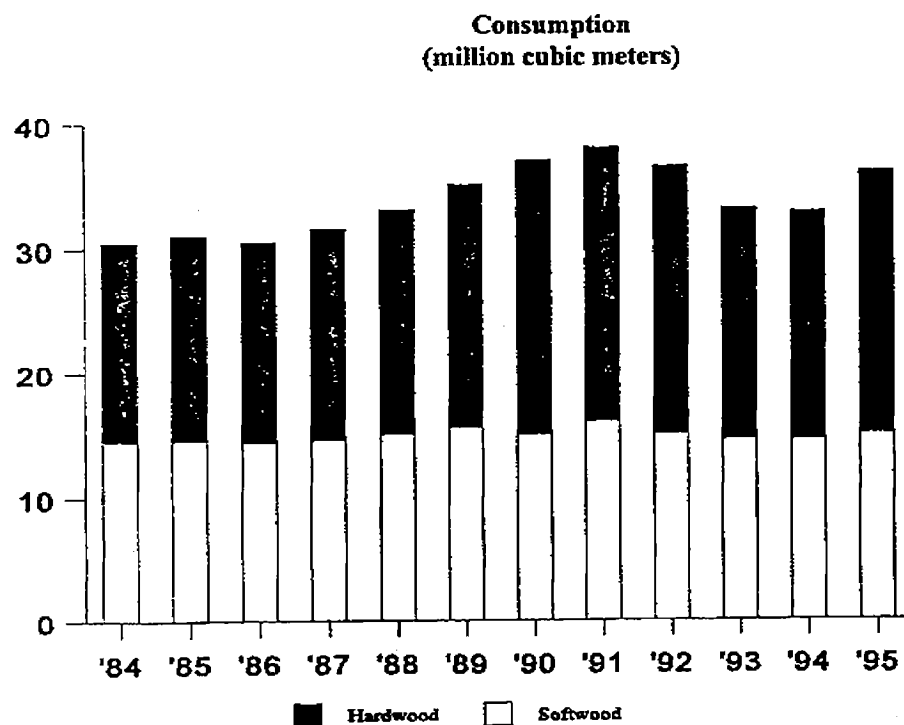
Source: Pulp and Paper International, July 1996

Asian Wood Chip Market

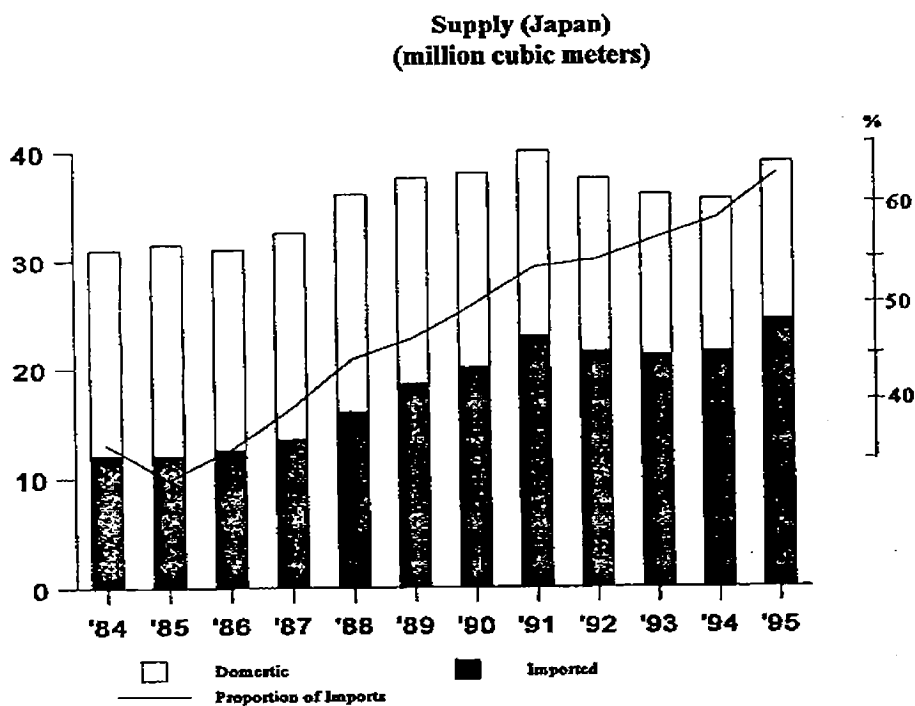
The international wood chip trade continues to be dominated by the Japanese pulp and paper industry. About 80% of world wood chip trade, by volume, is centred on Japan. The Japanese pulp and paper industry has grown substantially over the last 20 years. Japan Paper Association statistics indicate that per capita consumption of paper and board has increased from 119 kilograms in 1975 to 239 kilograms in 1995. The Japanese population has increased from 111 million in 1975 to 125.6 million in 1995. Total paper and board consumption has increased from 13.1 million tonnes in 1975 to 30 million tonnes in 1995.

Total pulpwood consumption in Japan has actually decreased from 38.1 million cubic meters to 35.5 million cubic meters from 1990 to 1994, largely due to the depressed state of the industry in the early 1990's, and the increase in recycled fibre used. However, the industry has been picking up again, as pulpwood consumption in Japan has increased to 37.2 million cubic meters in 1995. Details of pulpwood consumption and supply are summarized below.

Trends in Pulpwood Supply and Demand at Pulp Mills (Japan)



Source: Ministry of International Trade and Industry found in the JPA Statistics



Source: Ministry of International Trade and Industry found in the JPA Statistics

Pulpwood Supply and Consumption (Japan)
(in thousand cubic meters)

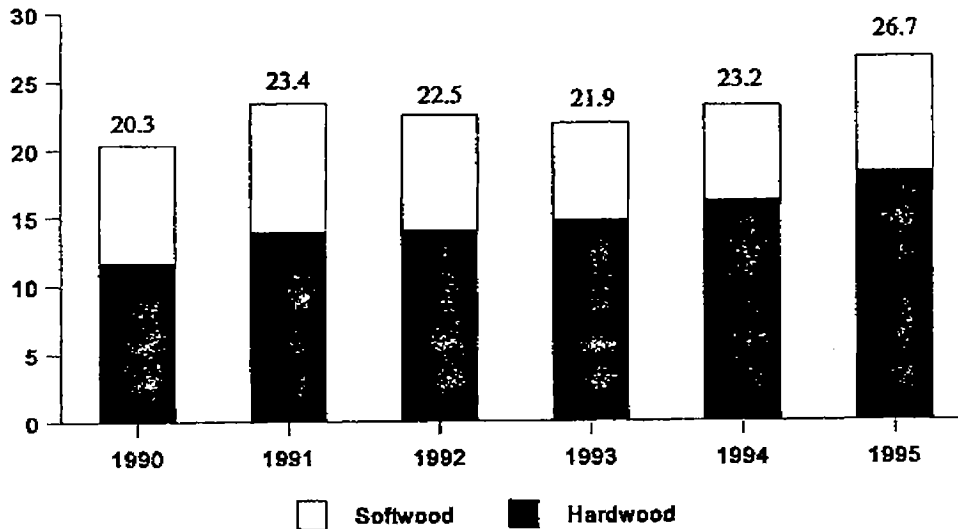
Year	Total Supply							Consumption		
	Domestic supply			Imports			GRAND TOTAL	Softwood	Hardwood	TOTAL
	Softwood	Hardwood	Total	Softwood	Hardwood	Total				
1989	9,095	9,355	18,450	8,608	10,068	18,676	37,126	17,527	19,314	36,841
1990	9,015	8,950	17,964	8,605	11,378	19,983	37,947	17,767	20,373	38,140
1991	9,006	8,182	17,188	9,194	13,378	22,572	39,760	17,923	21,333	39,256
1992	8,700	7,225	15,925	8,017	13,258	21,275	37,200	16,789	20,633	37,422
1993	8,353	6,130	14,483	7,098	13,943	21,041	35,524	15,621	19,939	35,560
1994	8,536	4,842	13,378	6,718	15,056	21,774	35,151	15,449	20,126	35,574
1995	9,010	4,368	13,377	7,333	17,146	24,479	37,856	15,828	21,332	37,159

Source: Ministry of International Trade and Industry found in the JPA Statistics

The composition of Japanese pulpwood imports continues to change. Hardwood pulpwood imports increased from 10.1 million cubic meters in 1989 to 17.1 million cubic meters in 1995. Softwood pulpwood imports decreased from 8.6 million cubic meters to 7.3 million cubic meters over the same period. This drop reflects, among other things: the substitution of hardwood for softwood; a rise in the processing of imported softwood logs which generates low cost 'domestic' softwood chips; a major increase in recovered paper use, most of which has been softwood fibre based, and so has replaced virgin fibre; and the faster growth in demand for printing and writing papers (hardwood based) compared with packaging paper and newspapers (softwood based).

Softwood pulpwood imports have decreased from 48% of total softwood pulpwood consumption in 1990 to 45% in 1993, and to 43% in 1994, but increased to 46% in 1995. By contrast, hardwood imports have increased from 56% of hardwood pulpwood consumption in 1990 to 70% in 1993, to 75% in 1994, and to 80% in 1995.

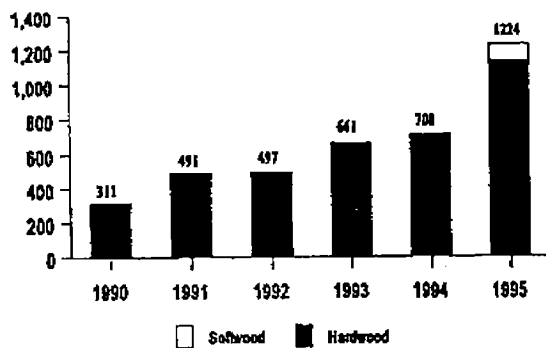
Japanese Hardwood and Softwood Chip Imports (million cubic meters)



Source: Ministry of Finance as reported by Neilson/Flynn

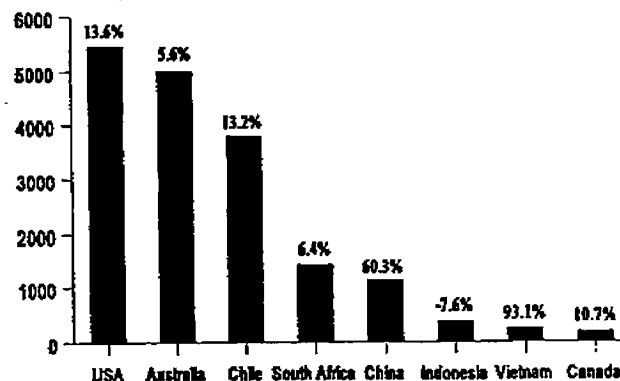
Hardwood chip import demand increased from 1994 to 1995 by 13.3% to 18.4 million cubic meters. The Australian natural forest hardwood resource continued to be the major hardwood chip supply source for the Japanese industry, with approximately 5 million cubic meters imported in 1995, being 27.3% of the total. Chile and South Africa were the third and fourth largest exporters in 1995, respectively, to Japan followed by China which had the largest percentage increase, 60.3% among the top five largest exporters to Japan, as shown on the chart below.

Japanese Chip Imports from China (Thousand cubic meters)



Source: Ministry of Finance as reported by Neilson/Flynn

1995 Japanese Hardwood Chip Imports (Thousand cubic meters)



Note: Percentage increase/decrease versus 1994

Source: Ministry of Finance as reported by Neilson/Flynn

China and the Pulp and Paper Market

There are an estimated 6,000 paper mills in China. About 1,600 are owned by the Department of Light Industry, with a production of 9 million tonnes in 1994. The other 4,400 are primarily village and town enterprises, and produced a reported 12.4 million tonnes in 1994.

As set forth below, paper and board consumption has continued to increase at an average rate per year of 16.4% from 1990 to 1995 and 8.6% in 1995, as both population growth and per capita consumption increases have spurred demand.

China Paper and Board Consumption, 1990-1995
(Million metric tonnes unless otherwise noted)

	1990	1991	1992	1993	1994	1995
Total Pulp & Paper Production	13.7	14.8	17.2	18.7	21.4	24.0
Total Pulp & Paper Consumption	14.5	16.0	19.4	20.9	24.3	26.4
Per Capita Consumption (kg)	12.7	13.8	16.6	17.2	20.2	21.9

Source: Asian Pulp and Paper as reported by Neilson/Flynn

The increase in the production of paper and board has been lagging consumption increases and the shortfall has been made up with increased imports reaching 3.6 million tonnes in 1995 as reported by China Custom Statistics (1995).

Chinese paper and board consumption in 1995 was 26.4 million tonnes. The official projection of the Chinese paper industry for consumption in 2000 is 27 million tonnes, but growth in the last few years has likely rendered this estimate as being too conservative.

Management of the Company believes that another factor affecting the paper industry in China is the conversion from non-wood pulps to traditional wood pulp. According to The International Woodchip and Pulplog Trade: Supply and Demand Trends and the Outlook for 1996, dated December 1995, wheat, rice, straw, reed bagasse and bamboo are the staple fibres used in papermaking and pulp made from wood fibre represented about 12% of the total raw material used in the industry. Major cost, environmental and quality problems have arisen from the high use of non-wood fibre pulps and Chinese paper industry sources estimate that woodpulp will provide 18% of the fibre produced by 2000. This would require 20 million cubic meters of pulpwood, almost three times the current usage.

BUSINESS STRATEGY

The Company's original business plan comprised three integrated strategies: plantation and wood chip production; forestry products trading; and forestry chemicals and boards. Based on the success of its original eucalyptus plantation investment in the Leizhou EJV in 1994, the Company focused its efforts on expanding rapidly in the management and operation of, and investment in, tree plantations in the PRC and the production of wood chips, while at the same time reducing its involvement in the forestry and board chemical businesses. To facilitate this growth, the Company entered into five new co-operative joint venture arrangements with local forestry bureaus

in three of the southern provinces in the PRC. This new plantation land, when fully phased-in to the joint ventures, is expected to provide the Company with a total plantation hectareage of 623,000 hectares, thereby allowing the Company to produce an expected estimated sustainable annual yield of approximately 4 million BDMT of eucalyptus, aspen and pine chips. See "Business of the Company - Business Operations".

The Company's expansion and operating strategy has been predicated on several key components. The Company has identified existing plantation land which management believes is well-serviced with regards to infrastructure. The plantations are located in southern China, which offers hot, humid, tropical and sub-tropical climatic conditions which provide for short cycles (from planting to harvesting) for eucalyptus, aspen and pine trees. The areas covered by the Company's Joint Ventures have close access to deep water ports, which facilitates low cost transportation to the Japanese, South Korean and Taiwanese markets. Pursuing plantation areas which are accessible to the coast helps the Company to maintain its low cost position and facilitates the export of wood chips.

Management believes that the Company is the first, and continues to be the only, foreign-owned producer and exporter of wood chips in the PRC. As a result of structuring its investments in the Company's Joint Ventures on a basis which provides enhanced employment opportunities for the local residents and economic benefits for the local forestry bureaus, management believes the Company is well-positioned to maintain its leading position going forward.

BUSINESS OPERATIONS

(i) Products

The Company is principally engaged in growing hardwood (eucalyptus and aspen) and softwood (pine) trees on the Company's Joint Venture plantations in southern China. Wood chips, the principal product of the Company, are produced from these trees when harvested. Wood fibre from these wood chips is the major raw material used for global paper and board production. Wood fibre represents about 60% (based on 1994 estimates) of the total fibre requirement for paper production, although recycled paper is an increasingly important component. Other materials include non-wood fibres and fillers. Wood chips are also used as feedstock for oriented strand board and medium-density fibreboard. Currently, other than producing wood chips from the Company's Joint Ventures' eucalyptus trees, the Company also acts as sales agent for wood chips from its Guangxi CJV PRC partner to meet customers' demands. As more of the plantation lands are phased-in by the CJVs, the Company expects to be able to produce sufficient wood chips to meet demand without having to purchase chips from its partners in the Company's Joint Ventures, thus providing the Company with a higher profit margin.

In management's experience, the specifications and characteristics of the different kinds of tree species currently expected to be grown on the 623,000 hectares of plantation lands available to be phased-in by the Company's Joint Ventures, as well as the anticipated costs of the plantation program to be incurred by the Company over the plantation cycle, are as follows:

Species	Eucalyptus	Aspen	China Southern Pine
Plantation cycle	5 years	5 years	12 years
Cost of plantation program (U.S.\$ per hectare)	767	1,005	704
Standing timber yield per hectare per cycle	90 m ³	128 m ³	135 m ³
Annual growth rate per year	18 m ³	25.6 m ³	11.25 m ³
Wood chip yield per hectare per cycle	40.2 BDMT	42 BDMT	52 BDMT

(ii) Sales and Marketing

The Company's wood chips are sold domestically in the PRC and are also sold to export markets, principally in Japan, South Korea and Taiwan. Export sales are all made in U.S. dollars. Wood chip shipments of BDMT for the nine months ended September 30, 1996 and for fiscal 1995 and 1994 are provided below:

Market	September 30 1996	December 31 1995	1994
(in thousands of BDMT)			
Export	260	291	156
PRC	<u>130</u>	<u>46</u>	<u>-</u>
Total	<u>390</u>	<u>337</u>	<u>156</u>

The Company sets prices for its products without government control and adjusts its prices in response to market conditions. Management believes that its eucalyptus wood chips are sold at prices competitive with those major suppliers with which it competes. The price of eucalyptus wood chips in Asia is generally determined by the Australian export price because Australia is one of the world's largest suppliers of natural forest eucalyptus wood chips. Prices for hardwood chips and softwood chips in Asia also vary based on the country to which they are sold. It is the Company's experience that prices obtained in Japan are greater than those obtained in Taiwan and South Korea, with Taiwan generally commanding the lowest prices of these three countries. Management of the Company believes that selling prices obtained in the PRC market have generally been more favourable than those in the export market as a result of the rising demand for fibre due to the large population and increasing literacy rates in China. The average selling price of wood chips sold through the Leizhou EJV for the nine months ended September 30, 1996 was U.S.\$86 per BDMT compared to U.S.\$102 per BDMT attained in fiscal 1995. This decrease in the average selling price of wood chips is attributable primarily to a substantial increase in shipments for the nine months ended September 30, 1996 to Taiwan by the Leizhou EJV. There were more shipments to Taiwan in the first three quarters of 1996 compared to the same period in 1995, as the Company believes that demand from Japan has softened due to what the Company understands to be the high inventory buildup which occurred in the second half of 1995 and early 1996. The average selling price of wood chips sold by the Company's Guangxi CJV joint venture partner with the Company acting as a sales agent for the nine months ended September 30, 1996 was U.S.\$103 per BDMT. This higher average selling price was achieved since most of these shipments were to the PRC, which tends to command better prices than export sales to Taiwan. The Company earned commission income of approximately U.S.\$3,202,000 for the nine months ended September 30, 1996 as sales agent on these shipments made by its Guangxi CJV PRC partner.

The Company typically enters into arrangements with terms of 6-12 months pursuant to which the Company is required to provide, and the purchaser is required to purchase, specified amounts of wood chips. Under the arrangements, letters of credit are generally required to be posted for payment. Currently, the Company's Joint Venture PRC partners have entered into contracts governing these arrangements. It is the Company's intention that, when it takes over the sales and marketing functions from its joint venture PRC partners, it may enter into sales contracts with customers directly. The Company expects that it will be able to do so once it has put in place the facilities for the establishment of letters of credit, which the Company expects will occur in early 1997. Due to the importance of delivering wood chips within a certain time after timber is chipped, so that they maintain their relative freshness, the Company typically maintains about a week of inventory at the CJVs and port locations at any time. The Company negotiates its selling prices for the export market twice a year due to exchange rate fluctuations and current local market rates. Selling prices for the PRC market are usually also determined on a contractual basis twice a year.

Wood chips produced by the Leizhou EJV are sold in the export market by the Company's joint venture partner under an arrangement that was established in 1994. It is the intention of the Company to carry out the sales and marketing function of the Leizhou EJV by the Company's own sales force in 1997.

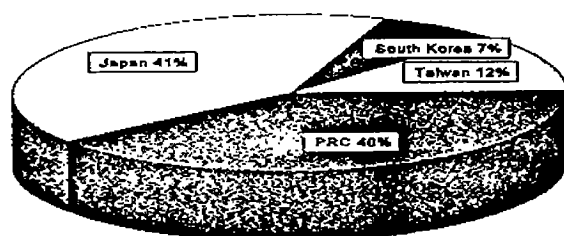
The U.S.\$12,177,000 due from the Leizhou EJV joint venture partner as at September 30, 1996 represents cash collected from the sale of wood chips by the Leizhou EJV joint venture partner on behalf of the Leizhou EJV. As originally agreed by the Company, the cash is being retained by the Leizhou EJV joint venture partner to fund the ongoing plantation costs of the Leizhou EJV. At the end of 1995, the Company commenced discussions with the Leizhou EJV joint venture partner for the repayment of some or all of the amount due by early 1997. The Leizhou EJV joint venture partner has incurred planting and maintenance costs on behalf of the Leizhou EJV which could be applied against part of the amount due to the Company. In addition, the balance could be used to offset the required remaining capital contribution of U.S.\$4,300,000 owing to the Leizhou EJV by the Company, or be repaid to the Company.

Marketing of wood chips produced by the CJVs is administered by the Company's sales force based in the PRC and Hong Kong. Management believes that demand for wood chips in the PRC has historically exceeded, and continues to exceed, production capacity. This has allowed the Company to obtain a higher price on its product in the local market compared to export sales. Sales in the PRC are made to local pulp and paper manufacturers by direct and frequent visits. The Company has not encountered serious competitive pressure within the PRC, where the demand for wood chips exceeds the supply.

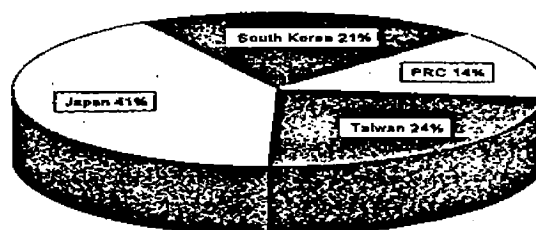
Total export shipments (including those from the Leizhou EJV) estimated for 1996 account for approximately 60% of the total estimated wood chip shipments of the Company. Export shipments for the nine months ended September 30, 1996 represent 66.7% of total shipments. Of the 259,574 BDMT in total export sales of wood chips by the Leizhou EJV and the Guangxi CJV for the nine months ended September 30, 1996, approximately 60% were to Japan which is the world's largest importer of wood chips. Sales to Japan by the Company are made to the trading houses, which has historically been the manner in which wood chips are sold in the Japanese market, rather than directly to the end users. It is the Company's experience that this practice appears to be changing recently as some end users are beginning to source their wood chips directly from the suppliers. The Company is currently engaging in marketing and business development activities with end users in Japan to develop relationships so that it may also be able to sell directly to such customers in the future.

The following diagram illustrates management's expectations of the Company's shipments for 1996 compared to that for 1995:

Estimated 1996 Shipments



1995 Shipments



Management expects that as the Company develops significant wood fibre resources over the next few years as a result of the planned phase-in of its plantation lands, it will also be developing a marketing strategy to become a preferred supplier of wood fibre to pulp and paper manufacturers in Asia. Part of its marketing strategy will include inviting its customers to visit its plantations and operations, regular meetings with customers at the customers' plants to determine their specific needs and requirements, providing technical support and after-sales service and specific targeting of new customers.

(iii) Chipping Facilities

The Company's Leizhou EJV operates a three-line chipping plant with an annual capacity of approximately 250,000 tonnes of wood chips. The plant is located approximately 50 km from the Leizhou EJV plantation and approximately 80 km from the Zhanjiang port. Zhanjiang port is one of the ports that the Company uses to export its wood chips to Japan, South Korea and Taiwan. All of the Company's eucalyptus trees harvested in the Leizhou EJV are chipped in this facility. The wood chips produced in this facility are generally stored in the plant for no more than one week before being transported by trucks to the Zhanjiang port for export.

It is the Company's intention to use approximately \$7.5 million of the proceeds from this offering to fund the acquisition or expansion of chipping plants in existing or future provinces in which the Company operates. The Company expects that these additional chipping plants, which are expected to be completed by the end of 1997, will provide it with an additional annual capacity of approximately 1.3 million BDMT of wood chips. These additional chipping plants are to be located in close proximity to ports and the Company's Joint Venture plantations.

(iv) Fibre Supply and Process

The Company currently produces its wood chips from two sources of supply: (1) standing timber purchased from the local forestry bureaus and (2) timber grown on the Leizhou EJV's eucalyptus plantations. As the trees planted by the CJVs on the CJV plantation lands mature and are harvested, 70% of the timber from these trees will be owned by the Company and will provide the bulk of the sustainable fibre base utilized by the Company to produce chips.

The Company currently manages and operates 20,000 hectares of tree plantation lands in the Leizhou EJV. The Company has phased-in approximately 30,000 hectares (including the 20,000 hectares from the Leizhou EJV), or approximately 5% of the lands currently under contract. Under the CJV Agreements, the CJV PRC partners are

required to contribute up to 603,000 hectares of tree plantation lands, subject to the Company's determination that such lands are acceptable. Once the Company determines that specified lands are acceptable and it takes control thereof for the purposes of its management and operations under the terms of the relevant CJV Agreement, such lands are considered to be "phased-in".

Standing Timber from the Local Forestry Bureaus

The Company believes that the eucalyptus, aspen and pine plantations anticipated to be phased-in by the CJVs will be comprised of (i) lands on which there are mature trees aged five years or more and which are ready for harvesting; (ii) lands on which there are trees which are between one to five years old; and (iii) bare land which is available for the planting of new trees.

To generate cash flow to fund ongoing planting and maintenance costs, it is the Company's strategy, in the early stages of its operations, to phase-in plantation lands which, immediately prior to the phase-in, have mature trees ready for harvesting. The Company may then purchase the timber from these mature trees from the forestry bureaus at wholesale prices and sell the wood chips produced from the trees at a profit to customers in the PRC or in the export market. After the harvesting of these mature trees planted by the forestry bureaus, the bare lands are then phased-in to the CJVs. It is only after any existing crop has been harvested that bare lands may be phased-in to the CJV. Under the arrangements relating to the existing CJVs, the trees replanted on the phased-in plantation lands are then owned and managed by the CJVs, with 70% of the resulting harvested trees ultimately being owned by the Company and 30% being owned by the Company's Joint Venture PRC partner. When the Company takes possession of its share of the harvested trees, it is able to sell the resulting wood chips in either the domestic or export market. See "Business Operations - Sales and Marketing".

Due to cash flow constraints in 1996, the Company earned commission income for the first nine months of 1996 of approximately U.S.\$3,202,000 from wood chips trading on behalf of its CJV PRC partner rather than purchasing the standing timber. With the proceeds of the offering, the Company expects that future chip shipments from the CJV will be purchased and sold by the Company as principal rather than on an agency basis, thereby providing the Company with a higher margin.

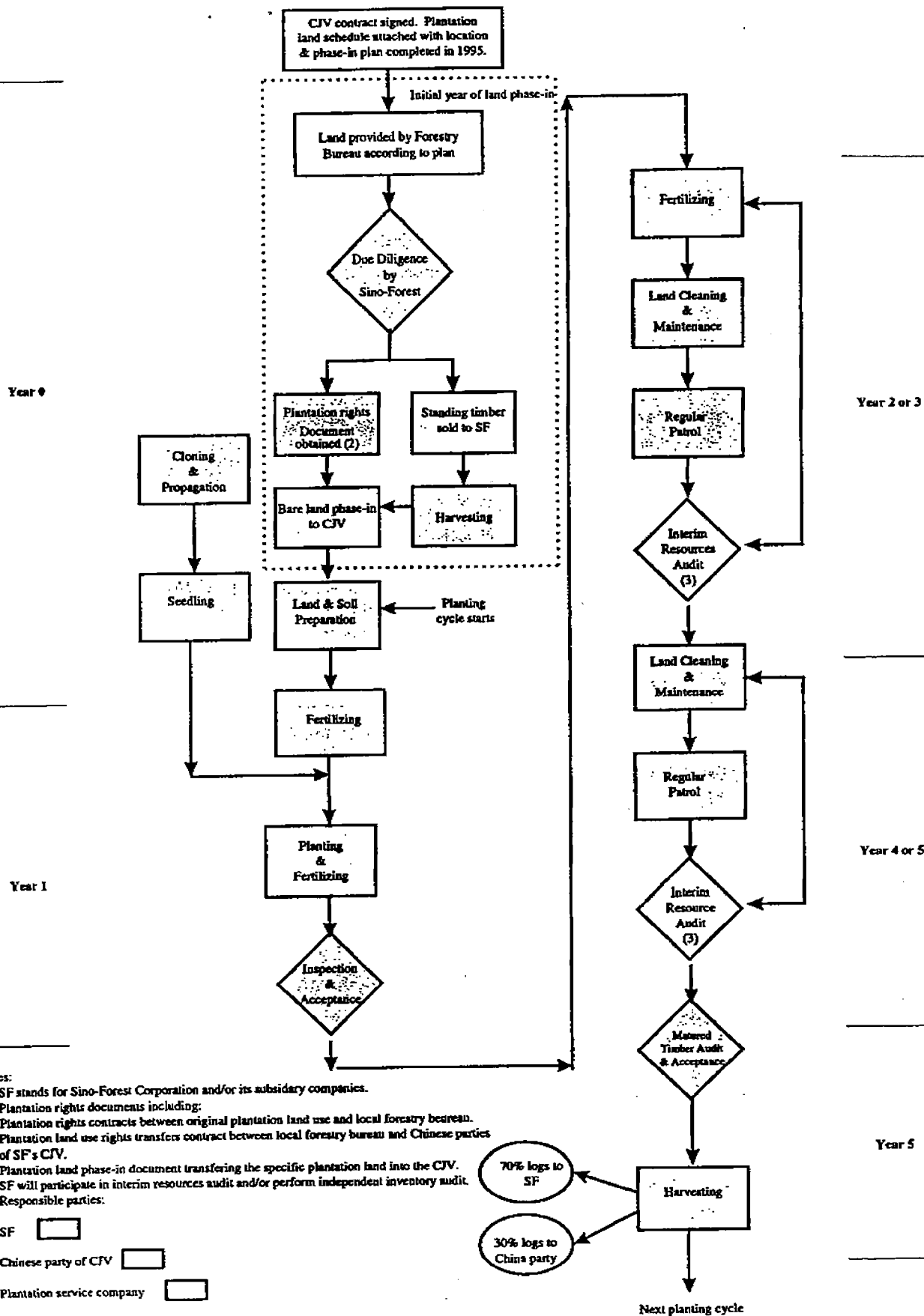
Timber from the Leizhou EJV Plantation

The Leizhou EJV operates 20,000 hectares of eucalyptus tree plantation. The eucalyptus tree plantation of the Leizhou EJV is located on the Zhanjiang Leizhou peninsula in Guangdong Province. This plantation supports crops of eucalyptus trees which in management's experience have a cycle (from planting to harvesting) of approximately five years and which are specifically genetically engineered for the soil and semi-tropical climate conditions of southern China. In 1994 and 1995, there were approximately 156,300 BDMT and 204,200 BDMT, respectively, of eucalyptus wood chips produced by the Leizhou EJV. In 1996, the Company expects to maintain its production volume from the Leizhou EJV plantation at approximately 200,000 BDMT.

Planting, Maintenance and Harvesting - CJV Plantations

The diagram below sets out the plantation phase-in, planting, maintenance and harvesting procedures of the Company. The diagram also sets out the responsibilities of each CJV party over the 5-year growth cycle for eucalyptus plantation.

Plantation Phase-in, Planting & Harvesting Flow Chart



Location and Hectarage of Plantations

The Company's Joint Venture plantations are all located in southern China as set out in the table below:

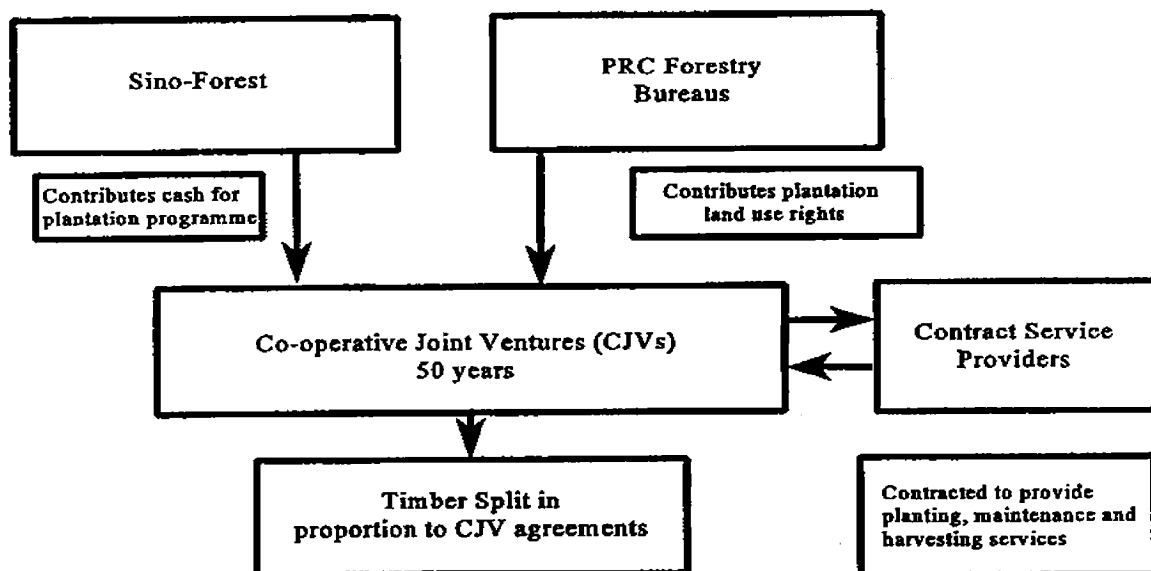
Names of Joint Ventures	Name of Joint Venture Partners	Province	Term	Hectares
Guangxi Guijia Forestry Company Ltd.	Guangxi Forestry Development Centre	Guangxi	50 years	250,000
Jiangxi Jiachang Forestry Development Company Ltd.	Jiangxi Forestry Economic & Technology Development Co.	Jiangxi	50 years	250,000
Gaoyao City Jiayao Forestry Development Ltd.	Gaoyao City Forestry Trading Development Co.	Guangdong	50 years	33,000
Guangdong Huazhou Jiazhou Forestry Development Co. Ltd.	Guangdong Huazhou Forestry Enterprise Co.	Guangdong	50 years	20,000
Heyuan City Jianhe Forestry Development Ltd.	Heyuan City Forestry Services Ltd.	Guangdong	50 years	50,000
Zhanjiang Leizhou Eucalypt Resources Development Company Ltd.	Leizhou Forestry Bureau	Guangdong	30 years	<u>20,000</u>
TOTAL				<u>623,000</u>

- (1) See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Capital Contribution Commitments" for capital contribution requirements and "Business Operations - Fibre Supply and Process" for the stage of development of the joint ventures.

Other than Zhanjiang Leizhou Eucalypt Resources Development Company Ltd., being the Leizhou EJV in which the Company has a 53% equity interest, all of the other forestry joint ventures of the Company are CJVs in respect of which the Company is entitled to a 70% share in the volume of timber the Company determines to cut.

Structure of the CJVs

The following chart illustrates the structure of the Company's CJVs:



The term of each CJV is 50 years, subject to extension upon a proposal by the unanimous consent of the board of directors of the CJV and approval of the original examining authority. The CJV may also be terminated under certain circumstances, such as the occurrence of heavy losses in production and the CJV being unable to continue its operations, the failure of a party to perform its obligations such that the CJV is unable to continue its operations, and the CJV conducting its business in violation of the laws of China and the relevant authorities terminating its operations. Upon termination, all land use rights will cease and the CJV shall be liquidated and the remaining assets after liquidation of the CJV shall be distributed to the parties in accordance with their product-sharing ratio subject to the payment of taxation, salaries of staff or other debts.

The CJV PRC partner is required to contribute plantation land use rights to the CJV and the Company is required to contribute cash for the plantation program.

The CJV PRC partner's responsibilities include the following:

- (a) providing suitable plantation lands to the CJV on a timely basis and in the quantity as stipulated in the CJV Agreement, handling procedures for obtaining the plantation land use rights for the CJV and handling all disputes in connection with lands;
- (b) dealing with the relevant authorities in China for the establishment and licensing of the CJV;
- (c) obtaining the harvesting license, timber transportation permit and other certificates required by laws and regulations for the CJV;
- (d) procuring for the CJV the necessary infrastructure such as water, electricity and transportation; and

- (e) assisting in the recruitment of local operation and management personnel, technical personnel and other personnel as required.

The Company's responsibilities include the following:

- (a) providing capital and funding contributions by instalments based on the progressive needs of the plantation and ensuring that the plantation base is developed as planned;
- (b) providing international operation and management techniques, production technology, quality standards and a system of quality inspection;
- (c) assigning personnel to the plantation base to carry out standard inspections on operations and management and training of technical personnel; and
- (d) providing international market information and technical information to the CJV.

It is a general policy of the PRC that a person who harvests or otherwise cuts down trees is required to replant on the harvested plantation lands to maintain the ecological equilibrium.

(v) Competition

The markets for wood chips are competitive and are sensitive to cyclical changes in pulp production levels and in the economy. Changes in the level of competition, government regulations on timber harvesting, industry capacity and the economy could have a significant impact on the Company's selling prices and overall profitability. The Company competes with Australian and North and South American wood chip producers selling hardwood chips in the East Asian market. The Company believes that it has an advantage over its competitors selling in the East Asian market because of its close proximity to its principal export marketplace, being Japan, South Korea and Taiwan. The Company is able to produce eucalyptus wood chips at a lower delivered cost due to lower shipping charges and labour costs. Further, stricter government regulations on timber harvesting in North America and the announcement by the Australian government of its intention to reduce total hardwood chip export licence volume for 1996 by 13% from 1995 have provided the Company the opportunity to meet the demand caused by the resulting loss in supply of hardwood chips to the Asian market.

The Company also competes on a smaller scale in the domestic PRC market with local producers, including its PRC partners. The Company believes that its status as a foreign-owned joint venture provides it with the flexibility to sell its products in other PRC provinces since it is not subject to local government preferences for local firms to sell their products locally. The Company also believes that it is in a better position to compete with many of its local competitors in terms of access to foreign investment capital for expansion, production, distribution networks, level of technological development and recruitment of additional experienced management. The Company's Joint Venture plantations, which the Company believes are strategically located close to deep water ports and transportation infrastructure, also provide the Company with an added advantage in ensuring reliable timely supply of wood chips to its customers in the PRC. Management believes that the Company is the first, and continues to be the only, foreign-owned producer and exporter of wood chips in the PRC.

(vi) Research and Development

Research and development is carried out at the research facilities of the Leizhou EJV and by independent laboratories and research centres. The Company has a forestry advisory committee which is comprised of professional foresters and experts from the PRC in eucalyptus, aspen and pine trees. These professional foresters are closely associated with the provincial and municipal forestry bureaus and provide industry and plantation operations advice to the Company on a regular basis.

In 1995, the Company engaged two of the principal forestry institutes in the PRC to carry out research and development activities for an annual retainer fee plus project fees. The research and development rights belong to both the Company and the respective forestry institutes. Neither party may sell such rights to a third party without the consent of the other party. One of these forestry institutes, the Nanjing Forestry University of Jiangsu Province, is considered by the Company to be the PRC's leading university for forestry training. The project team for the Company's research is under the leadership of the former President of the University. The other forestry institute, the Institute of Science and Technological Information under the Chinese Academy of Forestry in Beijing, is considered by the Company to be China's foremost forestry scientific and technical information research institute. It has agreed to provide the Company with current information on: (i) forestry policies; (ii) national, provincial and local industrial development; and (iii) world-wide technical developments.

The Company spent approximately U.S.\$442,145 (none of which funds came from proceeds of the offering of Special Warrants) for several projects in 1996 including those relating to the following:

- genetic banks of cloning species for eucalyptus and aspen;
- growth rate increases and cycle reduction for eucalyptus and aspen;
- mixed cloning and tracing and proving the origin of the cloned species;
- development of new clone species for masson pine to increase growth rate;
- tissue culture propagation in relation to mediums;
- propagation methods which involved fertilizers, irrigation and density;
- pest control by means of genetic re-organization for aspen; and
- wood fibre characteristics and their application in panel board manufacturing.

(vii) Regulatory Structure and Ownership

Leizhou EJV

The Leizhou EJV is organized under the laws of the PRC as a Sino-foreign EJV enterprise and is a "legal person" with limited liability. The Leizhou EJV Agreement was approved by the Commission of Foreign Economic Relations and Trade of the Municipality of Zhanjiang on January 28, 1994. As the amount of investment contemplated by the Leizhou EJV Agreement was less than U.S.\$30 million, the Leizhou EJV Agreement did not require the approval of the central PRC government. The Leizhou EJV formally came into existence and began operations on January 29, 1994 when it was issued a business licence and was registered as a Sino-foreign EJV enterprise by the Administration for Industry and Commerce of Zhanjiang. The Company and the LFB have an interest in the profits of the Leizhou EJV in the same proportion (i.e., 53% and 47%) as their respective investments in the Leizhou EJV. As with all Sino-foreign EJV enterprises, the Leizhou EJV is subject to an extensive amount of statutory law relating to matters such as establishment and formation, distribution, taxation, accounting, foreign exchange and labour management.

The operations of the Leizhou EJV are governed by the EJV Law, the Leizhou EJV Agreement and the Articles of Association of the Leizhou EJV. Pursuant to the governmental approval of the Leizhou EJV Agreement referenced previously, the term of the Leizhou EJV is for 30 years which term may be extended upon the mutual agreement of the Company and the LFB and approval from the applicable PRC governmental agencies. The Leizhou EJV is governed by a board of directors consisting of seven members, of whom four, including the Chairman, are nominated by the Company and three, including the Vice-Chairman, by the LFB. The day to day management of the Leizhou EJV is the responsibility of a General Manager, appointed by the board of directors.

The Leizhou EJV Agreement, in accordance with EJV Law, provides that the Leizhou EJV shall annually provide for a reserve fund, enterprise development fund and employee welfare and incentive fund, such provision to be determined by the board of directors having regard to the economic situation of the Leizhou EJV. No amounts for these funds have been provided by the Leizhou EJV since its inception. After provision for such funds, taxation and losses in prior years, the profits of the Leizhou EJV will be available for distribution to the Company and the LFB in proportion to their capital contributions, such distributions to be authorized by the board of directors.

Under the EJV Law, the existence of the Leizhou EJV may be terminated in certain limited circumstances including expiration of the joint venture, inability to continue operations due to severe losses, failure of a party to honour its obligations under the Leizhou EJV Agreement (including failure to meet deadlines for capital contributions) and the Articles of Association in such a manner as to impair the operations of the Leizhou EJV and force majeure. The Leizhou EJV Agreement provides that on liquidation in accordance with the EJV Law, the net assets of the Leizhou EJV (after payment of creditors and taxes) realized on the sale of the assets will be distributed to the Company and the Leizhou EJV in proportion to their respective investments in the Leizhou EJV.

Co-operative Joint Ventures

The CJV Law is the primary PRC legislation governing CJVs. CJVs may take two separate forms. The first type does not involve the creation of an entity with legal person status which is separate and distinct from the joint venture parties. All of the Company's CJVs are of the second type which combines certain characteristics of the true CJV with those of the EJV. In this type of CJV, a separate business entity is created having legal person status, with the joint venture parties' liability limited to their investment contributions.

The CJV Law contemplates parties to a CJV contributing investment or providing "terms of co-operation". Either may take the form of cash, industrial property rights, proprietary technology, land use rights or other property rights.

The CJV Law permits the parties to a CJV to distribute joint venture revenues through distribution of profits, distribution of products or other means agreed to between them. In CJVs, profit distribution is entirely based on the provisions of the joint venture contract and is not necessarily proportional to the value of the contributions of the parties.

CJVs with legal person status are terminated and wound up in much the same manner as EJVs, except that specific rules set out in the joint venture contract, rather than the parties' capital contributions, determine the distribution of liquidation proceeds.

(viii) Income Tax for CJVs and EJVs

A CJV with legal person status, and an EJV, will be liable for PRC enterprise income tax under the Income Tax Law. Under the Income Tax Law, a CJV and an EJV are subject to a national tax imposed at the rate of 30%

on its net income. In addition, a local income tax of 3% of taxable income is levied by the local government, resulting in an effective tax rate of 33%. The Company's CJVs and the Leizhou EJV are eligible for a total exemption from taxation for two years beginning with the first profit-making year of the CJVs and the Leizhou EJV and a 50% reduction during the subsequent three years (such time periods during which taxes are exempt or reduced being referred to herein as "tax holidays"). Subject to the approval of the relevant authorities, joint ventures categorized as forestry projects may be allowed a 15% - 30% reduction of the amount of income tax payable for a further period of ten years after tax holidays.

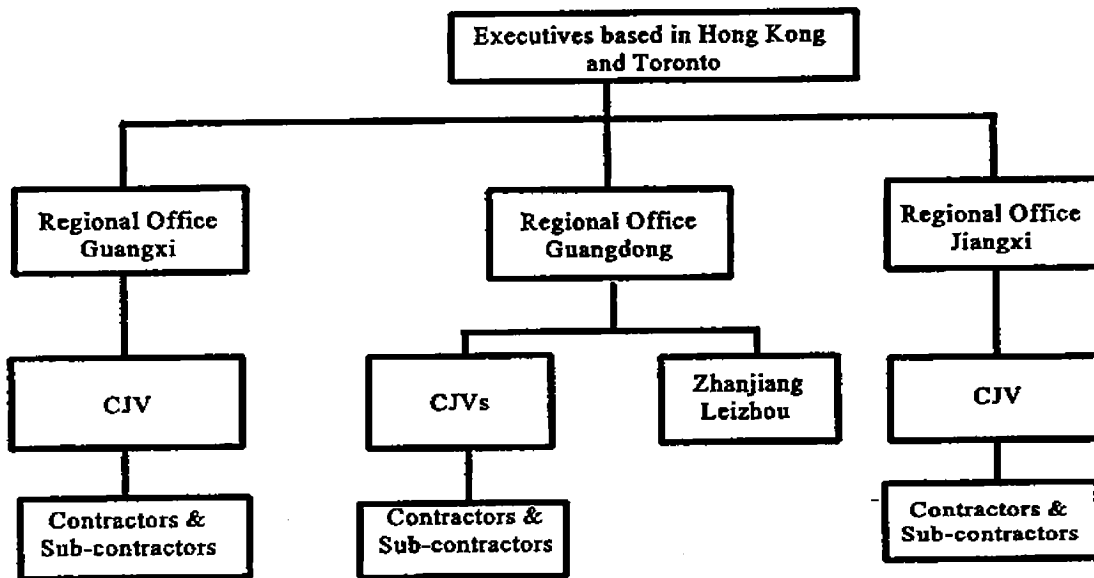
(ix) Employees

As of November 15, 1996, the Company employed 372 people which are categorized by function as follows:

<u>Function</u>	<u>Number of Employees</u>
Executives and senior management	5
Regional offices executives and employees in the PRC	16
Sales, marketing and administration	6
Plantation management and technical staff of CJVs	35
Junior staff and workers in Leizhou EJV	<u>310</u>
Total number of employees	<u>372</u>

It is the Company's strategy to maintain a small group of high quality and professional personnel who will direct, manage, control and ensure that the Company's business is properly carried out by its PRC contractors and sub-contractors. The operations of the Company are divided into three levels: the executive offices in Hong Kong and Toronto; regional offices in each of the three PRC provinces where the Company operates; and the PRC EJV and CJV companies. Management of the Company resides in Hong Kong and Toronto but travels frequently to the PRC. Certain senior management of the Company spend more than 70% of their time in the PRC visiting all the Company's plantations on a rotational basis and meet regularly with the relevant officers of the various PRC forestry bureaus. The Chief Executive Officer of the Company is the Chairman of the Board for most of the CJVs. Management members of the Company are either directors, general managers or executives to the regional offices of the EJVs and CJVs, and are involved in the running of all joint venture entities in the PRC. The regional offices are staffed with three to four direct employees. These employees are forestry professionals and have strong financial control and management skills. The CJVs' work force is provided by the CJV PRC partner as agreed under the CJV Agreements and the Plantation Service Contracts. They are mainly contracted workers who are hired on an "as needed" basis. These workers are assigned to the operations of the plantations, transportation of logs and wood chips, and the operations of the chipping plants. See "Business of the Company - Business Operations - Plantation Service Company".

The following chart sets out the Company's management and operational structure:



(x) Plantation Service Company

The Company's CJV plantation companies have each entered into the Plantation Service Contracts with the Service Companies. The term of each Plantation Service Contract is 12 years (or no less than two plantation cycles), and six months prior to the expiration of such term, the CJV will renew the Plantation Service Contract for a term of no less than 12 years or two circulation periods based upon the previous performance of services provided by the Service Company. The Plantation Service Contract is based on a "cost-plus" arrangement which provides the Service Companies with a profit of 10%. All costs, fees and expenses are required to be submitted to the board of directors of the CJV for approval before payment. The services to be provided by the Service Companies include overall design for plantation, construction design, preparation for ploughing, levelling of land, growth of seedlings, fertilization pesticides, planting of trees and replanting, cultivation, management and preservation and procedures such as examination, inspection and acceptance.

The Plantation Service Contract specifies the targeted timber output (harvest rate) in each planting cycle that must be produced by the Service Company. The target is established by the board of directors of the CJV with the agreement of the Service Company. If the target is exceeded, the Service Company receives 30% of the excess portion of timber output. But, if the target is not achieved, the Service Company must compensate the CJV in an amount equivalent to 30% of the deficient portion of timber output.

MANAGEMENT AND DIRECTORS

DIRECTORS AND OFFICERS

The names, municipalities of residence, offices held and principal occupations of the directors and officers of Sino-Forest are as follows:

Name and Municipality of Residence	Position(s) Held	Principal Occupation
Allen T.Y. Chan ⁽¹⁾ Hong Kong	Chairman, Chief Executive Officer and Director	Officer of Sino-Forest
Kai Kit Poon Hong Kong	President and Director	Officer of Sino-Forest
Leslie W.L. Chan Hong Kong	Executive Vice President	Officer of Sino-Forest
Kee Y. Wong Toronto, Ontario	Senior Vice President, Corporate Development and Chief Financial Officer	Officer of Sino-Forest
Lawrence K.P. Hon Hong Kong	Senior Vice President, Operations	Officer of Sino-Forest
Andrew R. Agnew Toronto, Ontario	Treasurer	Senior Associate of Gornitzki, Thompson & Little, a merchant banking group
John Thompson ⁽¹⁾ Toronto, Ontario	Secretary and Director	Principal of Gornitzki, Thompson & Little, a merchant banking group

Name and Municipality of Residence	Position(s) Held	Principal Occupation
Edmund Mak ⁽¹⁾ Vancouver, B.C.	Director	Real estate marketing, Royal LePage Real Estate Ltd. (real estate company)
James F. O'Donnell Toronto, Ontario	Director	President of O'Donnell Capital Corp. and Chairman of O'Donnell Management (fund manager)

(1) Member of the Audit Committee

Each of the foregoing persons has held the position shown as his or her principal occupation for the last five years except as set forth below.

Allen T.Y. Chan

Mr. Allen T.Y. Chan was Director of A D Sinensis & Associates Ltd. (project financing and management consultancy) from August 1991 to August 1993 before he founded Sino-Wood. Since Sino-Wood became a wholly-owned subsidiary of Sino-Forest in March 1994, Mr. Chan has been Chairman and Chief Executive Officer. Mr. Chan has over 12 years of experience in structuring joint ventures in the PRC in the following industries: hotel, healthcare, oil and gas, real estate, restaurant and garment manufacturing.

Kai Kit Poon

Mr. Kai Kit Poon was one of the founders of, and was the President of, Sino-Wood from September 1993 to March 1994. Mr. Poon has been President and a director of Sino-Forest since March 1994. Mr. Poon has over 34 years of experience in the PRC forestry industry. Mr. Poon was General Manager of Ka Hung Woodworks Ltd. (a wood product, manufacturing and trading company) from December 1990 to August 1993. From August 1962 to October 1977, he was employed as a scaling engineer by Guangdong Forestry Bureau. Since June 1979, he has been engaged in the trading and manufacture of forest products in the PRC and Hong Kong. Mr. Poon graduated from Guangzhou Chungnam Forestry University, Guangdong, PRC in 1962.

Leslie W.L. Chan

Ms. Leslie W.L. Chan has served as a senior management member for ten years at Abbott Laboratories (a multinational healthcare company) in both the United States and Asia. Her last position was that of Regional Manager for Hong Kong, PRC, Taiwan and Philippines from January 1989 to November 1991. Ms. Chan was also a Director of A D Sinensis & Associates Ltd. from December 1991 to August 1993. Ms. Chan was one of the founders of, and has been the Executive Director of, Sino-Wood since September 1993. Ms. Chan was appointed Executive Vice President of Sino-Forest in December 1996.

Kee Y. Wong

Mr. Kee Y. Wong was appointed Senior Vice President, Corporate Development, and Chief Financial Officer of Sino-Forest effective October 1, 1996. Prior to joining Sino-Forest, Mr. Wong was a partner with Ernst & Young in Toronto where he acted as auditor and business advisor to many growth-oriented companies. Mr. Wong is a fellow of the Institute of Chartered Accountants in England and Wales. He is also a Chartered Accountant in Canada.

Lawrence K.P. Hon

Mr. Lawrence K.P. Hon was Deputy Managing Director for Hong Kong, PRC, Taiwan and Korea of KNP BT (a forestry group specializing in paper packaging and printing) from April 1990 to May 1994. Mr. Hon was Vice President, Operations of Sino-Wood from May 1994 to June 1995. He was Vice-President, Operations of Sino-Forest from June 1995 and became Senior Vice President, Operations of Sino-Forest in December 1996. Mr. Hon is a professional accountant with fellowship in the respective accountants' associations in both Hong Kong and the U.K. He also holds an M.B.A. degree and a professional qualification in Information Technology.

Andrew R. Agnew

Mr. Andrew R. Agnew has been associated with Gornitzki Thompson & Little since March 1991 except for a 15 month period when he was a Vice President of Majendie Securities Inc. during 1993 to 1994. He was appointed Treasurer of Sino-Forest in June 1996. Mr. Agnew is a Chartered Financial Analyst and has over 25 years experience in the Canadian securities industry.

John Thompson

Mr. John Thompson is also Chairman of the Board of Directors of Pembridge Inc. and a director of Polyphalt Inc. and SIRIT Technologies Inc.

Edmund Mak

Mr. Edmund Mak has been engaged in real estate marketing in Vancouver with Royal LePage Real Estate Ltd. since November 1989. Mr. Mak has 22 years of business and management experience with large multi-national corporations and local companies in a variety of industries: computers and high technology equipment, transportation, construction, oil and gas, textiles and real estate. He is a graduate of the University of Toronto with an M.B.A. degree.

James F. O'Donnell

Mr. James F. O'Donnell was President of Mackenzie Financial Corp. (a mutual fund dealer) prior to May 1993. Mr. O'Donnell is also a director of Midland Walwyn Capital Inc.

EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth the compensation earned by Sino-Forest's Chief Executive Officer during the financial years ended December 31, 1995 and 1994. Sino-Forest has only one "executive officer" within the meaning of the applicable legislation governing compensation disclosure whose compensation must be disclosed.

Name and Principal Position	Year	Annual Compensation			Long Term Compensation			All Other Compensation (\$)
		Salary (\$)	Bonus (\$)	Other Annual Compensation (\$)	Awards		Payouts	
					Securities Under Options Granted (#)	Restricted Shares or Restricted Share Units (\$)	Long Term Incentive Plan Payouts (\$)	
Allen T.Y. Chan, Chairman and Chief Executive Officer	1995	\$64,000	nil	nil	nil	nil	nil	nil
	1994	nil	nil	nil	nil	nil	nil	nil

No options were granted to, or exercised by, the named executive officer during the most recently completed financial year. There are no outstanding options of the named executive officer as at December 31, 1995.

Sino-Forest has no defined pension benefit plans.

The Company is required to make certain payments to corporations in which various directors and officers of the Company, or their family members, have interests. See "Interests of Management and Others in Material Transactions".

Director Compensation

During the financial year ended December 31, 1995, no cash or other form of compensation was paid or is payable to the directors of Sino-Forest acting in such capacity nor has any compensation been paid to the date hereof other than options as described under "Management and Directors - Executive Compensation - Options to Purchase Securities".

Options to Purchase Securities

The board of directors of Sino-Forest has established the Plan pursuant to which options to purchase Class A Subordinate-Voting Shares may be granted to employees and insiders of Sino-Forest or any of its subsidiaries or any other person or company engaged to provide ongoing management or consulting services for Sino-Forest or for any entity controlled by Sino-Forest. Under the terms of the Plan, the maximum number of Class A Subordinate-Voting Shares which may be issued under the options granted pursuant to the Plan is 4,200,000, provided that:

- (a) the number of shares reserved for issuance pursuant to the options issued and outstanding under the Plan, together with options issued and outstanding under any other employee related plan of Sino-Forest or options for services granted by Sino-Forest to insiders of Sino-Forest, shall not exceed 10% of the issued and outstanding Class A Subordinate-Voting Shares;
- (b) the number of shares which may be issued, within any one-year period, pursuant to the options issued and outstanding under the Plan, together with those shares which may be issued and outstanding under any other employee-related plan of Sino-Forest or options services granted by Sino-Forest to insiders of Sino-Forest, shall not exceed 10% of issued and outstanding Class A Subordinate-Voting Shares;

- (c) the number of shares which may be issued, within any one-year period, pursuant to the options issued and outstanding under the Plan, together with those shares which may be issued under any other employee-related plan of Sino-Forest or options for services granted by Sino-Forest to any one insider and such insider's associates, shall not exceed 5% of the issued and outstanding Class A Subordinate-Voting Shares; and
- (d) the number of shares reserved for issuance pursuant to options issued and outstanding under the Plan granted by Sino-Forest to any one person shall not exceed 5% of the issued and outstanding Class A Subordinate-Voting Shares.

On September 30, 1996, the board of directors of Sino-Forest passed a resolution which deleted clauses (a) to (c), above, and increased the maximum number of shares which may be issued under options issued and outstanding pursuant to the Plan to all participants to 10,000,000, subject to all necessary shareholder approval and the approval of all applicable regulatory authorities. Shareholder approval will be sought to the proposed changes to the Plan at the next annual meeting of shareholders to be held in the summer of 1997. The TSE has given approval to such changes, subject to such shareholder approval being obtained.

Sino-Forest may designate, from time to time, those persons who are eligible to participate in the Plan and the number of shares subject to options, the earliest exercise date, the expiry date, vesting periods, the exercise price and any other matters relating thereto, subject to compliance with applicable laws and regulations and the applicable rules of any stock exchange upon which any of the shares of Sino-Forest may be listed. The exercise price of each option shall be equal to the value of Sino-Forest's Class A Subordinate-Voting Shares, determined as of the date immediately preceding the date of grant in accordance with the Plan.

The Plan also allows Sino-Forest to make loans or provide guarantees for loans by financial institutions to assist participants to purchase shares upon the exercise of the options so granted or to assist the participants to pay any income tax exigible upon the exercise of the options. Any such loans granted by Sino-forest or any subsidiary shall be full recourse to the participants and secured by the shares purchased with the proceeds of the loan, and shall be at such rates of interest, if any, and on such other terms as may be determined by Sino-Forest.

The following is a summary of how all outstanding options granted are held as at the date of this prospectus.⁽¹⁾

Group of Optionees	Exercise Price	Expiry Date	Shares Under Option	Market Value at Time of Grant
Executive Officers of Sino-Forest (7 Persons)	\$0.60	November 4, 1999	150,000	\$0.70
	\$0.60	January 15, 2001	100,000	\$0.60
	\$1.35	June 26, 2001	1,378,000	\$1.35
	\$1.10	October 1, 2001	500,000	\$1.10
	\$1.55	September 30, 2001	3,315,000	\$1.55
Directors of Sino-Forest (other than Executive Officers) (2 Persons)	\$0.55	March 21, 1999	200,000	N/A
	\$1.35	June 26, 2001	148,000	\$1.35
	\$1.55	September 30, 2001	200,000	\$1.55
Employees of Subsidiary Companies (2 Persons)	\$0.60	November 4, 1999	150,000	\$0.70
	\$0.60	January 15, 2001	100,000	\$0.60
	\$1.35	June 26, 2001	140,000	\$1.35
	\$1.55	September 30, 2001	50,000	\$1.55
Total			<u>6,431,000</u>	

Note:

- (1) Options to acquire the following number of Class A Subordinate-Voting Shares expire on the following dates: (a) 200,000 on March 21, 1999, (b) 300,000 on November 4, 1999, (c) 200,000 on January 15, 2001, (d) 1,666,000 on June 26, 2001, (e) 500,000 on October 1, 2001, and (f) 3,565,000 on September 30, 2001. The latter options expiring on September 30, 2001 were granted on September 30, 1996 at an exercise price of \$1.55 per Class A Subordinate-Voting Share. The exercise of (i) all of the options expiring on September 30, 2001, and (ii) options to acquire 316,000 Class A Subordinate-Voting Shares expiring on October 1, 2001 is subject to receipt of any necessary shareholder approval and the approval of all applicable regulatory authorities as described above.

INDEBTEDNESS OF DIRECTORS AND SENIOR OFFICERS

The following table sets forth the currently outstanding indebtedness to the Company of all officers and directors of the Company which was incurred in connection with the purchase of Class A Subordinate-Voting Shares under the Plan.

INDEBTEDNESS OF DIRECTORS, EXECUTIVE OFFICERS AND SENIOR OFFICERS UNDER SECURITIES PURCHASE PROGRAMS					
Name	Involvement of Issuer or Subsidiary	Largest Amount Outstanding During Fiscal 1995 (\$)	Amount Outstanding as at November 25, 1996 (\$)	Financially Assisted Securities Purchases During Fiscal 1995 (\$)	Security for Indebtedness
Lawrence Hon Senior Vice President, Operations of Sino-Forest	Sino-Forest	nil	60,000 ⁽¹⁾	nil	Promissory Note and Deed of Pledge

Note:

- (1) The indebtedness was incurred in April 1996 to enable options to acquire 100,000 Class A Subordinate-Voting Shares to be exercised. The principal sum of \$60,000 is non-interest bearing and is due on April 30, 1997 and if Mr. Hon ceases to be an employee of Sino-Forest, the principal sum shall become payable on demand.

CONSOLIDATED CAPITALIZATION

(in thousands of U.S. dollars)

	Outstanding as at September 30, 1996	Outstanding as at December 31, 1996	Outstanding as at December 31, 1996 after giving effect to this issue ⁽¹⁾
DEBT			
Convertible Debenture ⁽²⁾⁽³⁾	<u>\$3,000</u>	<u>\$3,000</u>	<u>\$3,000</u>
NON-CONTROLLING INTERESTS⁽³⁾	<u>18,359</u>	<u>18,359</u>	<u>18,359</u>
SHAREHOLDERS' EQUITY			
Class A Subordinate-Voting Shares ⁽³⁾	6,874 (37,150,000 shrs.)	6,874 (37,150,000 shrs.)	26,947 (61,150,000 shrs.)
(unlimited shares authorized)			
Class B Multiple-Voting Shares ⁽³⁾	-	-	-
(6,000,000 authorized)	(6,000,000 shrs.)	(6,000,000 shrs.)	(6,000,000 shrs.)
Series A Preference Shares ⁽³⁾ .	Nil	Nil	Nil
(unlimited authorized)			
Special Warrants	Nil	20,073 (24,000,000 Special Warrants)	Nil
Retained Earnings ⁽³⁾	<u>11,860</u>	<u>11,860</u>	<u>11,860</u>
Total Shareholders' Equity	<u>18,734</u>	<u>38,807</u>	<u>38,807</u>
TOTAL CAPITALIZATION	<u>\$ 40,093</u>	<u>\$60,166</u>	<u>\$ 60,166</u>

(1) Reflects the issuance of 24,000,000 Special Warrants for net proceeds (after deducting underwriting fees of \$1,950,000 and estimated expenses of the offering of \$550,000) of \$27,500,000, converted at the exchange rate of Cdn. \$1.37 per U.S.\$1.00 as at December 31, 1996 into U.S.\$20,072,993. Excludes the possible issuance of (i) up to 6,431,000 Class A Subordinate-Voting Shares upon the exercise of stock options pursuant to the Plan (see "Management and Directors - Executive Compensation Options to Purchase Securities"); (ii) up to 2,400,000 Class A Subordinate-Voting Shares upon exercise of the Compensation Options (see "Private Placement and Plan of Distribution"); (iii) up to a maximum of 6,778,130 Class A Subordinate-Voting Shares pursuant to the convertible loan agreement with Deutsche Bank A.G. of Hong Kong (See Note 8 under "Notes to Consolidated Financial Statements"); and (iv) Class A Subordinate-Voting Shares upon conversion of the Class B Multiple-Voting Shares (see "Description of Share Capital - Authorized Capital - Class A Subordinate-Voting Share and Class B Multiple-Voting Share Attributes").

(2) Pursuant to the convertible loan agreement with Deutsche Bank A.G. of Hong Kong (see Note 8 under "Notes to Consolidated Financial Statements").

(3) The amount of the Convertible Debenture, Non-Controlling Interests, Class B Multiple-Voting Shares, Series A Preference Shares and Retained Earnings as at December 31, 1996 and as at December 31, 1996 after giving effect to this issue represents the balance disclosed in the consolidated balance sheet at September 30, 1996. The amount of the Class A Subordinate-Voting Shares as at September 30, 1996 and as at December 31, 1996 represents the balance disclosed in the consolidated balance sheet as at September 30, 1996.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(all amounts are in U.S. dollars, unless otherwise indicated)

RESULTS OF OPERATIONS

Nine Months ended September 30, 1996 compared to Nine Months ended September 30, 1995

The segmented net revenue and net income for the nine months ended September 30, 1996 and 1995 are as follows:

	Nine months ended September 30, 1996			Nine months ended September 30, 1995 ⁽¹⁾		
	Wood chips \$	Other \$	Total \$	Wood chips \$	Other \$	Total \$
	(thousands of U.S. dollars)					
By Industry Segment						
Revenue						
Sales	12,754	31	12,785	18,448	1,653	20,101
Commission income	<u>3,202</u>	<u>2,210</u>	<u>5,412</u>	<u>-</u>	<u>653</u>	<u>653</u>
	<u>15,956</u>	<u>2,241</u>	<u>18,197</u>	<u>18,448</u>	<u>2,306</u>	<u>20,754</u>
Income (loss) from operations	6,583	446	7,029	7,458	(1,179)	6,279
Equity in losses of Jiangxi EJV's	-	(250)	(250)	-	(121)	(121)
Interest income (expense)	-	(159)	(159)	-	22	22
Other income	<u>-</u>	<u>-</u>	<u>-</u>	<u>6</u>	<u>4</u>	<u>10</u>
Income before income taxes	6,583	37	6,620	7,464	(1,274)	6,190
Provision for income taxes - current	<u>797</u>	<u>-</u>	<u>797</u>	<u>-</u>	<u>-</u>	<u>-</u>
Income before non-controlling interests	5,786	37	5,823	7,464	(1,274)	6,190
Non-controlling interests	<u>(1,327)</u>	<u>-</u>	<u>(1,327)</u>	<u>(3,508)</u>	<u>118</u>	<u>(3,390)</u>
Net income for the period	<u>4,459</u>	<u>37</u>	<u>4,496</u>	<u>3,956</u>	<u>(1,156)</u>	<u>2,800</u>

Note:

- (1) Reflects the reduction in equity interest in the chemical and board businesses from 55% to 30% at the end of the second quarter of 1995.

The Company recorded net income of \$4.5 million for the nine months ended September 30, 1996, a 61% increase compared to net income of \$2.8 million for the corresponding period in fiscal 1995. This significant increase in earnings is attributable primarily to the following:

- (i) increased sales of wood chips from 159,452 BDMT to 389,586 BDMT which included 254,730 BDMT of wood chip shipments in which the Company earned commission income of approximately \$3,202,000 as sales agent;
- (ii) increased commission income from lumber trading; and
- (iii) no significant increase in expenses.

The increase in net income for the nine months ended September 30, 1996 was achieved notwithstanding the delay in obtaining equity financing. On October 2, 1996, the Company completed an offering of 24,000,000 Special Warrants for gross proceeds of Cdn.\$30 million of which Cdn.\$15 million is held in escrow pursuant to the Special Warrant Indenture. See "Private Placement and Plan of Distribution". The net proceeds from the offering will be sufficient to fund the Company's plantation phase-in plan.

The results for the Company's EJVs in the chemical and the board businesses were no longer consolidated for the nine months ended September 30, 1996 as a result of the reduction of equity interest from 55% to 30% and the transfer of effective control to the Company's Jiangxi EJV joint venture partners. Accordingly, non-wood chip income represents primarily the commission income earned on lumber trading on behalf of other companies in Hong Kong and the PRC. Commission income on wood chips represents the amount earned on wood chips trading on behalf of its Guangxi joint venture partner. Non-wood chip income for the nine month period ended September 30, 1995 includes the results of the Jiangxi EJVs to the dates when effective control was transferred to the Jiangxi EJVs joint venture partners. After those dates, the Company's share of losses in the Jiangxi EJVs was equity accounted for and shown as a separate line after income (loss) from operations.

An analysis of the wood chip shipments for the nine months ended September 30, 1996 and the corresponding period in fiscal 1995 in thousands of BDMT is provided below:

Wood Chip Shipments

Nine months ended September 30
(thousands of BDMT)

Market	<u>Leizhou EJV</u>		<u>Guangxi CJV</u>		<u>Total</u>	
	<u>1996</u>	<u>1995</u>	<u>1996</u>	<u>1995</u>	<u>1996</u>	<u>1995</u>
Export	134.9	159.5	124.7	-	259.6	159.5
PRC	-	-	130.0	-	130.0	-
	<u>134.9</u>	<u>159.5</u>	<u>254.7⁽¹⁾</u>	<u>-</u>	<u>389.6</u>	<u>159.5</u>

- (1) Sino-Forest Resources Inc. earned commission income of approximately \$3,202,000 as a sales agent on these shipments for the nine months period ended September 30, 1996 [September 30, 1995 - \$nil]. The Company will use a portion of the proceeds from the special warrant offering to lease or acquire additional chipping facilities, with the net impact being that future chip shipments from the Guangxi CJV will be sold as principal rather than on an agency basis, at a higher margin.

Export shipments (including Guangxi CJV) for the nine months ended September 30, 1996 represent 66.6% of total shipments compared to 100% for the corresponding period in fiscal 1995. The Company's

export shipments are primarily to Japan, South Korea and Taiwan. Demand for wood chips in both the export and PRC markets is expected to be strong for the remainder of the year and 1997. Increasing fibre demand in the PRC is expected to continue due to the large population and increasing literacy rates in the PRC. The Company expects its U.S. dollar export shipments to be approximately 60% by the end of 1996.

Year ended December 31, 1995 compared to Year ended December 31, 1994

A summary of net revenue and net income by segment for 1995 and 1994 are as follows:

	Year ended December 31, 1995			Year ended December 31, 1994		
	Wood chips \$	Other \$	Total \$	Wood chips \$	Other \$	Total \$
	(thousands of U.S. dollars)					
By Industry Segment						
Revenue						
Sales	23,949	1,525	25,474	13,612	4,667	18,279
Commission income	<u>663</u>	<u>1,286</u>	<u>1,949</u>	<u>-</u>	<u>2,203</u>	<u>2,203</u>
	<u>24,612</u>	<u>2,811</u>	<u>27,423</u>	<u>13,612</u>	<u>6,870</u>	<u>20,482</u>
Income (loss) from operations	9,568	(826)	8,742	3,361	947	4,308
Equity in losses of Jiangxi EJV	-	(262)	(262)	-	-	-
Interest income (expense)	-	(6)	(6)	58	-	58
Other income	<u>8</u>	<u>12</u>	<u>20</u>	<u>45</u>	<u>7</u>	<u>52</u>
Income before non-controlling interests	9,576	(1,082)	8,494	3,464	954	4,418
Non-controlling interests	<u>(4,140)</u>	<u>-</u>	<u>(4,140)</u>	<u>(1,629)</u>	<u>221</u>	<u>(1,408)</u>
Net income for the year	<u>5,436</u>	<u>(1,082)</u>	<u>4,354</u>	<u>1,835</u>	<u>1,175</u>	<u>3,010</u>

The Company recorded net income of \$4.4 million for the year ended December 31, 1995, a 44.7% increase compared to 1994 net income of \$3.0 million. This increase in earnings is attributable primarily to:

- (i) increased shipments of wood chips from 156,300 BDMT to 336,700 BDMT (including 132,500 BDMT supplied by its Guangxi CJV PRC partner in 1995 and sold on a commission basis); and
- (ii) increased average selling prices for wood chips from \$72 per BDMT in 1994 to \$102 per BDMT in 1995.

The annual phase-in of plantation lands to the CJVs did not contribute to the 1995 results as they had just commenced operations.

Due to a number of factors including a lower than expected average selling price per BDMT of wood chips during the year, the 1995 results were approximately 10% lower than management's expectations. An average selling price of \$102 per BDMT was realized in 1995, a healthy gain of approximately 41% over the \$72 per BDMT attained in 1994, but slightly short of the budgeted price of \$105 per BDMT. In addition,

the delay in arranging new financing during 1995 slowed down the completion of certain capital projects at the CJVs and delayed the Company from producing wood chips in Guangxi with its own chipping facilities. Consequently, overall profit margin in the wood chip business was lower than budget as the Company was required to fulfil contracts with wood chips supplied by its Guangxi CJV PRC partner outside of the CJV Agreement. On these sales, the Company earned commission income of \$663,000 in 1995 [1994 - \$nil] which is much lower than the profit margin it would have otherwise earned if the chips had been produced using the Company's own facilities. These wood chip trading opportunities on behalf of the Guangxi CJV PRC partner in the second half of 1995, however, allowed the Company to expand its customer list to include domestic wood chip sales to local pulp mills in China for the first time. It also provided the Company the opportunity to test its operational capabilities in handling higher overall volumes of wood chips in the future.

An analysis of the wood chip shipments in fiscal 1995 and 1994 in thousands of BDMT is provided below:

Wood Chip Shipments						
Year ended December 31						
(thousands of BDMT)						
Market	Leizhou EJVs		Guangxi CJV		Total	
	1995	1994	1995	1994	1995	1994
Export	204.2	156.3	86.3	-	290.5	156.3
PRC	-	-	46.2	-	46.2	-
	<u>204.2</u>	<u>156.3</u>	<u>132.5⁽¹⁾</u>	<u>-</u>	<u>336.7</u>	<u>156.3</u>

(1) Sino-Forest Resources Inc. earned commission income of approximately \$663,000 as a sales agent on these shipments in 1995.

The share in losses of the Jiangxi EJVs of \$262,000 represents the reduction in equity interests from 55% to 30% in five of the EJVs as mentioned previously. These EJVs are no longer consolidated as subsidiaries but are equity accounted for from the dates when effective control was transferred to its joint venture partners.

FINANCIAL POSITION AND LIQUIDITY

At the beginning of 1995, the Company had planned to complete an equity financing of approximately \$10.0 million by mid-1995. However, as equity for emerging markets fell out of favour in 1995, particularly after the Mexican currency crises early in the year, Sino-Forest was faced with some difficulties in realizing its equity financing plan.

To overcome this shortcoming, the Company obtained new trade financing of \$4.5 million through two European banks to assist in the execution of its wood chip contracts with its Asian customers in the second half of 1995. In addition, a private placement for Cdn.\$1.2 million was completed in September 1995.

To provide funding for the operations of the CJVs, in January 1996, Sino-Wood entered into a \$3 million convertible loan agreement with a commercial bank. See note 8 of the consolidated financial

statements included in this prospectus for further details. This loan provided the Company the funds to meet its required initial cash capital contributions to the CJVs.

Cash generated from operations, before changes in non-cash working capital items, remained relatively stable at \$6.6 million for the nine months ended September 30, 1996, compared to \$7.0 million in the corresponding period in fiscal 1995. The change in non-cash working capital balances, which totalled \$1.2 million in 1996, reduced net cash flow from operations for 1996 to \$5.4 million, compared to \$9.1 million in the corresponding period in 1995.

As at September 30, 1996, Sino-Forest had cash and short term deposits of approximately \$0.4 million. Management believes that the cash to be generated from its operations and the net proceeds from the Special Warrants offering of approximately Cdn.\$27.5 million will be adequate to fund its growth strategy and to accelerate the planned phase-in of its 623,000 hectares of plantation lands for at least the next two years.

CAPITAL CONTRIBUTION COMMITMENTS

In accordance with the contractual obligations set out in the various joint venture agreements and memoranda as modified with the agreement of its joint venture partners, the Company is required to contribute additional cash as described below:

The Jiangxi EJVs

Subject to the approval of the FERT of the PRC, the Company was required to make a further \$2.2 million contribution by December 1996 in order to maintain its 30% equity interest in each of the Jiangxi EJVs in the chemical and board businesses. However, subsequent to the submission to the FERT to amend the memoranda of understanding, the Company has conducted preliminary discussions with its Jiangxi EJV joint venture partners and the FERT to restructure its Jiangxi EJVs with the objective of reducing or eliminating its requirements to make further capital contributions. As at December 31, 1996 the Company had not made any further capital contributions. Management expects that further capital contributions will not be made and in such event, the Company's equity interest in each of the Jiangxi EJVs will be reduced to an amount to be negotiated with its Jiangxi EJV joint venture partners, which amount must be approved by the FERT.

The Leizhou EJV

The Company was required to make further capital contribution of \$4.3 million to the Leizhou EJV by December 1996 to maintain its 53% equity interest. As at September 30, 1996, the Company had an amount due from its Leizhou EJV joint venture partner of \$12,177,000. At the end of 1995, the Company commenced discussions with its Leizhou EJV joint venture partner for the repayment of some or all of the amount due by early 1997. As part of these discussions, the required remaining capital contribution of \$4.3 million could be offset by the Company by the amount due from its Leizhou EJV joint venture partner.

The CJVs

In January 1996, the Company's subsidiaries made initial capital contributions of \$1.7 million to the CJVs. The remaining balance of \$12,255,000, in aggregate, was due as to \$185,000 in January, 1996 and \$12,070,000 to be contributed as part of the ongoing annual expenses for plantation costs. The annual

payment for plantation costs could be varied, subject to changes in the plantation development plan. The \$185,000 that was due in January, 1996 has been withheld pending the satisfactory performance of its joint venture partner.

The estimated cash requirements will be satisfied from internal resources generated from operations, the amount due from its Leizhou EJV joint venture partner and the cash resources available from the Special Warrant offering.

OUTLOOK

The outlook for the Company's operations for the remainder of 1996 and 1997 is positive. Despite the recent downward price adjustment for wood chips in certain markets, the Asian economies continue to be very strong. The Company believes that the Japanese and Chinese markets' paper and board consumption is in the upward trend. According to the Ministry of International Trade and Industry of Japan, Japanese hardwood pulpwood imports have increased 13.9% from 1994 to 1995.

Beyond 1996, with the proceeds of the Special Warrant offering and its internally generated cash flow, the Company believes that it will be able to accelerate the phase-in of the remainder of the 623,000 hectares of plantation lands. The Company expects that it will have, when fully-phased-in, 623,000 hectares of plantations under its management, thereby allowing the Company to produce an expected sustainable annual yield of approximately 4 million BDMT of wood chip fibre. In addition, the Company plans to expand its plantation and wood chip businesses further by forming similar new CJVs in other provinces or to increase its plantation base in Guangxi, Jiangxi and Guangdong. In this regard, management has initiated discussions with the appropriate authorities in these provinces.

The Company will continue to pursue its strategy of identifying appropriate strategic alliances with established international wood products companies to develop long-term integration opportunities for its wood fibre resources in "value-added" products, such as oriented strand board and medium density fibreboard. In April 1996, the Company signed a memorandum of understanding with a unit of Boise Cascade Corporation of Idaho, U.S.A. to jointly carry out an assessment of the Company's fibre supply and to examine the most effective way for it to be used as a feedstock for new board plants to be built in the PRC. At the present time, it is the Company's intention to be a significant fibre provider to these board plants without becoming a significant equity holder as a result of cash investments.

PRINCIPAL SHAREHOLDERS

The following table sets forth persons (other than nominee holders) who, as at November 25, 1996, to the knowledge of Sino-Forest, own of record or beneficially, directly or indirectly, more than 10% of the Class A Subordinate-Voting Shares before giving effect to this offering:

Number of Shares Owned
(Percentage of Class and Type of Ownership)

Name	Class A Subordinate-Voting Shares	Class B Multiple-Voting Shares	Percentage of Voting Rights
ADS Holdings (BVI) Limited ("ADS") ⁽¹⁾	5,195,005 Shares (13.98%) (of record and beneficially)	nil	7.7%
Natural Forest Limited ("NFL") ⁽²⁾	4,786,905 Shares (12.89%) (of record and beneficially)	2,250,000 Shares (37.5%) (beneficially)	23.9%
Forest Investment Partners, Ltd. ("FIP") ⁽³⁾	2,592,000 Shares (6.98%) (of record and beneficially)	3,750,000 Shares (62.5%) (beneficially)	31.8%

- (1) ADS is owned by three family trusts under which family members and associates of Mr. Allen Chan and Ms. Leslie Chan are beneficiaries. See "Management and Directors".
- (2) NFL is controlled by Mr. Kai Kit Poon.
- (3) FIP is controlled by Mr. Allen Chan and Ms. Leslie Chan.

As at December 4, 1996, the directors and senior officers of Sino-Forest as a group beneficially owned, directly or indirectly, approximately 36.6% of the Class A Subordinate-Voting Shares and 100% of the Class B Multiple-Voting Shares.

Pursuant to certain agreements, the Corporation and/or certain shareholders are required to take all necessary action, or to use their reasonable best efforts, to ensure the appointment of representatives of the other parties to the board of directors of Sino-Forest.

PROMOTER

Mr. Allen Chan, Ms. Leslie Chan and Mr. Kai Kit Poon may be considered to be promoters of Sino-Forest (as defined in applicable securities legislation) in that they took the initiative in reorganizing the business of Sino-Forest as described under "Organization of the Company". On March 17, 1994, Mr. Chan, Ms. Chan and Mr. Poon collectively sold all of their interests in Sino-Wood and after the reorganization, held or controlled indirectly 16,200,000 Class A Subordinate-Voting Shares, being 50.6% of the then outstanding Class A Subordinate-Voting Shares, and 6,000,000 Series A Preference Shares, being all of the then outstanding Series A Preference Shares (which were subsequently converted into Class B Multiple-Voting Shares). Except as disclosed in this paragraph and under "Interest of Management and Others in Material Transactions", Mr. Chan, Ms. Chan and Mr. Poon have received and will receive compensation (or assets, services or other consideration) from Sino-Forest or its subsidiaries only in their capacities as directors and/or officers of such corporations.

INTEREST OF MANAGEMENT AND OTHERS IN MATERIAL TRANSACTIONS

Mr. John Thompson is also a director, officer and significant shareholder of GTL Securities Inc., one of the Underwriters of this offering. See "Private Placement and Plan of Distribution".

Effective January 1, 1994, GTL Investments Corp., a corporation of which Mr. John Thompson is a director, officer and significant shareholder, and a related company acquired 69.8% of the common shares of Mt. Kearsarge Minerals Inc. (one of the amalgamating corporations of Sino-Forest), as a result of the payment of \$155,571 for the issuance of common shares of Mt. Kearsarge Minerals Inc. and the purchase from third parties of additional common shares for \$10,000. Upon the Amalgamation, shareholders of Mt. Kearsarge Minerals Inc. received one Class A Subordinate-Voting Share for every ten common shares of Mt. Kearsarge Minerals Inc. and, therefore, GTL Investments Corp. and the related company received 2,094,277 Class A Subordinate-Voting Shares for its common shares of Mt. Kearsarge Minerals Inc. On March 11, 1994, prior to the Amalgamation, 1028412 Ontario Inc. (the other amalgamating corporation of Sino-Forest) by way of two transactions issued 1,790,000 common shares and 900,000 Series A Purchase Warrants (each Series A Purchase Warrant entitling the holder thereof to purchase one common share at \$1.50 per share which Series A Purchase Warrants expired on August 31, 1995 without being exercised) to a non-controlled affiliate of GTL Investments Corp. for total proceeds of \$100,000 and 11,000,000 common shares and 11,000,000 Series A Purchase Warrants (each common share and Series A Purchase Warrant comprising a "Unit") at \$0.60 per Unit for total proceeds of \$6,600,000 (the "Second Private Placement"). The principals of GTL Investments Corp. also purchased 1,110,000 Units under the Second Private Placement. Upon the Amalgamation on March 17, 1994, each holder of common shares of 1028412 Ontario Inc. received one Class A Subordinate-Voting Share for each common share held.

GTL Securities Inc. also entered into an underwriting agreement with 1028412 Ontario Inc. (the other amalgamating corporation of Sino-Forest) dated February 11, 1994 pursuant to which GTL Securities Inc. received a fee of \$335,000 for its services in connection with the two private placements mentioned above for a total of 12,790,000 common shares and 11,900,000 Series A Share Purchase Warrants of 1028412 Ontario Inc. for total proceeds of \$6,700,000. Prior to the issuance of such securities, 1028412 Ontario Inc. had not previously carried on any business.

CanAsia Partners Limited (now called GTL Securities (Hong Kong) Limited) and Mackreth & Allen Partners, Limited entered into a fiscal agency agreement with Sino-Forest dated March 17, 1994 pursuant to which GTL Securities (Hong Kong) Limited and Mackreth & Allen Partners, Limited were appointed as exclusive financial advisers to the Company. Notice has been sent by Sino-Forest to terminate the fiscal agency agreement effective March 17, 1997. A waiver of the rights under such agreement was executed in connection with the offering of the Special Warrants. The fees paid or payable under the fiscal agency agreement were \$279,000 for the year ended December 31, 1994, \$26,000 for the year ended December 31, 1995 and \$487,500 for the year ended December 31, 1996 (plus Broker Special Warrants as disclosed under "Private Placement and Plan of Distribution"). See Note 12(b) under "Notes to Consolidated Financial Statements." Mr. John Thompson, a director and officer of Sino-Forest, is a shareholder and officer of GTL Securities (Hong Kong) Limited. At the time of entering into such agreement, Mackreth & Allen Partners, Limited was owned and controlled by certain officers and directors of Sino-Forest, which persons have subsequently disposed of their interests in Mackreth & Allen Partners, Limited.

Pursuant to an agreement dated as of December 15, 1994, A D Sinensis & Associates Limited provided Sino-Wood with certain corporate services which included cash management, risk management, sales and marketing, governmental relations and investor relations, during the financial year ended December

31, 1995 at a cost of approximately U.S.\$487,000. For 1996, Sino-Wood agreed to pay A D Sinensis Global Inc. a monthly fee equivalent to approximately U.S.\$36,230 for these services pursuant to an agreement dated as of December 15, 1995. A new agreement containing similar terms between Sino-Wood and A D Sinensis Global Inc. is being negotiated for services to be provided in 1997. Mr. Allen Chan, a director and officer of Sino-Forest, is a director of A D Sinensis & Associates Limited and A D Sinensis Global Inc. Ms. Leslie Chan, an officer of Sino-Forest, is a director of A D Sinensis & Associates Limited and of A D Sinensis Global Inc. The shareholders of A D Sinensis & Associates Limited are family members of Ms. Chan and the shareholders of A D Sinensis Global Inc. are two family trusts under which family members and associates of Mr. Chan and Ms. Chan are beneficiaries and trustees.

Pursuant to an agreement dated December 15, 1995, Telstar Enterprises Limited provided Sino-Wood with certain corporate services rendered in 1996, including governmental relations and technical services, for which Telstar Enterprises Limited received a monthly fee of the equivalent of approximately U.S.\$11,650. A new agreement containing similar terms between Sino-Wood and Telstar Enterprises Limited is being negotiated for services to be provided in 1997. Mr. Kai Kit Poon, a director and officer of Sino-Forest, is a director and the sole shareholder of Telstar Enterprises Limited.

ORGANIZATION OF THE COMPANY

Sino-Forest was formed under the *Business Corporations Act* of Ontario upon the Amalgamation of Mt. Kearsarge Minerals Inc. and 1028412 Ontario Inc. on March 14, 1994 pursuant to a reverse take-over transaction (the "Reverse Take-Over"). The articles of amalgamation were amended by articles of amendment filed on July 20, 1995 to effect certain changes in the provisions attaching to the Class A Subordinate-Voting Shares and the Class B Multiple-Voting Shares of Sino-Forest.

1028412 Ontario Inc. was incorporated under the laws of Ontario on April 30, 1993. Mt. Kearsarge Minerals Inc. was incorporated under the laws of Ontario by letters patent dated October 12, 1927 under the name Rhyolite Rouyn Mines, Limited. By articles of revival dated March 21, 1985, Rhyolite Rouyn Mines, Limited was revived. By articles of amendment dated July 31, 1985 the name was changed to Deerfoot Resources Inc., by articles of amendment dated December 14, 1989 the name was changed to Geneva Lake Minerals Corporation and by articles of amendment dated June 17, 1992 the name was finally changed to Mt. Kearsarge Minerals Inc. Mt. Kearsarge Minerals Inc. was a resource company which had been involved in the exploration of minerals.

Shareholders of Mt. Kearsarge Minerals Inc. approved the Reverse Take-Over in a shareholders' meeting dated March 11, 1994.

In connection with the Reverse Take-Over, on March 17, 1994, Sino-Forest acquired all of the issued and outstanding shares of Sino-Wood from Mr. Allen Chan, Ms. Leslie Chan and Mr. Kai Kit Poon in exchange for 16,200,000 Class A Subordinate-Voting Shares (being 50.6% of such shares after the Reverse Take-Over), 6,000,000 Series A Preference Shares (being all of such shares outstanding after the Reverse Take-Over) and 8,100,000 Series B Share Purchase Warrants. The Series B Share Purchase Warrants expired on June 30, 1995 without being exercised. The 16,200,000 Class A Subordinate-Voting Shares and the 6,000,000 Series A Preference Shares issued in connection with the acquisition of Sino-Wood were deposited under the Escrow Agreement referred to under "Escrow Agreement". The 6,000,000 Series A Preference Shares were converted into 6,000,000 Class B Multiple-Voting Shares in September 1995.

Sino-Wood was incorporated as a limited company under the Companies Ordinances of Hong Kong on September 24, 1992. Sino-Wood was inactive for the period from the date of incorporation to December 31, 1993, except for entering into several agreements in 1993 with certain State-Owned Enterprises in the PRC to acquire controlling interests in six EJV's. The EJV's commenced business as of January 1, 1994. In May 1995, Sino-Wood through its subsidiaries, entered into five CJVs in three provinces in the PRC to expand the scope of its plantation business. See "Business of the Company".

The executive offices of Sino-Forest are located at 1409 Great Eagle Centre, 23 Harbour Road, Wanchai, Hong Kong. The registered office of Sino-Forest is located at Suite 2004, P.O. Box 86, 200 King Street West, Toronto, Ontario, M5H 3T4. The principal business office of Sino-Forest in Canada is located at 90 Burnhamthorpe Road West, Suite 1208, Mississauga, Ontario, L5B 3C3.

PRICE RANGE AND TRADING VOLUME OF THE CLASS A SUBORDINATE-VOTING SHARES

The Class A Subordinate-Voting Shares were listed on the ASE from June 23, 1994 until March 20, 1996 when it was delisted at the request of Sino-Forest. The following table sets forth the price range and the aggregate trading volume of the Class A Subordinate-Voting Shares on, and as reported by, the ASE for the periods indicated:

<u>Calendar Period</u>	<u>High</u>	<u>Low</u>	<u>Volume</u>
1994			
Fourth Quarter	0.94	0.61	1,214,395
1995			
First Quarter	1.10	0.80	1,236,086
Second Quarter	0.96	0.75	339,583
Third Quarter	0.85	0.61	312,955
Fourth Quarter ⁽¹⁾	0.72	0.55	44,600

(1) The last trade on the ASE occurred on October 10, 1995.

The Class A Subordinate-Voting Shares of Sino-Forest were listed on the TSE on October 12, 1995 and currently trade under the symbol "TRE.A". The following table sets forth the price range and the aggregate trading volume of the Class A Subordinate-Voting Shares on, and as reported by, the TSE for the periods indicated:

<u>Calendar Period</u>	<u>High</u>	<u>Low</u>	<u>Volume</u>
1995			
October 12 to December 31	0.75	0.51	1,118,143
1996			
First Quarter	1.54	0.60	10,576,611
Second Quarter	1.70	1.31	3,441,765
July	1.52	1.10	377,304
August	1.50	1.20	616,395
September	1.60	1.20	769,650

October	1.53	1.15	908,210
November	1.43	1.16	803,950

PRIOR SALES

The only prior sales of Class A Subordinate-Voting Shares within the past 12 months were 1,650,000 Class A Subordinate-Voting Shares issued in May 1996 pursuant to stock options exercised under Sino-Forest's stock option plan for the aggregate amount of \$990,000.

DILUTION

The following table sets forth the dilution per Class A Subordinate-Voting Share based on the Company's unaudited consolidated balance sheet as at September 30, 1996, after giving effect to the issuance of Class A Subordinate-Voting Shares issuable upon the exercise of the Special Warrants excluding the Compensation Options:

Offering price per Special Warrant	\$ 1.25
Net tangible book value before this offering ⁽¹⁾	\$ 0.59
Increase in net tangible book value attributable to this offering ⁽²⁾	\$ 0.20
Pro forma net tangible book value after giving effect to this offering	\$ 0.79
Dilution to subscribers	\$ 0.46
Percentage of dilution in relation to offering price	36.8%

- (1) Net tangible book value per share represents shareholders' equity less the amount of goodwill as at September 30, 1996, divided by the number of Class A Subordinate-Voting Shares and Class B Multiple-Voting Shares outstanding at the date thereof.
- (2) After deducting the underwriting fees of \$1,950,000 and the estimated expenses of this offering of \$550,000. See "Private Placement and Plan of Distribution".
- (3) Amounts have been translated into Canadian dollars using the exchange rate as at November 25, 1996 of Cdn.\$1.34 per U.S.\$1.00.

DESCRIPTION OF SHARE CAPITAL

THE OFFERING

The offering consists of 24,000,000 Class A Subordinate-Voting Shares of Sino-Forest issuable pursuant to the exercise of an equal number of previously issued Special Warrants.

AUTHORIZED CAPITAL

The authorized capital of Sino-Forest consists of:

- (i) an unlimited number of Class A Subordinate-Voting Shares;
- (ii) 6,000,000 Class B Multiple-Voting Shares; and

- (iii) an unlimited number of Preference Shares, issuable in series.

As at November 25, 1996, 37,150,000 Class A Subordinate-Voting Shares, 6,000,000 Class B Multiple-Voting Shares and no Preference Shares were issued and outstanding before giving effect to the exercise of the Special Warrants.

Class A Subordinate-Voting Share and Class B Multiple-Voting Share Attributes

Rank

Each Class A Subordinate-Voting Share and each Class B Multiple-Voting Share has the same rights and is equal in all respects except with respect to voting, dividends and the rights of conversion as described below.

Voting

The holders of Class A Subordinate-Voting Shares and Class B Multiple-Voting Shares are entitled to receive notice of and to attend all meetings of the holders of shares (other than separate meetings of the holders of shares of any other class of shares or of any series thereof). At such meetings, each holder of Class A Subordinate-Voting Shares is entitled to one vote for each share and each holder of Class B Multiple-Voting Shares is entitled to five votes per share.

Dividends

The Class A Subordinate-Voting Shares rank in priority to the Class B Multiple-Voting Shares as to the payment of dividends. No dividends may be declared or paid on the Class B Multiple-Voting Shares in any fiscal year unless in the same fiscal year dividends in an amount per share at least equal to the amount of dividends per share proposed to be declared or paid on outstanding Class B Multiple-Voting Shares have been declared or paid on the Class A Subordinate-Voting Shares.

Conversion of Class B Multiple-Voting Shares into Class A Subordinate-Voting Shares

Each holder of Class B Multiple-Voting Shares shall be entitled at any time and from time to time to have all or any part of the Class B Multiple-Voting Shares held converted into Class A Subordinate-Voting Shares on a share-for-share basis. This conversion right shall be exercised by notice in writing to the Company's transfer agent at its office at 5th Floor, 393 University Avenue, Toronto, Ontario, M5G 1E6 accompanied by the certificate(s) representing the Class B Multiple-Voting Shares in respect of which such right is exercised. See also "Take-over Bid Protection" below.

Dissolution

Upon the liquidation or dissolution of Sino-Forest or any other distribution of its assets among its shareholders for the purpose of winding-up its affairs, the assets of Sino-Forest available for payment or distribution, after giving effect to the preference of the holders of Preference Shares, shall be paid or distributed to the holders of Class A Subordinate-Voting Shares and the holders of Class B Multiple-Voting Shares in equal amounts per share without preference or distinction.

Subdivisions, Consolidations and Other Changes

In the event of (i) any subdivision, consolidation, reclassification or other change in the Class A Subordinate-Voting Shares or the Class B Multiple-Voting Shares, (ii) any reorganization of the share capital of Sino-Forest affecting the Class A Subordinate-Voting Shares or the Class B Multiple-Voting Shares, or (iii) any amalgamation of Sino-Forest with another company, appropriate adjustments shall be made to the dividend rights, the voting rights, the dissolution rights and the conversion rights attaching to the Class A Subordinate-Voting Shares and the Class B Multiple-Voting Shares so as to preserve their respective rights inter se in all respects.

Take-over Bid Protection

The articles of Sino-Forest and the Coattail Agreement describe an offer giving rise to the conversion right, provide certain procedures to be followed in order to effect the conversion and provide that, upon any such offer, Sino-Forest or the transfer agent shall communicate in writing to the holders of Class A Subordinate-Voting Shares the full details as to the offer and the mode of exercise of the conversion right.

The holders of the Class A Subordinate-Voting Shares are provided with certain rights relating to take-over bids. The articles of Sino-Forest and the Coattail Agreement provide that if a beneficial owner of Class B Multiple-Voting Shares transfers any of such shares to a purchaser who has made an offer for all the outstanding Class B Multiple-Voting Shares and who has not made an identical offer for all or substantially all of the Class A Subordinate-Voting Shares or transfers Class B Multiple-Voting Shares to a purchaser who is not otherwise a permitted transferee under the Coattail Agreement, then all of the Class B Multiple-Voting Shares so transferred shall, after notice is sent by the Trustee to the holders thereof, automatically be converted into Class A Subordinate-Voting Shares. There are no restrictions on the ability of the beneficial holder of Class B Multiple-Voting Shares to convert any of the Class B Multiple-Voting Shares into Class A Subordinate-Voting Shares or subject to compliance with applicable securities laws, to subsequently transfer such Class A Subordinate-Voting Shares to third parties. A permitted transferee includes a person who at the time of transfer holds Class B Multiple-Voting Shares or a corporation which is wholly-owned, directly or indirectly, by a person who at the time of the transfer holds Class B Multiple-Voting Shares.

Preference Share Attributes

The board of directors of Sino-Forest may issue the Preference Shares at any time and from time to time be issued in one or more series. Subject to the limitations set out in the articles of Sino-Forest, the board of directors shall determine the designations, rights, privileges, restrictions and conditions attaching to a particular series. No rights, privileges, restrictions or conditions attached to a series of Preferred Shares shall, however, confer upon a series a priority in respect of dividends or return of capital in the event of the liquidation, dissolution or winding-up of Sino-Forest over any other series of Preferred Shares. The Preferred Shares are entitled to a preference over the Class A Subordinate-Voting Shares and the Class B Multiple-Voting Shares. The holders of the Preferred Shares are not entitled to receive notice of, to attend nor to vote at any meeting of shareholders of Sino-Forest, except as provided by law or in accordance with any voting rights which may from time to time be attached to any series of Preferred Shares.

MATERIAL CONTRACTS

The only material contracts entered into by the Company during the past two years not in the ordinary course of business are the Underwriting Agreement and the Special Warrant Indenture referred to under "Private Placement and Plan of Distribution".

Copies of the material contracts may be inspected at the offices of Aird & Berlis at BCE Place, Suite 1800, 181 Bay Street, Toronto, Ontario M5J 2T9 during normal business hours at any time during the period of distribution of the Class A Subordinate-Voting Shares to the public and for a period of 30 days thereafter.

PRIVATE PLACEMENT AND PLAN OF DISTRIBUTION

On October 2, 1996, Sino-Forest, through the Underwriters, issued and sold to investors, by way of the Private Placement, 24,000,000 Special Warrants at a price of \$1.25 each. The price of the Special Warrants, namely \$1.25, was determined by negotiation between Sino-Forest and the Underwriters. The Special Warrants were offered pursuant to the Underwriting Agreement.

In consideration for its services in connection with the Private Placement, Sino-Forest has paid to the Underwriters an aggregate fee of \$1,950,000 representing 6.5% of the gross proceeds on the sale of the Special Warrants. As additional compensation, Sino-Forest also granted to certain of the Underwriters Broker Special Warrants to acquire non-assignable Compensation Options without payment of any additional consideration. The Compensation Options entitle the holders thereof to purchase an aggregate of 2,400,000 Class A Subordinate-Voting Shares at an exercise price of \$1.44 for each Class A Subordinate-Voting Share, subject to adjustment, at any time on or before October 2, 1998.

The Special Warrants were issued under the Special Warrant Indenture. Each Special Warrant may be exercised to acquire one Class A Subordinate-Voting Share without payment of any additional consideration at any time prior to 5:00 p.m. (local time) on November 2, 1997, after which time they will expire.

Sino-Forest has agreed to use its reasonable best efforts to obtain receipts for a (final) prospectus for the distribution of the Class A Subordinate-Voting Shares on the exercise of the Special Warrants under the *Securities Act* (Ontario), the *Securities Act* (Manitoba) and the *Securities Act* (Northwest Territories). If a receipt for the (final) prospectus qualifying the Class A Subordinate-Voting Shares has not been issued by the securities regulatory authorities of Ontario, Manitoba and Northwest Territories prior to 5:00 p.m. (local time) on January 30, 1997, the holders of Special Warrants shall be entitled to receive 1.085 Class A Subordinate-Voting Shares (instead of one Class A Subordinate-Voting Share) in respect of each Special Warrant exercised. If a receipt has been issued for the (final) prospectus on or before 5:00 p.m. (local time) on October 2, 1997, any unexercised Special Warrants will be exercised by the Special Warrant Agent on the fifth business day after the issuance of such receipt, on behalf of the holders thereof without any further action on the holders' part. If receipts have not been issued for the (final) prospectus on or before October 2, 1997, any unexercised Special Warrants will be exercised by the Special Warrant Agent on behalf of the holders thereof without any further action on the holders' part.

The Special Warrants and the Broker Special Warrants were issued pursuant to exemptions from the prospectus requirements of applicable Canadian securities legislation. The distribution of the Class A Subordinate-Voting Shares to be issued upon the exercise of the Special Warrants and certain Compensation

Options to be issued upon the exercise of the Broker Special Warrants will be qualified under Canadian securities laws, only, by this prospectus and will be issued pursuant to exemptions from the registration requirements of applicable Canadian securities legislation. Any Class A Subordinate-Voting Shares issued upon the exercise of Special Warrants or Compensation Options issued upon the exercise of the Broker Special Warrants prior to the issuance of receipts for the (final) prospectus will be subject to hold periods under applicable securities legislation.

Pursuant to the Special Warrant Indenture, the Underwriters, on behalf of the holders of Special Warrants, deposited with the Special Warrant Agent the Escrowed Funds. The Escrowed Funds are held in escrow by the Special Warrant Agent to be released to Sino-Forest upon the earlier of (i) receipt by the Special Warrant Agent from Sino-Forest of a copy of a receipt for the (final) prospectus from the securities regulatory of each of the provinces of Ontario and Manitoba and the Northwest Territories and (ii) October 2, 1997. Notwithstanding the foregoing, upon any exercise of the Special Warrants by the holders of Special Warrants in accordance with the Special Warrant Indenture, the Special Warrant Agent shall, as soon as reasonably practicable thereafter (or such later date as may be directed in writing by Sino-Forest), release to Sino-Forest that proportion of the Escrowed Funds then held by the Special Warrant Agent that the number of Special Warrants so exercised is to the aggregate number of Special Warrants issued and outstanding immediately prior to such exercise.

United States Restrictions

Neither the Special Warrants nor the Class A Subordinate-Voting Shares issued upon the exercise thereof have been or will be registered under the U.S. Securities Act and they may not be offered or sold in the United States of America or to, or for the account of, U.S. persons except in transactions exempt from the registration requirements of the U.S. Securities Act. Each of the Underwriters has agreed that, except as permitted by the Underwriting Agreement, neither it nor any of its affiliates nor any person acting on its behalf or on behalf of its affiliates has made or will make any offer to sell or any solicitation of an offer to buy, any such securities to any person in the United States.

Purchasers can resell the Special Warrants or the Class A Subordinate-Voting Shares only pursuant to Regulation S or otherwise pursuant to an exemption from registration under the U.S. Securities Act. A resale of the Special Warrants or the Class A Subordinate-Voting Shares will generally comply with Regulation S so long as (i) the offer relating to such resale is not made to a person in the United States, (ii) neither the reseller, any affiliate of the reseller, nor any other person acting on behalf of the reseller or any of its affiliates engaged in "directed selling efforts" (as such term is defined in Rule 902(b) under the U.S. Securities Act), and (iii) either (A) at the time the buy order is originated, the buyer is outside the United States, or the reseller and any person acting on such reseller's behalf reasonably believe that the buyer is outside the United States, or (B) the resale transaction is executed in, or through the facilities of a "designated offshore securities market" as specified in Rule 902(a) under the U.S. Securities Act and neither the reseller nor any person acting on behalf of the reseller knows that the transaction has been pre-arranged with a buyer in the United States. The provisions of Regulation S impose additional restrictions on resales by distributors (as such term is defined in Rule 902(c) under the U.S. Securities Act), affiliates of the Company and dealers or other persons who receive a selling commission, fee or other remuneration with respect to such resales.

In addition, until 40 days after the commencement of the offering, an offer or sale of the Special Warrants or the Class A Subordinate-Voting Shares within the United States by a dealer (whether or not participating in the offering) may violate the registration requirements of the U.S. Securities Act.

The foregoing summary of certain complex United States securities laws does not purport to be complete and is not intended and should not be construed as legal advice to any purchaser of Special Warrants or Class A Subordinate-Voting Shares. Each such purchaser should consult with legal counsel regarding the application of such laws.

USE OF PROCEEDS

The estimated net proceeds to the Company from the sale of the 24,000,000 Special Warrants is approximately \$27.5 million after deducting the Underwriters' fees and the expenses of this offering which will be paid from the proceeds of the offering. Of such net proceeds, approximately \$15 million will be used to fund the accelerated phase-in programme of the Company's CJV tree plantations in southern China. Approximately \$7.5 million will be used to fund the acquisition or expansion of chipping plants in existing or future provinces in which the Company operates. The Company expects that these additional chipping plants, which are expected to be completed by the end of 1997, will provide the Company with an additional annual capacity of approximately 1.3 million BDMT of wood chips. These additional chipping plants are to be located in close proximity to ports and the Company's Joint Venture plantations. Approximately \$3.4 million will be used for the expansion of port facilities, and the balance of \$1.6 million will be used as working capital for general corporate purposes. One-half of the gross proceeds of the issue of the Special Warrants, being \$15,000,000, is held in escrow by the Special Warrant Agent in accordance with the terms of the Special Warrant Indenture.

DIVIDEND POLICY

Sino-Forest has not declared any dividends on its shares. Other than restrictions on the payment of dividends imposed by law and the priority of the Class A Subordinate-Voting Shares over the Class B Multiple-Voting shares with respect to the payment of dividends, there are no restrictions which would prevent Sino-Forest from paying dividends. Any payment of dividends on Class A Subordinate-Voting Shares and Class B Multiple-Voting Shares is at the discretion of the board of directors of Sino-Forest and is dependent upon Sino-Forest's results of operations, financial condition, financing requirements and other factors that the board of directors deems relevant.

ESCROW ARRANGEMENTS

The 16,200,000 Class A Subordinate-Voting Shares of Sino-Forest issued in connection with the acquisition of Sino-Wood were deposited with Equity Transfer Services Inc., as escrow agent, pursuant to the terms of an escrow agreement dated March 17, 1994 with NFL, ADS, FIP and Well Conduct Corporation, Equity Transfer Services Inc. and GTL Securities Inc. The shares deposited thereunder may not be released from escrow without the prior written consent of Sino-Forest and GTL Securities Inc. except as provided therein. Pursuant to such escrow agreement, 20% of the shares deposited thereunder were released on each of March 17, 1995 and March 17, 1996 and 20% of the shares are to be released automatically on March 17 of each of the years 1997, 1998 and 1999. The escrow agreement was amended by an agreement made as of January 28, 1997 to also require the prior written consent of the Ontario Securities Commission to releases from escrow, subject to the automatic releases contained in the original agreement, and notwithstanding the other release provisions contained therein.

RISK FACTORS

Prospective investors should consider carefully, in addition to the other information contained in this prospectus, the following risk factors in connection with the Class A Subordinate-Voting Shares offered hereby:

Political and Economic Considerations

The value of the Company's investment in its joint ventures may be adversely affected by significant political, economic and social uncertainties in the PRC. The PRC is a developing country and shares with other developing countries the characteristic of having a socio-political system that is prone to sudden and, to outsiders, unpredictable events and evolvement. The policy for economic reform in the PRC to change its economic system from a centrally-planned economy to a market-oriented economy with Chinese characteristics has been in place since 1979 and has been reaffirmed many times by the NPC, the politburo of the Communist party of the PRC, and the State Council. Though not without set-backs and hiatus, economic reform has had far reaching effects on the economic system of the PRC and has resulted in sustaining high economic growth for some 16 years. Due to recent political policies adopted by the PRC, certain foreign governments in Southeast Asia, such as Japan, and in the United States, may adopt new policies with respect to trade with China. There is no guarantee that in the event of a major change of decision-makers at the most senior political level, the existing economic policy of the PRC will not be changed, or that the socio-political stability so crucial to the economic growth in the past decade will not suffer.

The principal participants in the PRC's economy (which, in part, overlap) are State-Owned Enterprises; Collectively-Owned Enterprises; Privately-Owned Enterprises; joint-stock companies, including joint-stock companies that are subject to varying degrees of State ownership; and FIEs. State-Owned Enterprises continue to constitute the largest section of the economy.

The PRC's rapid economic growth has led to periodic cycles of high inflation. In order to control economic expansion and combat inflation, the Chinese government adopted measures to control prices, credit, expenditures and investment. At the same time, the Chinese government has moved to accelerate the reform of the monetary system, the financial system, taxation and public finance. The austerity program has caused bank credit to tighten and may have a dampening effect on the various expansion plans of the joint ventures.

The Chinese government has recently confirmed that the PRC's economic development will follow a model of market economy under socialism. Under this direction, it is expected that the PRC will continue to strengthen its economic and trading relationships with foreign countries and business development in the PRC will follow market forces and rules of economics.

Legal System and Enforcement

As the PRC's legal system develops, the promulgation of new laws, changes to existing laws and the pre-emption of local regulations by national laws may adversely affect foreign investors. In circumstances where adequate laws exist, it may not be possible to obtain swift and equitable enforcement of the laws or any changes to the interpretation of laws.

The Company believes its joint ventures have obtained the governmental approvals necessary to permit them to conduct their business. Sino-Forest has been advised by its Chinese counsel that if every CJV or EJV carries out its business in accordance with the joint venture contract under which it was formed and under the PRC laws, any further required approval could be obtained. If there is any administrative review, approval or action by various national, provincial or local agencies of the PRC government which causes a CJV or EJV serious damage, the PRC law permits redress to the court with respect to certain of these administrative actions.

Though Chinese law expressly protects the status and rights of Sino-foreign joint ventures and enterprises, the State reserves the right, in special circumstances, to terminate joint ventures and provide compensation therefor. There can be no assurance, however, that such compensation will be adequate or timely.

Environmental Considerations

The Environmental Protection Law of the PRC was adopted by the Standing Committee of NPC of the PRC on December 26, 1989. Under the Environmental Protection Law, the division in the State Council responsible for environmental protection has the power to set national environmental quality standards and environmental protection agencies of lower levels of government have power to set local standards to supplement the national standards in areas where the national standards are silent. Due to the very short history of the Environmental Protection Law, national and local environmental protection standards are still in the process of being formulated, experimented and implemented. It is a general policy of the PRC that a person who harvests or otherwise cuts down trees is required to replant on the harvested plantation lands to maintain the ecological equilibrium. The Company believes that the joint ventures have no outstanding notices, orders or directives from central or local environmental protection agencies or local government authorities alleging any breach of national or local environmental quality standards by the Company's joint ventures, and the joint ventures have complied with all existing environmental protection laws, regulations, administrative orders and standards. Given the nature of their businesses, there is a possibility that the joint ventures will have to meet higher environmental quality standards as the economy of the PRC and its level of environmental consciousness increase in the coming years.

Failure to Make Capital Contribution

The CJV Law and the EJV Law stipulate that the first instalment of the capital contribution by a joint venture party shall not be less than 15% of the portion of the registered capital subscribed to by the joint venture party and must be within three months of the issuance date of the business licence of the CJV or EJV, as the case may be. In the event of a breach of the statutory requirement, the CJV or EJV may automatically cease to exist and all prior approvals are automatically revoked.

Where joint venture parties have met their obligations on payment of the first instalment on capital contribution, the CJV Law and the EJV Law provide that where a joint venture party fails to meet its subsequent obligation to make capital contribution three months after it becomes due, relevant government authorities shall issue a notice to the joint venture parties demanding that the capital contribution be made within one month. Failure to comply with the demand will give government authorities the right to revoke the business licence of the CJV or EJV and all prior approvals, thereby forcing the CJV or EJV into winding-up proceedings. The risk of governmental action in the event of the Company's inability to meet its contribution commitments is a significant risk. However, the delay of capital contribution under certain conditions can be negotiated among the parties and if the reasons for delay are rational and agreed upon by

the parties, the contract can be revised and approval can be obtained from the relevant authority. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Capital Contribution Commitments".

Competition

The markets for wood chips are competitive and are sensitive to cyclical changes in industry capacity and in the economy. Changes in the level of competition, government regulations on timber harvesting, industry capacity and the economy will have a significant impact on the Company's selling prices and overall profitability. The Company competes with a large number of international forest products selling wood chips in the East Asia market. The Company also competes in the domestic market with local firms on a smaller scale, including its PRC partners. It is expected that the Company will increase its revenue significantly in the domestic market over the next few years as wood chips and related forestry products in the PRC will continue to be in big demand as the country moves forward on its economic developments.

Fluctuations in Selling Price of Wood Chips

The operating results of the Company can be significantly affected by fluctuations in the selling price of wood chips. Wood chips produced by the Company are primarily supplied to pulp manufacturers in Japan, Taiwan and South Korea and more recently in China. The pulp market industry is cyclical in nature. World pulp prices are affected by a number of factors including the world's economic growth rate and the demand for paper products.

Dependence on Key Personnel

The Company is currently dependent upon a small number of key management personnel and success during its initial growth period will depend, in part, on their abilities. The loss of the services of certain key management personnel may adversely affect the performance of the Company.

Limited Operating History

Since the Company's Joint Ventures commenced operations in 1994 and 1995, they are in the early stages of development and have relatively brief operating histories, and therefore, investment in the securities offered by Sino-Forest should be considered speculative.

Joint Venture Arrangements

Co-operation and agreement among the Company's joint venture partners is an important factor for the operational and financial success of the joint ventures. In certain circumstances, the Company is not able to control the decision making process of the joint ventures without the concurrence of the joint venture partners. The Company does, however, through contractual provisions and representatives appointed by it, have the ability to control most material decisions. Disputes among the partners over joint venture obligations or other matters, or the early termination or non-renewal of the joint venture agreements, could materially adversely affect the businesses of the Company. However, the Company has not to date experienced any significant disagreements with its partners. The joint ventures may also be terminated under certain circumstances as described under "Business Operations".

Control of the Company

Mr. Allen Chan, a director and officer of Sino-Forest, together with Ms. Leslie Chan, an officer of Sino-Forest, own beneficially shares entitling them to 39.5%, and Kai Kit Poon, a director and officer of Sino-Forest, currently owns beneficially shares entitling him to 23.9%, of the voting rights attached to the outstanding shares of Sino-Forest (see "Principal Shareholders"). Assuming that no options are exercised and no additional securities of Sino-Forest are issued, other than in connection with the exercise of the Special Warrants, Mr. Chan, together with Ms. Chan and Mr. Poon would own beneficially shares entitling them to 29.1% and 17.6% respectively of the voting rights attached to the outstanding shares of Sino-Forest. As a result, they will continue to exercise a high degree of control over Sino-Forest following this offering.

Exchange Rate

The information presented in this prospectus relating to the exchange rate of the Canadian dollar is furnished as a matter of information only. The fluctuations in the U.S. dollar/Canadian dollar exchange rate that have occurred in the past are not necessarily indicative of fluctuations in that rate that may occur. Exchange rate fluctuations relative to other currencies are also a risk factor. A significant portion of the Company's sales revenue is received in United States dollars. The Company remits only foreign exchange funds to the PRC to cover contracted operating costs in the local Chinese Renminbi. This reduces the Company's currency risk affecting its operations in the PRC.

The usage, movement and conversion of foreign currency in the PRC are subject to legislative and administrative restriction and control. The Chinese government imposes control over the conversion of its national currency RMB into foreign currencies and remittance thereof out of the PRC must be conducted through the Bank of China or other authorized financial institutions to deal in foreign currencies or, for conversion only, through the authorised banks or foreign exchange adjustment centres.

Reliability of Information on the PRC

While the information contained in this prospectus or appended hereto regarding the PRC has been obtained from a variety of government and private sources, independent verification of this information is not in all cases available and there can be no assurance that the sources from which it is taken or on which it is based are wholly reliable. Official statistics in relation to the PRC may be produced on a basis different from that used in Western countries.

LEGAL PROCEEDINGS

The Company is not a party to, nor is any of its property subject to, any legal proceeding that is material to the Company and no such proceeding is known to be contemplated.

LEGAL MATTERS

Certain legal matters in respect of the Special Warrants and the Class A Subordinate-Voting Shares have been and will be passed upon on behalf of Sino-Forest by Aird & Berlis, Toronto and on behalf of the

Underwriters by Osler, Hoskin & Harcourt.

AUDITORS, TRANSFER AGENT AND REGISTRAR

The auditors of Sino-Forest are Ernst & Young, Chartered Accountants, Toronto, Ontario.

The transfer agent and registrar for the Class A Subordinate-Voting Shares is The R-M Trust Company at its principal office in Toronto.

CONTRACTUAL RIGHT OF ACTION FOR RESCISSION

In the event that a holder of a Special Warrant who acquires a Class A Subordinate-Voting Share upon the exercise of the Special Warrant as provided for in this prospectus is entitled under applicable securities legislation to the remedy of rescission by reason of this prospectus or any amendment thereto containing a misrepresentation, such holder shall be entitled to rescission not only of the holder's exercise of its Special Warrant but also of the private placement transaction pursuant to which the Special Warrant was initially acquired, and shall be entitled in connection with such rescission to a full refund of all consideration paid on the acquisition of the Special Warrant. In the event such holder is a permitted assignee of the interest of the original Special Warrant subscriber, such permitted assignee shall be entitled to exercise the rights of rescission and refund granted hereunder as if such permitted assignee was the original subscriber. The foregoing is in addition to any other right or remedy available to a holder of a Special Warrant under section 130 of the *Securities Act* (Ontario) or corresponding provisions of other securities legislation, as the case may be, or otherwise at law.

PURCHASERS' STATUTORY RIGHTS

Securities legislation in several of the provinces provides purchasers with the right to withdraw from an agreement to purchase securities within two business days after receipt or deemed receipt of a prospectus and any amendment. In several of the provinces and the territories, applicable securities legislation further provides a purchaser with remedies for rescission or, in some jurisdictions, damages where the prospectus and any amendment contains a misrepresentation or is not delivered to the purchaser, provided that such remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's Province or Territories. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's Province or Territories for the particulars of these rights or consult with a legal advisor.

AUDITORS' REPORT

To the Board of Directors of
Sino-Forest Corporation

We have audited the consolidated balance sheets of **Sino-Forest Corporation** as at December 31, 1995 and 1994 and the consolidated statements of income and retained earnings and changes in financial position for each of the years in the four-year period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 1995 and 1994 and the results of its operations and the changes in its financial position for each of the years in the four-year period ended December 31, 1995 in accordance with generally accepted accounting principles.

Toronto, Canada,
May 8, 1996
[except as to note 15 which
is as of October 2, 1996].

(Signed) Ernst & Young
Chartered Accountants

Sino-Forest Corporation

CONSOLIDATED BALANCE SHEETS

[Expressed in thousands of United States dollars]

As at

	September 30, 1996 \$	December 31, 1995 \$	December 31, 1994 \$
<i>[unaudited]</i>			
ASSETS			
Current			
Cash and short-term deposits	389	323	2,116
Accounts receivable	3,932	2,607	2,617
Inventories <i>[note 5]</i>	134	200	2,197
Other receivables and prepaid expenses	2,235	1,317	936
Total current assets	6,690	4,447	7,866
Due from PRC parties <i>[note 6]</i>	14,788	14,737	5,633
Jiangxi Investments <i>[note 3]</i>	2,092	2,342	—
Capital assets, net <i>[note 7]</i>	18,446	9,988	17,075
Goodwill, net <i>[note 2]</i>	34	35	36
	42,050	31,549	30,610
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current			
Bank indebtedness	—	—	149
Accounts payable and accrued liabilities	593	655	802
Income taxes payable	799	—	—
Other payables	393	179	65
Total current liabilities	1,785	834	1,016
Convertible debenture <i>[note 8]</i>	3,000	—	—
Total liabilities	4,785	834	1,016
Non-controlling interests	18,359	17,026	21,112
Shareholders' equity			
Share capital <i>[note 9]</i>	6,874	6,151	5,321
Retained earnings	11,860	7,364	3,010
Cumulative translation adjustment	172	174	151
Total shareholders' equity	18,906	13,689	8,482
	42,050	31,549	30,610

See accompanying notes

On behalf of the Board:

Director

(Signed) John Thompson

Director

(Signed) James F. O'Donnell

Sino-Forest Corporation

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

[Expressed in thousands of United States dollars, except for earnings per share information]

	Nine months ended		Years ended			
	September 30, 1996	September 30, 1995	December 31, 1995	December 31, 1994	December 31, 1993	December 31, 1992
	\$	\$	\$	\$	\$	\$
<i>[unaudited]</i>						
Revenue	18,197	20,754	27,423	20,482	—	—
Costs and expenses						
Cost of sales	8,657	11,580	15,191	12,971	—	—
Selling, general and administration	1,955	2,228	2,697	1,777	—	—
Depreciation, amortization and depletion	556	667	793	1,426	—	—
	11,168	14,475	18,681	16,174	—	—
Income from operations	7,029	6,279	8,742	4,308	—	—
Equity in losses of Jiangxi Investments [note 3]	(250)	(121)	(262)	—	—	—
Interest (expense) income [note 8]	(159)	22	(6)	58	—	—
Other income	—	10	20	52	—	—
Income before income taxes	6,620	6,190	8,494	4,418	—	—
Provision for income taxes - current [note 10]	797	—	—	—	—	—
Income before non-controlling interests	5,823	6,190	8,494	4,418	—	—
Non-controlling interests	1,327	3,390	4,140	1,408	—	—
Net income for the period	4,496	2,800	4,354	3,010	—	—
Retained earnings, beginning of period	7,364	3,010	3,010	—	—	—
Retained earnings, end of period	11,860	5,810	7,364	3,010	—	—
Earnings per share [note 11]						
Basic	\$0.11	\$0.08	\$0.12	\$0.10	—	—
Fully diluted	\$0.09	\$0.08	\$0.12	\$0.08	—	—

See accompanying notes

Sino-Forest Corporation

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

[Expressed in thousands of United States dollars]

	Nine months ended		Years ended			
	September 30, 1996	September 30, 1995	December 31, 1995	December 31, 1994	December 31, 1993	December 31, 1992
	\$	\$	\$	\$	\$	\$
	<i>[unaudited]</i>					
OPERATING ACTIVITIES						
Net income for the period	4,496	2,800	4,354	3,010	—	—
Add items not affecting cash						
Depreciation, amortization and depletion	556	667	793	1,426	—	—
Non-controlling interests	1,327	3,390	4,140	1,408	—	—
Equity in losses of Jiangxi Investments	250	121	262	—	—	—
	6,629	6,978	9,549	5,844	—	—
Net change in non-cash working capital balances	(1,226)	2,147	(1,822)	(3,310)	(1)	—
Cash provided by (used in) operating activities	5,403	9,125	7,727	2,534	(1)	—
FINANCING ACTIVITIES						
Issuance of convertible debenture	3,000	—	—	—	—	—
Issuance of share capital	723	885	885	5,808	1	1
Share issue costs	—	(55)	(55)	(489)	—	—
Cash provided by financing activities	3,723	830	830	5,319	1	1
INVESTING ACTIVITIES						
Increase in amount due from PRC parties	(51)	(7,123)	(9,104)	(5,633)	—	—
Purchase of capital assets	(9,014)	(451)	(547)	(595)	—	—
Decrease in cash on reduction of equity interest in Jiangxi Investments <i>[note 3]</i>	—	(675)	(675)	—	—	—
Investments in the PRC <i>[note 3]</i>	—	—	—	(3,895)	—	—
Cash acquired on investments in the PRC <i>[note 3]</i>	—	—	—	4,004	—	—
Purchase of goodwill	—	—	—	(37)	—	—
Cash used in investing activities	(9,065)	(8,249)	(10,326)	(6,156)	—	—
Effect of exchange rate changes on cash	5	72	125	269	—	—
Net increase (decrease) in cash during the period	66	1,778	(1,644)	1,966	—	1
Cash and short-term deposits net of bank indebtedness, beginning of period	323	1,967	1,967	1	1	—
Cash and short-term deposits net of bank indebtedness, end of period	389	3,745	323	1,967	1	1

See accompanying notes

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

1. SIGNIFICANT ACCOUNTING POLICIES

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

Basis of consolidation

These consolidated financial statements include the accounts of the Company and its subsidiaries, some of which have a minority interest. All significant intercompany accounts and transactions have been eliminated on consolidation.

The Company's investments in the Sino-foreign co-operative joint ventures [each a "PRC CJV", collectively, the "PRC CJVs"] are accounted for on the proportionate consolidation basis. Accordingly, the accounts reflect the Company's pro-rata share of the assets, liabilities, revenue, expenses and cash flows of its PRC CJVs.

Investments in Sino-foreign equity joint venture enterprises over which the Company exercises significant influence but not joint control are accounted for under the equity method.

Translation of foreign currencies

Foreign currency transactions and balances, and the financial statements of integrated foreign operations, are translated into United States dollars using the temporal method. Under this method, monetary items are translated at the rate of exchange in effect at the balance sheet dates. Non-monetary items are translated at the historical exchange rate. Revenue and expense items are translated at the average exchange rates prevailing during the year, except for depreciation, amortization and depletion which are translated at the same exchange rates as the assets to which they relate. Exchange gains and losses are included in income in the current year.

Financial statements of self-sustaining foreign operations are translated into United States dollars using the current rate method. Under this method, assets and liabilities denominated in the foreign currency are translated at the rate of exchange in effect at the balance sheet dates while revenue and expense items [including depreciation, amortization and depletion] are translated at the average exchange rates prevailing during the year. Exchange gains and losses from the translation of such financial statements are deferred and disclosed as a separate component of shareholders' equity.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

Inventories

Raw materials are valued at the lower of average cost of acquisition and replacement cost. Work-in-progress and finished goods are stated at the lower of cost and net realizable value. Cost comprises direct materials and direct labour costs including applicable overheads incurred to bring the inventories to their present condition and location, and is calculated using the weighted average method. Net realizable value represents the anticipated selling price less all further costs for completion and distribution.

Goodwill

Goodwill is amortized over forty years on a straight-line basis.

Capital assets

Capital assets are recorded at cost. Repairs and maintenance expenditures are charged to income; major betterments and replacements are capitalized. Depreciation and amortization are provided on a straight-line basis to reduce the original cost of capital assets to estimated residual values over the following estimated useful lives:

Land use rights and buildings	30 years
Machinery and equipment	15 years
Office furniture and equipment	10 years
Vehicles	10 years
Leasehold improvements	over the lease term

The costs of timber holdings which include planting, maintenance and harvesting costs are capitalized over a period of 5 to 12 years based on the growth cycle of the type of trees. The costs of timber holdings are depleted when the trees are harvested on the basis of the volume of timber cut.

Revenue

Revenue from sales of products is recognized upon shipment to customers. Commission income is recognized as revenue when services are rendered.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

2. ACQUISITION OF SINO-WOOD PARTNERS, LIMITED

On March 14, 1994, Mt. Kearsarge Minerals Inc. ["Mt. Kearsarge"], a corporation incorporated under the laws of Ontario, Canada, changed its name to Sino-Forest Corporation as a result of an amalgamation with 1028412 Ontario Inc. ["Ontario"]. At the time of the amalgamation, Ontario had working capital and shareholders' equity of \$4,550,000 [Cdn. \$6,182,000]. This amalgamation has been accounted for as a pooling of interests.

On March 17, 1994, Sino-Forest acquired all the issued and outstanding common shares of Sino-Wood Partners, Limited ["Sino-Wood"] in exchange for 16,200,000 Class A Subordinate-Voting Shares, 6,000,000 Series A Preference Shares and 8,100,000 Series B share purchase warrants of Sino-Forest. The then existing shareholders of Sino-Wood, as a group, held greater than 50% of the Class A Subordinate-Voting Shares of Sino-Forest after the share exchange. This acquisition has been accounted for as a reverse takeover and for accounting purposes Sino-Wood has been treated as the acquiror of Sino-Forest.

Under the purchase method of accounting, the net assets of Sino-Forest were adjusted to reflect the following estimated fair values:

	\$
Net assets acquired	133
Goodwill	37
	170

Sino-Wood was inactive for the period from incorporation on September 24, 1992 to December 31, 1993, except for entering into various agreements in 1993 with certain state-owned enterprises in the People's Republic of China [the "PRC"] to acquire 53% to 55% equity interest in six Sino-Foreign equity joint venture enterprises as described in note 3.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

3. INVESTMENTS IN THE PRC

Effective January 1, 1994, Sino-Wood acquired the following Sino-foreign equity joint venture enterprises in the PRC:

- 53% equity interest in Zhangjiang Leizhou Eucalypt Resources Development Co. Ltd. ["Leizhou EJV"] in Guangdong Province; and
- 55% equity interest in Jiangxi Ganjia Wood Industrial Co. Ltd., Jiangxi Ganzhou Pencheng Chemical Industry Co. Ltd., Jiangxi Chuigang Forest Products & Chemical Industry Co. Ltd., Jiangxi Dongyuan Chemical Industry Co. Ltd. and Jiangxi Xuesong Forest & Chemical Industry Co. Ltd. [collectively, the "Jiangxi Investments"].

The interests were acquired for an aggregate purchase price of \$3,895,000 satisfied by initial cash capital contributions by Sino-Wood.

These acquisitions have been accounted for under the purchase method of accounting. A summary of the net assets acquired and consideration given in the acquisitions of Leizhou EJV and Jiangxi Investments are as follows:

	\$
Net assets acquired	
Capital assets	17,994
Inventories	1,572
Cash	4,004
	23,570
Non-controlling interests	(19,675)
	3,895
Consideration given	
Initial cash capital contributions	3,895

Pursuant to the contractual obligations set out in the various joint venture agreements and memoranda of implementation, total capital contributions, in the form of cash, to be made by Sino-Wood to Leizhou EJV and Jiangxi Investments in order to maintain its 53% and 55% equity interests therein, respectively, amounted to \$22,240,000 of which \$3,895,000 was contributed in 1994 and the remaining balance of \$18,345,000 was to be paid in instalments in December 1995 and January 1996. However, during 1995, the terms of the capital contributions obligations were amended as described below.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

[a] Jiangxi Investments

In 1995, the Company made a strategic decision to develop and focus on the plantation and wood chip businesses and to reduce its involvement in the chemical business conducted by the Jiangxi Investments. As a result of this decision, Sino-Wood conducted negotiations with its Jiangxi Investments joint venture partners to reduce its equity interest and operational involvement in the Jiangxi Investments.

Pursuant to the memoranda of understanding signed between Sino-Wood and Jiangxi Xuesong Forest & Chemical Industry Co. Ltd. and each of the other four Jiangxi Investments on June 28, 1995 and May 14, 1995 [the "MOU Dates"], respectively, the Jiangxi Investments joint venture partners agreed that Sino-Wood would reduce its equity interests in each of the Jiangxi Investments from 55% to 30% and to amend the memoranda of implementation to change the composition of the board representation in line with the proposed change in equity interests. In addition, it was agreed that with effect from the same date, the Jiangxi Investments joint venture partners would have effective control over the operations of the Jiangxi Investments.

Consequently, with the signing of the memoranda of understanding above, the Company did not make the previously required December 1995 [\$12,175,000] and January 1996 [\$1,870,000] capital contributions. The Jiangxi Investments joint venture partners have instead agreed that Sino-Wood will make a remaining capital contribution of \$2,187,000 by December 1996 in order to maintain its reduced 30% equity interest in the Jiangxi Investments.

According to the laws of the PRC on Joint Ventures using Chinese and Foreign Investment, the reduction of equity interests in the Jiangxi Investments and any amendments to the memoranda of implementation, including amendments to the board representation and timing of capital contributions, requires approval from the Department of Foreign Economic Relations and Trade of the PRC [the "FERT"]. A formal application to change the equity interests, composition of the board and timing of remaining capital contributions was submitted to the FERT for approval on March 29, 1996. Based on discussions with the FERT, management and the Jiangxi Investments joint venture partners do not anticipate any problems obtaining the approval required to implement the changes stated above. Accordingly, the Jiangxi Investments have been accounted for by the equity method as of the MOU Dates where effective control of these Jiangxi Investments has been passed to the joint venture partners.

Subsequent to the submission to the FERT to amend the memoranda of understanding, Sino-Wood has conducted discussions with its Jiangxi Investments joint venture partners and the FERT to restructure its Jiangxi Investments. The proposed restructuring which is expected to be completed in early 1997 may reduce or eliminate the requirement to make any further capital contributions to its Jiangxi Investments.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

The carrying value of the Jiangxi Investments of \$2,547,000 as at the MOU Dates was transferred to long-term investments and consists of the following:

	\$
Cash	675
Inventories	1,648
Accounts receivable	70
Other receivables and prepaid expenses	2,330
Capital assets, net	6,821
	<u>11,544</u>
Accounts payable and accrued liabilities	(376)
Other payables	(257)
	<u>10,911</u>
Non-controlling interests	(8,364)
Carrying value of Jiangxi Investments transferred to long-term investments	<u>2,547</u>

[b] Leizhou EJV

Pursuant to the contractual obligations set out in the joint venture agreement and memorandum of implementation, the total capital contributions, in the form of cash, to be made by Sino-Wood to Leizhou EJV in order to maintain its 53% equity interest therein amounted to \$5,300,000 of which a cash capital contribution of \$1,000,000 was made in 1994 with the remaining final instalment of \$4,300,000 due in January 1996.

As a result of discussions between Sino-Wood and the PRC joint venture partner, both parties have agreed to extend the deadline for the final instalment of the capital contributions to December 1996. An application for the extension has been made to the FERT for approval. Management and the PRC joint venture partner do not anticipate any problems obtaining the required approval as a result of their discussions with the FERT.

4. INVESTMENTS IN THE PRC CJVs

During 1995, as part of its expansion into the plantation and wood chip businesses, the Company through its subsidiaries entered into several joint venture agreements to form five PRC CJVs. Under the terms of the joint venture agreements, the contributions of the PRC joint venture partners are in the form of land use rights and the contributions of the Company's subsidiaries are in the form of cash to pay for the annual forestry service fees and plantation costs incurred by the PRC CJVs. Under the terms of the joint venture agreements, the Company's subsidiaries and the

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

respective PRC CJVs partners share in the volume of timber cut in the proportions of 70% and 30%, respectively.

As these PRC CJVs commenced commercial operations in late 1995, the Company's proportionate share of the financial position, operating results and cash flows were not significant for the year ended December 31, 1995. The major components of the Company's interests in these PRC CJVs for the nine months ended September 30, 1996 are as follows:

	\$
Consolidated balance sheets	
Current assets	880,035
Long-term assets	1,671,238
Current liabilities	(312,006)
Long-term liabilities	—
Consolidated statements of income	
Revenue	—
Costs and expenses	—
Net income	—
Consolidated statements of changes in financial position	
Cash flow from operating activities	2,239,267
Cash flow from financing activities	(2,239,267)
Cash flow from investing activities	—

Pursuant to the contractual obligations set out in the various joint venture agreements and memoranda of implementation, the total capital contributions, in the form of cash, to be made by the Company's subsidiaries to the PRC CJVs amounted to \$14,200,000 of which \$2,130,000 is required to be made, representing 15% of the Company's subsidiaries' total capital contributions, within 3 months from the respective dates of the business licenses of the PRC CJVs. At December 31, 1995, initial cash capital contributions of \$200,000 have been contributed by the Company's subsidiaries to the PRC CJVs. Further cash capital contributions of \$1,745,000 were made in January 1996. The remaining balance of \$12,255,000, in aggregate, is due as to \$185,000 in January 1996 and \$12,070,000 to be contributed as part of the ongoing annual expenses for plantation costs. The annual payment for plantation costs could be varied, subject to changes in the plantation development plan. The \$185,000 that is due in January 1996 has been withheld pending the satisfactory performance of its joint venture partner.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

5. INVENTORIES

Inventories consist of the following:

	September 30, 1996 \$	December 31, 1995 \$	1994 \$
Raw materials	90	144	1,388
Work-in-progress	40	52	494
Finished goods	4	4	315
	134	200	2,197

6. DUE FROM PRC PARTIES

The amount due from PRC parties consists of the following:

	September 30, 1996 \$	December 31, 1995 \$	1994 \$
Due from Leizhou Forestry Bureau ["LFB"]	12,177	14,009	3,946
Due from Guangxi Forestry Development Centre	2,486	663	—
Due from Jiangxi Forestry Economic & Technology Development Company ["JFE&TDC"]	125	65	644
Due from Jiangxi Anyuan County Chemical Factory	—	—	249
Due from Jiangxi Camphor Factory	—	—	794
	14,788	14,737	5,633

The above PRC parties are the joint venture partners of the Company's subsidiaries and joint ventures in the PRC. Except for the amount due from JFE&TDC which bears interest at 10.5% per annum, the amounts due are unsecured, non-interest bearing and have no fixed terms of repayment. The carrying value of the amounts due from PRC parties approximates the fair value. The \$12,177,000 due from LFB represents cash collected from the sale of wood chips on behalf of Leizhou EJV. As originally agreed by the Company, the cash is being retained by LFB to fund the ongoing plantation costs of the Leizhou EJV. At the end of 1995, the Company commenced discussions with LFB for the repayment of some or all of the amount due by early 1997. LFB has incurred planting and maintenance costs on behalf of the Leizhou EJV which could be applied against part of the amount due to the Company. In addition, the balance could be used to offset the

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

required remaining capital contribution of \$4,300,000 owing to the Leizhou EJV by the Company, or be repaid to the Company.

7. CAPITAL ASSETS

Capital assets consist of the following:

	<u>September 30, 1996</u>		<u>December 31, 1995</u>		<u>December 31, 1994</u>	
	Cost	Accumulated depreciation, amortization and depletion	Cost	Accumulated depreciation, amortization and depletion	Cost	Accumulated depreciation, amortization and depletion
	\$	\$	\$	\$	\$	\$
Land use rights and buildings	7,658	732	7,658	545	9,863	309
Timber holdings	12,350	1,606	3,506	1,270	2,954	856
Machinery and equipment	758	203	674	196	5,381	326
Office furniture and equipment	241	57	192	31	137	5
Vehicles	37	—	—	—	232	18
Leasehold improvements	—	—	—	—	22	—
	21,044	2,598	12,030	2,042	18,589	1,514
Less accumulated depreciation, amortization and depletion	(2,598)		(2,042)		(1,514)	
Net book value	18,446		9,988		17,075	

8. CONVERTIBLE DEBENTURE

On January 15, 1996, Sino-Wood entered into a \$3,000,000 convertible loan agreement with Deutsche Bank A.G. of Hong Kong. The convertible loan agreement provides that from January 15, 1998 until repayment of the loan, the loan is convertible in minimum amounts of \$500,000 into Class A Subordinate-Voting Shares of Sino-Forest at the lower of:

- five times the fully diluted [including the shares issued on conversion] earnings of the Company for the previous fiscal year; or

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

- at a 40% discount to the average closing prices of the shares on The Toronto Stock Exchange for the five trading days preceding the conversion notice.

However, in no circumstances can the conversion price be less than Cdn. \$0.60 per share.

The loan is for a period of 5 years and may be called by the bank after four years. Interest is payable, at the option of Sino-Wood, either quarterly or semi-annually based on the three-month or six-month LIBOR U.S. dollar deposit rate plus 2%. As at September 30, 1996, the interest rate on the loan was 7.87%. The loan is guaranteed by Sino-Forest and is collateralized by a first fixed and floating charges on the assets of the Company and its subsidiaries. The carrying value of the debenture approximates its fair value.

Interest expense for the nine months ended September 30, 1996, amounted to approximately \$159,000.

9. SHARE CAPITAL

Share capital consists of the following:

	September 30, 1996 \$	December 31, 1995 \$	December 31, 1994 \$
Authorized			
Unlimited Class A Subordinate-Voting Shares			
6,000,000 Class B Multiple-Voting Shares			
Unlimited Preference Shares, issuable in series, the first thereof consisting of 6,000,000 Series A Preference Shares			
Issued			
37,150,000 Class A Subordinate-Voting Shares [December 31, 1995 - 35,500,000; December 31, 1994 - 33,500,000]	6,874	6,151	5,321
6,000,000 Class B Multiple-Voting Shares [December 31, 1995 - 6,000,000; December 31, 1994 - nil]	—	—	—
Nil Series A Preference Shares [December 31, 1995 - nil; December 31, 1994 - 6,000,000]	—	—	—
	6,874	6,151	5,321

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

Authorized

Except with respect to voting, dividends and the rights of conversion described below, each Class A Subordinate-Voting Share and each Class B Multiple-Voting Share have the same rights and are equal in all respects:

- each holder of Class A Subordinate-Voting Shares will be entitled to one vote per share whereas each holder of Class B Multiple-Voting Shares will be entitled to five votes per share;
- the Class A Subordinate-Voting Shares rank in priority to the Class B Multiple-Voting Shares as to the payment of dividends; however, no dividends shall be declared or paid on the Class B Multiple-Voting Shares in any fiscal year unless in that fiscal year dividends shall have been declared or paid on Class A Subordinate-Voting Shares in an amount per share at least equal to or equivalent to the amount of the dividend per share proposed to be declared or paid on Class B Multiple-Voting Shares;
- each holder of Class B Multiple-Voting Shares shall be entitled at any time and from time to time to have all or any part of the Class B Multiple-Voting Shares held converted into Class A Subordinate-Voting Shares on a share-for-share basis; and
- as a condition of the issue of any Class B Multiple-Voting Share, the registered holder will be required to execute a Coattail Agreement under which the holder will agree not to effect a transfer of any Class B Multiple-Voting Share unless such transfer is made in accordance with the terms thereof and is a Permitted Transfer, as defined in the provisions attaching to the Class B Multiple-Voting Shares.

The Preference Shares may from time to time be issued in one or more series, each series of which shall have the rights and other features fixed by the Board of Directors of the Company. The Preference Shares of each series shall rank equally with the Preference Shares of every other series with respect to priority in payment of dividends and return of capital in the event of the liquidation, dissolution or winding-up of the Company and have a preference over the Class A Subordinate-Voting and the Class B Multiple-Voting Shares.

The holders of Series A Preference Shares shall not be entitled to receive any dividends. Except as otherwise required by the Business Corporations Act (Ontario), the holders of the Series A Preference Shares shall not be entitled to receive notice of or to attend any meetings of shareholders of the Company or to vote at any such meeting.

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[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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The Company may at any time after March 31, 1996 redeem the issued Series A Preference Shares at a redemption price of Cdn. \$0.01 per share. Subject to certain conditions, each holder of a Series A Preference Share shall be entitled prior to March 31, 1996 to have all or any part of the Series A Preference Shares held converted into fully paid and non-assessable Class B Multiple-Voting Shares on a share-for-share basis.

Issued

On January 1, 1994, Mt. Kearsarge issued 20,742,773 [2,074,278 post amalgamation] common shares through a private placement for cash proceeds of \$115,000.

On March 14, 1994, pursuant to the amalgamation described in note 2, every 10 common shares of Mt. Kearsarge were exchanged for one Class A Subordinate-Voting Share of Sino-Forest and 12,800,000 Class A Subordinate-Voting Shares of Sino-Forest were issued to the shareholders of Ontario in exchange for common shares of Ontario. Also, the Series A share purchase warrants previously issued by Ontario became exercisable. Each Series A share purchase warrant entitled the holder to acquire one Class A Subordinate-Voting Share of Sino-Forest on or before August 31, 1995 for Cdn. \$1.50 per share.

In addition, 16,200,000 Class A Subordinate-Voting Shares, 6,000,000 Series A Preference Shares and 8,100,000 Series B share purchase warrants of Sino-Forest were issued on March 17, 1994 in exchange for all issued and outstanding shares of Sino-Wood. Each Series B share purchase warrant entitled the holder to acquire one Class A Subordinate-Voting Share of Sino-Forest on or before June 30, 1995 for Cdn. \$1.50 per share.

None of the Series A and Series B share purchase warrants referred to above were exercised and, accordingly, expired on August 31, 1995 and June 30, 1995, respectively.

On November 30, 1994 and December 7, 1994, Sino-Forest issued 1,200,000 and 300,000 Class A Subordinate-Voting Shares, respectively, in two separate private placements for total net proceeds of \$672,000.

On September 11, 1995, the holders of 6,000,000 Series A Preference Shares exercised their rights to convert all the issued and outstanding Series A Preference Shares into fully paid and non-assessable Class B Multiple-Voting Shares on a share-for-share basis.

On September 22, 1995, Sino-Forest issued 2,000,000 Class A Subordinate-Voting Shares in a private placement for total net proceeds of \$830,000.

On April 18, 1996, options to purchase 1,650,000 Class A Subordinate-Voting Shares were exercised under the terms of the Company's stock option plan for total proceeds of \$723,000.

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

The following summarizes the changes to Class A Subordinate-Voting Shares of the Company as a result of the transactions described above:

	Number of shares [Post amalgamation]	\$
Mt. Kearsarge, shares outstanding, December 31, 1993	9,257,227	
Mt. Kearsarge, shares issued for cash, January 1, 1994	20,742,773	
	30,000,000	
Mt. Kearsarge, on amalgamation, March 14, 1994	1 for 10	
Mt. Kearsarge, shares outstanding following amalgamation	3,000,000	
Shares deemed issued on acquisition of outstanding shares of Mt. Kearsarge [see above]	3,000,000	170
Shares issued to Ontario on amalgamation, March 14, 1994	12,800,000	4,932
Shares issued to Sino-Wood, March 17, 1994	16,200,000	1
Sino-Forest, shares outstanding after giving effect to the reverse takeover on March 17, 1994	32,000,000	5,103
Shares issued subsequent to March 17, 1994		
Private placements for cash, November 30, 1994 and December 7, 1994	1,500,000	707
Sino-Forest, shares outstanding, before share issue costs	33,500,000	5,810
Less 1994 share issue costs	—	(489)
Sino-Forest, shares outstanding, December 31, 1994	33,500,000	5,321
Private placement for cash, September 22, 1995	2,000,000	885
Sino-Forest, shares outstanding, before share issue costs	35,500,000	6,206
Less 1995 share issue costs	—	(55)
Sino-Forest, shares outstanding, December 31, 1995	35,500,000	6,151
Shares issued on exercise of options, April 18, 1996	1,650,000	723
Sino-Forest, shares outstanding, September 30, 1996	37,150,000	6,874

The legal stated value of Sino-Forest's Class A Subordinate-Voting Shares differs from the carrying value reflected in these consolidated financial statements as a result of the accounting for the acquisition of Sino-Wood as described in note 2. The legal stated capital as at September 30, 1996 is Cdn. \$21,944,838 [December 31, 1995 - Cdn. \$20,954,838; December 31, 1994 - Cdn. \$19,754,838].

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Stock options

As at September 30, 1996, 6,431,000 options to purchase Class A Subordinate-Voting Shares of the Company at prices ranging from Cdn. \$0.55 per share to Cdn \$1.55 per share were outstanding to certain officers and directors of the Company and employees of Sino-Wood. 500,000 of these options expire in 1999 with the remaining 5,931,000 options expiring in 2001.

On September 30, 1996, the board of directors passed a resolution to increase the maximum number of shares which may be issued or reserved for issuance under the Company's stock option plan from 4,200,000 to 10,000,000, subject to the necessary shareholder and regulatory approvals. The exercise of 3,881,000 of the 6,431,000 outstanding options as at September 30, 1996 is subject to receipt of these approvals.

10. INCOME TAXES

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

	Nine months ended September 30,		Years ended December 31,			
	1996	1995	1995	1994	1993	1992
	\$	\$	\$	\$	\$	\$
Income before income taxes	6,620	6,190	8,494	4,418	—	—
Expected statutory rate	44.6%	44.3%	44.3%	44.3%	44.3%	44.3%
Expected income tax provision	2,953	2,742	3,763	1,957	—	—
Increase (decrease) in income taxes resulting from						
Unrecognized income tax losses	975	854	1,097	537	—	—
Income tax at different rates in foreign jurisdictions	(3,125)	(3,596)	(4,859)	(2,508)	—	—
Other	(6)	—	(1)	14	—	—
	797	—	—	—	—	—

The Leizhou EJV, the Jiangxi Investments and the PRC CJVs are governed by the Income Tax Laws of the PRC concerning Foreign Investment Enterprises and Foreign Enterprises and various local income tax laws [the "Income Tax Laws"]. Pursuant to the Income Tax Laws, Sino-foreign equity and co-operative joint venture enterprises generally are subject to income tax at an effective rate of 33% [30% state income taxes plus 3% local income taxes] on income as reported in their statutory financial statements. The Income Tax Laws fully exempt Sino-foreign equity and co-

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

operative joint venture enterprises from state and local income taxes for two years starting from the first profitable year of operations, followed by a 50% exemption for the next three years.

The Company also has income tax losses of approximately Cdn. \$750,000 which can be applied against future years' taxable income in Canada, the benefit of which has not been recorded. Cdn. \$260,000 of these tax losses will expire in 2001 and the remainder will expire in 2002.

11. EARNINGS PER SHARE

Earnings per share are calculated using the weighted average number of Class A Subordinate-Voting and Class B Multiple-Voting Shares outstanding during each period. The weighted average number of Class A Subordinate-Voting and Class B Multiple-Voting Shares outstanding were as follows:

	Weighted average	
	Basic	Fully diluted
September 30, 1996	42,503,297	55,745,297
September 30, 1995	34,005,494	34,705,494
December 31, 1995	35,894,521	36,594,521
December 31, 1994	28,879,178	46,709,863

12. RELATED PARTY TRANSACTIONS

[a] During the nine months ended September 30, 1996 and 1995 [and years ended December 31, 1995 and December 31, 1994], Sino-Wood had the following related party transactions with a company of which two of the directors of Sino-Wood are also the directors:

- a contract to provide corporate management services and office facilities to Sino-Wood at an aggregate cost of approximately \$446,000 and \$365,000, respectively [December 31, 1995 - \$487,000; December 31, 1994 - \$291,000];
- purchase of capital assets from the company at a total acquisition cost of nil and \$5,000, respectively [December 31, 1995 - \$5,000; December 31, 1994 - \$65,000]; and
- payment of nil and nil, respectively [December 31, 1995 - nil; December 31, 1994 - \$75,000], to the company with respect to services rendered including reimbursement of expenses in connection with the acquisition of Leizhou EJV and the Jiangxi Investments.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

- [b] During the nine months ended September 30, 1996 and 1995, share issue costs paid to two companies of which a director of the Company is one of the principals, with respect to related services rendered amounted to nil and \$26,000, respectively [year ended December 31, 1995 - \$26,000; year ended December 31, 1994 - \$279,000].
- [c] During the nine months ended September 30, 1996 and 1995, a company of which a director of the Company is one of the principals, provided investor relations and related consulting services to the Company of \$33,000 for each of the periods [year ended December 31, 1995 - \$44,000; year ended December 31, 1994 - \$35,000].

13. SEGMENTED INFORMATION

	Nine months ended September 30, 1996			Nine months ended September 30, 1995		
	Wood chips \$	Other \$	Total \$	Wood chips \$	Other \$	Total \$
BY INDUSTRY SEGMENT						
Revenue						
Sales	12,754	31	12,785	18,448	1,653	20,101
Commission income	3,202	2,210	5,412	—	653	653
	15,956	2,241	18,197	18,448	2,306	20,754
Income (loss) from operations	6,583	446	7,029	7,458	(1,179)	6,279
Identifiable assets	34,453	7,597	42,050	26,447	5,841	32,288
Depreciation, amortization and depletion	544	12	556	496	171	667
Capital asset additions	9,000	14	9,014	449	2	451

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

	Year ended December 31, 1995			Year ended December 31, 1994		
	Wood chips \$	Other \$	Total \$	Wood chips \$	Other \$	Total \$
BY INDUSTRY SEGMENT						
Revenue						
Sales	23,949	1,525	25,474	13,612	4,667	18,279
Commission income	663	1,286	1,949	—	2,203	2,203
	24,612	2,811	27,423	13,612	6,870	20,482
Income (loss) from operations	9,568	(826)	8,742	3,361	947	4,308
Identifiable assets	26,369	5,180	31,549	17,722	12,888	30,610
Depreciation, amortization and depletion	619	174	793	1,131	295	1,426
Capital asset additions	542	5	547	12,387*	6,202*	18,589

* includes acquisition [note 2]

BY GEOGRAPHIC SEGMENT

The Company conducts substantially all of its operations in one geographic area, East Asia. During the nine months ended September 30, 1996 and 1995, export sales from the PRC amounted to approximately \$14,301,000 and \$18,448,000, respectively [year ended December 31, 1995 - \$22,878,000; year ended December 31, 1994 - \$13,590,000].

14. COMMITMENTS

See notes 3 and 4 for capital contribution commitments to the Leizhou EJV, the Jiangxi Investments and the PRC CJVs.

Sino-Forest Corporation

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

[Information as at September 30, 1996 and for the nine-month periods ended September 30, 1996 and 1995 is unaudited.]

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

15. SUBSEQUENT EVENT

Pursuant to an underwriting agreement dated September 17, 1996, the Company, on October 2, 1996, issued and sold 24,000,000 special warrants priced at Cdn. \$1.25 per special warrant for aggregate gross proceeds of Cdn. \$30,000,000. The underwriters received a commission of 6.5% of gross proceeds and the Company also granted, to certain of the underwriters, broker special warrants to acquire non-assignable compensation options without payment of any additional consideration. The compensation options entitle the holders thereof to purchase an aggregate of 2,400,000 Class A Subordinate-Voting Shares at an exercise price of Cdn. \$1.44 for each Class A Subordinate-Voting Share, subject to adjustment, at any time on or before October 2, 1998. Each special warrant and compensation option is convertible into one Class A Subordinate-Voting Share. The Company expects to incur additional share issue costs of approximately Cdn. \$550,000.

If the Company fails to obtain receipts for a final prospectus in respect of the Class A Subordinate-Voting Shares to be issued upon the exercise of the special warrants from the securities regulators in Ontario, Manitoba and the Northwest Territories within 120 days after the date on which the purchase of the special warrants is completed, the holders of the special warrants will be entitled to receive 1.085 Class A Subordinate-Voting Shares, instead of one Class A Subordinate-Voting Share, in respect of each special warrant exercised without payment of any additional consideration.

CERTIFICATE OF THE COMPANY

DATED: January 28, 1997

The foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part VII of the *Securities Act* (Manitoba), by Part XV of the *Securities Act* (Ontario) and by the *Securities Act* (Northwest Territories) and the respective regulations thereunder.

(Signed) Allen T.Y. Chan
Chairman and Chief Executive
Officer

(Signed) Kee Wong
Senior Vice President, Corporate
Development and Chief Financial Officer

On behalf of the Board of Directors

(Signed) John Thompson
Director

(Signed) James F. O'Donnell
Director

CERTIFICATE OF THE UNDERWRITERS

DATED: January 28, 1997

To the best of our knowledge, information and belief, the foregoing constitutes full, true and plain disclosure of all material facts relating to the securities offered by this prospectus as required by Part VII of the *Securities Act* (Manitoba), by Part XV of the *Securities Act* (Ontario) and by the *Securities Act* (Northwest Territories) and the respective regulations thereunder.

FIRST MARATHON SECURITIES LIMITED CIBC WOOD GUNDY SECURITIES INC.

By: (Signed) David M.B. LeGresley

By: (Signed) Wayne Adlam

GTL SECURITIES INC.

SPROTT SECURITIES LIMITED

By: (Signed) Paul F. Little

By: (Signed) Lorne S. Graham

The following includes the name of each person having an interest, either directly or indirectly, to the extent of not less than 5% in the capital of:

FIRST MARATHON SECURITIES LIMITED: a wholly-owned subsidiary of First Marathon Inc.

CIBC WOOD GUNDY SECURITIES INC.: a wholly-owned subsidiary of The CIBC Wood Gundy Corporation, a majority-owned subsidiary of a Canadian chartered bank.

GTL SECURITIES INC.: Jacob Gornitzki, John Thompson and Paul F. Little.

SPROTT SECURITIES LIMITED: E. S. Sprott and R.D. Barnes.

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