

Company Name: Sino-forest Corp
Company Ticker: TRE CN
Date: 2011-06-14
Event Description: Q1 2011 Earnings Call

Market Cap: 825.69
Current PX: 3.36
YTD Change(\$): -19.93
YTD Change(%): -85.573

Bloomberg Estimates - EPS
Current Quarter: 0.308
Current Year: 2.009
Bloomberg Estimates - Sales
Current Quarter: 409.000
Current Year: 2507.571

Q1 2011 Earnings Call

Company Participants

- Louisa Wong
- David J. Horsley
- Allen T. Y. Chan
- William E. Ardell

Other Participants

- Richard Kelertas
- Sean Steuart
- Jit Ming Tan
- Benoit Laprade
- Andrew M. Kuske
- Paul C. Quinn
- Annisa Lee
- Mathura Yogarajah
- Charles Chang
- Zhi Wei, Feng

MANAGEMENT DISCUSSION SECTION

Operator

Good morning. My name is Sarah and I will be your conference operator today. At this time, I would like to welcome everyone to the Sino-Forest 2011 First Quarter Results Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

I would now like to turn the call over to Ms. Louisa Wong, Head of Investor Relations. Miss Wong, you may begin.

Louisa Wong

Thank you, Sarah. Good morning, good evening to all of you. Welcome to today's conference call on Sino-Forest's earnings results for the first quarter of 2011. My name is Louisa Wong, Senior Manager of Investor Relations and Communications Relations. We are joined today by Allen Chan, our Chairman and CEO; Dave Horsley, Senior Vice President and Chief Financial Officer; and by William Ardell, Lead Independent Director of Sino-Forest and Chair of the Independent Committee.

This call will be divided into two parts. In the first part, Dave and Allen will take us through the earnings results and business outlook. The second half, we will address the recent allegations made against Sino-Forest. We will then open the lines for a question-and-answer presentation.

Before we begin, I would like to remind our listeners that we will make forward-looking statements, including certain information that are current as of today and are subject to risks and uncertainties. The results or events predicted in these statements may differ materially from actual results or events due to many factors in China and Suriname, and other countries, including changes in tree-growing conditions, economic growth, currency exchange rate and taxation,

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fibre supply and demand, competitive pricing of wood products and land rentals, and projected levels of cost in the forest products industry worldwide.

For additional information regarding these and other factors, please refer to our public disclosure report filed on SEDAR at sedar.com. Sino-Forest disclaims any intention or obligation to update or revise any forward-looking statements. All amounts expressed in this call are denominated in U.S. dollars unless otherwise indicated.

Our earnings press release and presentation are available on the website at sinoforest.com. Under Investor Relations, click Earnings Releases. A copy of this MD&A and consolidated statements are also available on our website and also filed on SEDAR. There is also a video interview with our Chairman and CEO, Allen Chan, in which he discusses Sino-Forest's business model and are available on our website as well.

I will now turn over the call to our CFO, Dave Horsley, who will start off by telling us – discussing the company's first quarter results. Dave?

David J. Horsley

Thanks, Louisa, and thank you all for joining us on today's call. First, I'd like to express our gratitude for your patience and support over the last two weeks. Sino-Forest is a well-established company and a leading player in the forestry industry with 17 years of history.

We are suddenly facing a critical moment in our growth because of a grossly inaccurate and defamatory report by short seller Muddy Waters. Many of our stakeholders have endured losses while Muddy Waters benefited from the significant drop in the value of their investments, which it precipitated.

Since the report, many of you and other concerned parties reached out to us, being supportive, but also with questions. We hope to address them as much as we can today. We understand your concern and are anxious to make things right.

I will start by providing highlights of our first quarter earnings while Allen will offer an overview of the business landscape and outlook. We've also invited William Ardell to join us. Bill is chairman of the Independent Committee established to review the Muddy Water allegations and has been leading the ongoing investigation of the allegations made against us. The three of us will be available to answer your questions.

Our earnings results for the first quarter ended March 31, 2011 reflect continuing demand for both domestic and important wood fibre in China. With ongoing increases in log prices and our fibre cost cap under our long-term fibre purchase agreements, we also continue to obtain attractive gross margins. Given the current situation, Ernst & Young was not able to complete their review of the Q1 2011 financial statements.

We increased total revenues by 35%, and EBITDA by 34%, primarily due to higher sales of plantation fibre. Please bear in mind that our quarterly results reflects forestry sector seasonality in China. Over the past five years, we've generated an average of 14% of our total annual revenue in the first quarter, typically our lowest revenue quarter for the year.

Total revenue in Q1 2011 grew 35% to \$339 million with 39% higher sales of plantation fibre and 28% higher revenue from the trading of logs and other wood products. Total gross profit in Q1 increased 28% to \$126 million, although overall margin dropped about a two percentage points to 37% due to lower gross profit margin obtained from plantation fibre operations.

EBITDA was up 34% to \$192 million in the first quarter in line with revenues. And net earnings, however, declined to a loss of \$22 million from income of 16 million last year due to IFRS accounting which I will explain later. As a result, we recorded a loss of \$0.08 in diluted earnings per share from continuing operations in the first three months of the year.

Net cash used in operating activities remained relatively flat at \$121 million. Cash flows before movement in timber holdings increased from a cash outflow of \$5.3 million to a cash inflow of \$247 million, mainly as a result of a

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decrease in trade and other receivables.

Net increase of timber holdings increased from \$116 million to \$369 million. Therefore, net cash flow used in operating activities was relatively unchanged from the same period in 2010. Sales from our core plantation fibre business segment increased 39% to \$218 million in Q1, due to 32% increase in volume of fibre sold, and a 6% increase in the average selling price per cubic meter to \$89.

Gross profit margin from sales of standing timber dropped to \$44 per cubic meter in the three months ended March 31, 2011, compared to \$49 per cubic meter in the same period last year. Offsetting that was a 15% increase in the gross margin for logs to \$43 per cubic meter.

We sold plantation fibre volume of 2.5 million cubic meters during the first quarter, mostly of standing timber. The average yield for standing timber sales was 160 cubic meters per hectare in Q1, which was 11% lower than in the same period last year. And our yield for log sales dropped 43%, to 73 cubic meters per hectare.

During the quarter, we sold nearly 16,000 hectares of trees of which 10,000 were acquired under our master agreement, mainly in Guangxi, Hunan and Yunnan. By quarter end, our plantation area under management in the PRC was approximately 866,000 hectares, up 10% from the fourth quarter ended December 31, 2010.

First quarter revenue from the trading of domestic and imported logs and other wood products increased 28% to \$106 million, primarily due to a different mix of species of wood logs sold at a higher average selling price. And revenue from our manufacturing and other operations rose 14% to \$13 million in Q1, driven by increased sales of engineered wood flooring and recomposed wood products from our newly acquired HOMIX operation.

For the first time, we consolidated revenue from our majority ownership and interest in Greenheart Group, which was about \$1.7 million. We increased our capital expenditures by 125% to \$487 million in Q1, mostly for the acquisition of 100,000 hectares of trees, and majority of which were in Yunnan, Guangxi and Jiangxi under the Master Agreements.

For 2011 capital expenditures, management will review its planned acquisition pace and report changes to the original plan in the coming months. At the end of the first quarter, Sino-Forest's balance sheet remains strong, especially with cash and short-term deposits of \$1.1 billion.

Now, I'm going to explain in more detail the impact of adopting new IFRS accounting for this year and likely going forward. As well I'll discuss two other issues affecting our Q1 results. The adoption of IFRS, affected key components of our operating profit, but caused no change in revenue and only routine adjustments to cost of sales, selling and admin expenses, and financing costs. One aspect in particular that has impacted materially Sino-Forest's reported net income is the accounting for an aspect of the company's financing strategy, specifically our 2013 and 2016 convertible notes.

IFRS required the company to fair value the inherent equity convert option on a quarterly basis due to the existence of certain terms that are present in the convertible notes. As the Company stock price rises, the equity convert option becomes more valuable or more costly to the company, and therefore results in a charge to the income statement.

As of March 31, 2011, stock price was \$25.30. This resulted in a charge to the company's income statement of approximately \$53 million. As the stock price decreases, the equity convert option becomes less valuable or less costly to the company, and therefore results in a gain being recorded in the income statement.

Given the closing stock price on Friday, June 10, 2011, of \$4.47, the company will record a gain from the fair value of the equity convert option in the amount of approximately \$450 million in the company's Q2 2011 income statement.

In order to remove the stock price volatility from impacting the income statement, the company needs to amend certain language in the convertible notes and does not require the consent of the convertible note holders to do this.

The Board of Directors has passed a resolution to approve such amendment and the company will take the required steps to implement the change. In future quarters, after Q2 2011, the volatility of the stock market price will no longer affect reported net income.

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And the other minor IFRS impact in the company's reported profit before tax compared to Q1 2010 as previously reported were recording a gain on the change in the fair value of planted plantations, additional charges to cost of sales, selling and administrative expenses and financing costs. The gain on change in fair value of planted plantations was approximately \$10.4 million and the additional charges to cost of sales, selling and admin expenses, and financing costs was approximately \$10.1 million.

Other items that impacted Q1, 2011 were income tax expense, and selling and administrative expenses. While the base of this calculating the company's tax provision methodology changed from old Canadian GAAP to new IFRS Canadian GAAP, the actual provision and income statement was not materially affected in Q1, 2011.

However, as a result of new information that has become available in Q1, 2011, the company now assesses income tax by applying the of 15% for operations in all provinces in the PRC where the company conducts business as compared to only certain provinces last year. This has resulted in an additional non-cash tax charge in Q1 of approximately \$6 million.

Selling and administrative expenses rose from \$23 million in Q1 to \$30 million in Q1, 2011, primarily due to the fact that in Q1, 2011, the results included the consolidated results of Greenheart Group, including SG&A expenses in the amount of approximately \$5.8 million compared to nil last year. Last year, the company did not exercise significant influence on Greenheart Group and, therefore, did not consolidate the results.

So if you're trying to reconcile our reported results for purposes of comparing to either last year's Q1 results as reported or to analysts' estimates for Q1. If you take our reported results, add back the charge for fair valuing equity component of the convertible debt, add back one-time, non-cash tax charges of approximately \$6 million, and add the Greenheart SG&A of approximately \$5.8 million, this will bring you to an adjusted net income of approximately \$42 million or an adjusted EPS of approximately \$0.19.

In conclusion, excluding the impact of IFRS, Sino-Forest's financial performance from our continuing operations in the first quarter was steady and strong and we continue to build a solid foundation for sustainable growth and success in China.

With that, I'll now hand you over to Allen to discuss our business today. Allen?

Allen T. Y. Chan

Thank you, Dave, and hello everyone. We clearly have a lot to talk about and we are keen to address our concerns. We are very pleased with our results in the first quarter. Despite the intense media and market speculation, so far the last week or so, we remain steadfast in our belief of the long-term value and growth of the company – of our business. The growth drivers in our industry remain as compelling as ever. And Sino-Forest experienced an investment in the sector [ph] so we are (13:41) ideally placed to continue to benefit from the sector's continued growth as it meets China's demand for wood supplies.

Slide 21, we are proud to have prudently managed our assets over the past 17 years. Today, we have 33 – sorry, today we have \$3.3 billion (sic) [3.6 billion] (14:05) of standing timber assets and \$1.1 billion in cash. We will continue to grow our business through smart acquisitions and sustainable long-term replanting.

Sino-Forest has a solid foundation for expanding its portfolio of plantations across China. We have strategically announced expansion and we are especially focusing our efforts in highly populated inland provinces with projected double-digit economic growth, dense forest coverage and a growing demand for wood products for infrastructure and construction use.

In addition to our six long-term fibre acquisition master agreements, where we have already acquired 50% of the 1.3 million hectares, we announced last month the signing of two new agreements called Shaanxi and Yunnan to acquire approximately 200,000 hectares and 66,000 hectares, respectively, over a period of 10 years with a cap fibre price of RMB320 per cubic meter.

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The diameter of the trees are between 15 to 40 centimeters diameter, and age range between 25 to 50. The yield per hectare is only 90 cubic meters because they were sparsely planted.

Slide 23, we also maintain a positive outlook for the Chinese forestry sector in 2011. Everyone wants a piece of China [ph] and understand the result (15:33). The country continues to enjoy relatively strong economic growth fueled by a massive wave of industrialization and urbanization. Sino-Forest is going to be a key part of this, and by the end of 2013, we are looking to have planted 200,000 hectares of trees. We will continue to identify a secure, suitable land for sustainable long-term replanting that could enable us to achieve high-yield output of [ph] 200 and 215 (16:00) cubic meters per hectare.

For the last six months, fibre demand remained solid despite policy tightening and a general slowdown in construction. Although, the Yunnan provinces have not become impacted at this time. We recorded 2% to 6% increase in log prices.

Slide 24, I wish we could only talk about the positives, but I do not want to let this forum go by without touching on the events of the past week, which has been personally a very painful for me. It pains me to see a company that I have successfully built over the past 17 years maliciously attacked by a self-serving short-seller who stands to reap significant gains while we suffer. I am heavily disappointed by the losses and anguish that our shareholders have to bear these past several days.

I personally stand by and guarantee that the audited financial statements and the reports filed are accurate as any material connected to party transactions have been disclosed in our management discussions and analysis. While we have been transparent in our practices since we began the business in 1994, but do not feel comfortable to publicly disclosing certain proprietary information such as the name of our customers and disclose the exact locations of where our plantations are as it will impede our future long-term replanting program.

In the early 1990s, China has opened its doors to foreign investments into the forestry sector. However, it wasn't until the last five years we have been more players entering into this sector. Therefore, we feel it is important to protect our business acumen and industry intelligence amassed over those years.

Recently, [ph] our presently, we (18:01) revolved around our operation model, our right ownership of our plantations and our work with authorized intermediaries. We have tried our best to address these concerns recently using the channels available to us including posting critical supporting documents on our website. I want to use this call as an opportunity to help clear the confusions and to provide context and how the Forestry business operates in China.

Slide 25, I would like to briefly express the current situation before I go into a discussion about how our business model works. First, I would like to say that there are no inaccuracies in our corporate reports, filings or audited financial statements.

Second, we are deeply disappointed for our stakeholders by the significant decline in the price of our securities caused by both inaccurate and unfounded allegations. Third, to examine these allegations, the Board of Directors has formed a special committee of independent and financially qualified directors. Their biographies are disclosed in the earnings release issued before this conference call. Fourth, Sino-Forest will continue to focus on its business strategy of growing operations. And fifth, we are confident that our corporate reputation will be redeemed in due course while the investigation is completed.

Slide 26, I would now like to turn to a discussion about how Sino-Forest business differs from its U.S. peers. I believe this explanation will help you better understand our business model. We operate with two plantation models in China. In the purchase model, we buy standing timber, hold them for two to three years to capture fibre growth and benefit from increase in log prices. And three years later, sell the standing tree. We do not hold them. The buyer will then do the logging.

In the planted model, we plant trees on bare land or after harvesting, we lease land a long term for replanting with R&D improved seedlings. Upon maturity, we log them and sell them. By comparison, in North America, most forestry businesses operate on – in [indiscernible] (20:20) certain areas selectively, from natural forest, sudden loss of purchase or utilize them into their vertically integrated supply chains.

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Very often in North America, businesses can also own the land as well. In China, we cannot own the land. So we only buy the trees or we grow the trees. Furthermore, there remains a significant market opportunity in China. Sino-Forest has only a small share of the overall market. To quantify the opportunity, Chinese wood demand is roughly 450 million cubic meters. And last year, Sino-Forest produced about 17.6 million cubic meters so we have a long runway of growth ahead of us.

In addition, China has an approximate 50% deficit, meaning China has to import a significant amount of wood from abroad to satisfy its chronic fibre deficit. Our planted plantation model is designed to address this wood deficit situation by planting shorter cycle and quality and huge improved seedlings. Our aim is to becoming a major long-term wood source in – for China. We believe Sino-Forest is well-positioned to benefit from the ongoing liberalization of the Chinese economy, the transition from a highly structured to open economy and the changing rules and regulations.

Slide 27. Turning to Slide 27, I want to address one of the questions that has risen in the marketplace about our use of the authorized intermediaries or AI structure. I want to take this opportunity to walk you through the slide, which I think will help clarify an understanding of a sample transaction.

We use AI under our purchased plantation model to create on-shore, roll-up value. The reason for AI [ph] to assist (22:16) was quite common in early days of our operations. In the 1990s, an international company operating in China would have to use an offshore subsidiary to help it conduct business in the country. In those days, we could not form the Wholly Foreign Owned Enterprise or WFOE for short, on-shore. So we had to go through this AI structure.

In the first step, various land parcels are purchased by an agent acting on behalf of Sino-Forest. It is important to note that the suppliers and the buyers are two different companies. We buy trees from our plantation suppliers, who will round up trees for us and to sell to us. The consolidated parcels are sold as a plantation through a Sino-Forest British Virgin Islands subsidiary.

This agreement was historically signed by BVI subsidiaries of Sino-Forest. However, BVI companies are allowed to own trees, but can't hold plantation leases or sell or plant trees in China. Though WFOEs can own, sell or plant trees in China, they may hold plantation leases.

Sino-Forest has been in the process of investing new capital in the WFOEs structure, since WFOEs were permitted to trade timber in the last decade. They now account for about 43% – 44% of our asset base in area.

In a second step, the BVI company holds the trees for a period of roughly three years, while the trees grow, continue to grow and increase in value. After we hold those trees for approximately three years, where we capture growth of fibre, we then sell to through authorized intermediaries who acts as our entrusted sales agent.

Thirdly, the trees are sold by the BVI company wholesale to authorized intermediaries or AI for short, principally at standing timber. Authorized intermediaries is our own term. People also call them agents or other terms, but substantially – but essentially BVI company has to go through this kind of arrangement for the Chinese market.

Also, as China is such a big country with thousands and thousands of end-users and customers, it is better for us to be more efficient by selling through several long term and trusted customers or AIs as we call them. But timber is sold under specific contract, the details Sino-Forest responsibility to the AI and AI's responsibility to Sino-Forest. The AI is responsible for paying the corporate income tax, value-added tax, and other taxes when assets are realized. The AI can either sell off the plantations typically in small ones or harvest the trees for sale. The AI have 270 days to pay Sino-Forest and typically pays on average within 90 days.

Fourth, the AI pay the proceeds from the timber sales to the end users to a Sino-Forest designated purchasing agent rather than direct back to the BVI company. The AI pays under the terms of the contract, but since the BVI subsidiary cannot hold the [indiscernible] (25:40) stock exchange.

In a fifth step, the purchasing agent utilizing the money from the AI, purchases more parcels once ownership is transferred to the BVI company. Sino-Forest directs the AI to use the proceeds from the sales, which is a receivable to Sino-Forest, to purchase new plantation assets through an agent on behalf of Sino-Forest. They have been already been identified by Sino-Forest. As such, the closing value of the trees is redeployed to buy more trees. And the BVI entity

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acts as an onshore accumulator of value for our business.

If we chose to release that value, which hitherto investors have not been pushing us to do, given the growth aspect prospects, we could wind up a BVI entity, [ph] pay tax (26:35) and crystallize its value bringing it back for our shareholders.

Finally, of course, under the last step, you see the AIs having pay us and received the trees, cut the trees and sell the logs to hundreds of end users who utilize them to meet the strong demand for wood products in China.

As this structure clearly demonstrates, the suppliers and the buyers are two different companies, with a purchasing agent who run up trees for us acting as our supplier and then AIs who [indiscernible] (27:16) sales into the market acting as the buyer. In addition, we will note that we only work with AIs in our purchasing, in our purchase transition model which is what our BVI subsidiaries.

The money from this BVI business model stays on-shore [ph] with deposits from (27:26) the sale of standing timber being utilized to purchase more trees for BVI entity and creating more value as our base grows.

Under our Planted plantation model, we utilize our wholly foreign-owned enterprises. With regard to our – to all our material [indiscernible] (27:44) concessions, they are identified and disclosed in the Annual Report. And none of these AIs are [indiscernible] (27:52) parties to the company to management or to myself. In fact, all the [indiscernible] (27:58) party transactions which are material are identified and disclosed in the Annual Report. We do have ex-employees that are setting up companies that we do business with. For example, there's an ex-employee that left the company in '07. He has set up his own business, who we are now doing business with, because we know and trust him.

As for the identities of the AIs, we don't want to disclose them because the Chinese forestry business is highly competitive, and we face a multitude of competitors both domestic and foreign. There are a lot of new – a lot more newcomers, players in the area, and if we disclose the AIs' names, we are giving out a competitive advantage to others. Prior disclosure of an AI back in 2004, in Hunan Province, led to several small scale competitors undercutting us [ph] on time (28:51).

Our relationships with the AI represent a competitive advantage that we possess, and consequently, we do not publicly disclose their identities. Even though we do not disclose the AIs externally, we have disclosed to Ernst & Young, our auditor, all the identities and addresses and whereabouts of our AIs. And we also – we provided all these informations to PwC, as part of their review with the independent committee.

Slide 28, before turning the presentation over to Bill to discuss the Independent Committee's process that is now going through, I would like to take the time to discuss some of the glaring major errors in the Muddy Waters that demonstrate a lack of understanding of our business, a lack of review of our financial statement, and simply put, sloppy research.

It is worth noting that the company was not contacted by Muddy Waters for comment ahead of publication of its report. First, Muddy Waters asserts and I quote, "transporting the harvested logs would have required over 50,000 trucks driving on two lane roads winding through the mountains from this remote region, which is far beyond belief and likely road capacity," end of quote. If Carson Block had read the management discussion and analysis section of our Annual Information Form, on page eight, he would have found in our disclosure that we've sold the majority of our trees in Yunnan as standing timber, not cut logs.

Second, Muddy Waters alleges, quote, "the value of purchases made under Yunnan master agreement is overstated by approximately \$800 million," end of quote. However, Muddy Waters ignores the fact that in addition to purchases of [ph] 20,574 (30:45) hectares of plantations in [indiscernible] (30:49), we have purchased approximately 173,000 hectares of plantations in approximately 25 other counties in Yunnan Province as of December 31, 2010. These details are supported by the documentations we have recently posted in the Data Room on the website and in our financial filings. And as you have seen from the – from our website, we have called through – we have called [ph] some way (31:19) in demonstrating the ownership of these assets.

Third, Muddy Waters asserts, quote, "for accounting purposes, Sino-Forest treats AI as being both supplier and customer in transactions," end of quote. As the prior slide demonstrated, the AI is only the buyer not the supplier, and

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the purchasing agent is a separate end company from AI. Fourth, Muddy Waters alleges, quote, "Sino-Forest Board appears to be the retirement plan for partners of its auditors, Ernst & Young. It currently has five directors on its board from E&Y."

We actually have three directors, James Hyde, Garry West and James Bowland, all of which had worked at E&Y previously, but James Bowland was about 20 years ago. We believe this pattern of sloppy diligence and gross inaccuracy demonstrates the quality of work put out by Muddy Waters and its founder, Carson Block. We look forward to rehabilitating our business and having our reputation restored.

I'm pleased that we are joined by Bill Ardell, Chairman of our Independent Committee, and I will now turn it over to him. Thank you.

William E. Ardell

Thank you, Allen. While there are still many issues we can't address yet, we are using every resource available to provide a clear and thorough response as the outcome of this examination. We understand the urgency of the situation. Investors need to see the truth via a clear and transparent process. Since the release of the report, Sino-Forest Board of Directors has acted quickly and decisively.

On June 2, the Board established the independent committee to lead a thorough review of the allegations. The independent committee is comprised of three Sino-Forest independent directors; myself as the Chairman, James "Jamie" Hyde, and Jamie Bowland. We've also appointed independent counsel to help us review the allegations, Osler, Hoskin & Harcourt, a leading Canadian firm, Mallesons, a leading international firm, and we have been working around the clock with our advisors and we continue to map out the full scope of PwC's work and other independent advisors with the aim of ensuring that we have a complete and independently verified answer to the examination which have been – to the allegations which have been made.

The process of assembling and securing the data has commenced. We will then proceed to analyze this information focusing on the issues raised regarding the ownership of timber rights and valuation of assets and revenue.

At this time, we believe that we'll take at least two to three months for PwC to provide a complete report on the findings of the review, and I hope you will bear with us as the examination takes place. Rest assured we will keep you informed with the progress of our work.

With that, I think we're ready for questions. Thank you.

Louisa Wong

Thank you, gentlemen. We will now start the Q&A portion of this call. So may we ask you to limit your questions to a maximum of two or not more than two minutes. If you have any further questions, please rejoin the queue. Operator, please open the line.

Q&A

Operator

[Operator Instructions] And your first question comes from the line of Richard Kelertas from Dundee Capital Markets. Your line is open.

<Q - **Richard Kelertas**>: Yes, good morning, everybody. Allen, you mentioned that you didn't want to mention the names of your AI's, but you did have a fixed-income tour of the Central Forestry Bureau, the commission, and also your largest AI. These fixed-income analysts did meet these – this AI and had a discussion with him, could you talk

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about that a little bit, please?

<A - **Allen T. Y. Chan**>: Sure, that we conducted a tour, I think a month ago, for the fixed-income analyst for several days. We did take them to Beijing to visit the State Forestry Administration and went through our session of Q&A with the senior officers and to explain about the practice of Chinese forestry in China [ph] recreations (35:43) and the policies. And afterwards that, we took them to Shenzhen to meet with one of our major AIs in Shenzhen, and that took for another full hour that for – is open at Q&A for them to be – to get answers from this owner of this AI, to understand the business and also to understand the operation shift between us.

<Q - **Richard Kelertas**>: Thank you. Would we be able to see one of these AIs when the analysts – the equity analysts come on our tour in July?

<A - **Allen T. Y. Chan**>: Definitely, that we would introduce the equity analysts to one of the AI analysts, so that you can meet with them and ask questions.

<Q - **Richard Kelertas**>: Okay, great. Final question, then, is, Dave, on the tax liabilities and the provisions that you've made on your balance sheet, in your – sorry, in your annual report, can you discuss how that works with the AIs and how that is recorded?

<A - **David J. Horsley**>: Sure. As Allen said in the previous section of the conference call, under the agreement, the AIs are responsible for paying all of the tax income back and other taxes. From an accounting point of view, Sino-Forest provides a contingency in the event that those taxes have not been paid. Since we can't confirm one way or another, we take a conservative approach and we provide for income tax contingency in our balance sheet – excuse me. Here we have a liability of about \$190 million accrued on our financial statements in the event that those taxes weren't paid and Sino-Forest has to pay them.

<Q - **Richard Kelertas**>: And that would amount to, on a percentage basis for these AIs, approximately what per year?

<A - **David J. Horsley**>: Well, we provide for 100% of the income taxes that are earned by Sino-Forest, but should have been paid tax by the AI for three years plus the current year.

<Q - **Richard Kelertas**>: Okay, great. Thank you very much.

Operator

Our next question comes from the line of Sean Steuart from TD Securities. Your line is open

<Q - **Sean Steuart**>: Thanks. Good morning, everyone. A couple of questions. Allen, you mentioned in light of ongoing events you guys are taking a harder look at your acquisition schedule for this year. Can you talk a little bit about the magnitude to which acquisitions under the master agreements might be curbed over the next year?

<A - **Allen T. Y. Chan**>: Yes, sure. Definitely that we are taking a more prudent look on to the speed of expansion in China, but most important part is that we do have solid profitability over time for us to implement our master agreements. So even though that we intend to slow down over, let's say, the balance of the year, however, that we do have a certain room for us to implement master agreements in the future when things change.

<Q - **Sean Steuart**>: Can you just go into a bit more detail on the motivation there? If you guys are resolute that all of these allegations are incorrect, why pull back on the acquisition strategy near term? Are you just trying to demonstrate a more conservative approach to growth or are there other issues in play?

<A - **Allen T. Y. Chan**>: Well, basically, that it is in view of the [ph] sudden, (39:49) the present market sentiment, might not be the right word, that we want to show to people that we have the flexibility. That whether we want to go faster or we want to go slower. So it is more a demonstration that we are not falling out of options.

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<A - David J. Horsley>: And I think, secondly, this examination process is going to take a tremendous amount of time, operations people in the field and others and so that's going to impact in the short short term our ability to continue on the acquisition pace that we were on for the year.

<A - Louisa Wong>: Operator, hello?

Operator

Your next question comes from the line of Jit Ming Tan from Barclays Capital. Your line is open.

<Q - Jit Ming Tan>: Hi, good morning, thanks for the call. Just wanted to go back to the first question on the tax liabilities that you provided. David, you mentioned that you provide contingent liabilities provisions for 100% of the context for the first three years and the current year because you're not clear, you're not sure if the AIs have paid for the taxes. Correct me if I'm wrong, but isn't that a bit worrying that you don't know whether your AIs have paid the taxes?

<A - David J. Horsley>: Well, I'm not sure worrying is the right word for it. We just don't know and so we take the most conservative view, and that is that they haven't and we provide for it so there is no sort of worst case or downside. We've accounted for that in the financial statements and provide that provision, and the question is whether or not it has been paid at some point in the future or doesn't. But we can't – we just don't have access to that information.

<Q - Jit Ming Tan>: All right. Would you have – would the PRC government have a look at the taxes or the structure of the AIs and have they commented on it?

<A - David J. Horsley>: Not to my knowledge.

<Q - Jit Ming Tan>: Okay.

<A - Allen T. Y. Chan>: But we do have [ph] PRC (42:17) legal counsel reviewing all the whole structure that long time ago when we first started.

<Q - Jit Ming Tan>: Okay, understood. My last question is on your – the potential buyback of your stocks and bonds. Is there any chance that you might look into that in the near future?

<A - William E. Ardell>: It's Bill Ardell speaking. We've had lots of recommendations from various people that we should be looking at share buyback and particular reference was made to a number of the directors that this is an opportunity for them to be in and buying significant amounts of shares to demonstrate strong belief in the company. And I can assure you that if we had the choice, we certainly would at this stage. But we've been advised by counsel that we're unable to do so until the examination is completed. So any further discussion on share buybacks and things of that nature will have to wait until this examination is over.

<A - Allen T. Y. Chan>: Yes, I will add on that. That's a [indiscernible] (43:20).

<Q - Jit Ming Tan>: All right. I appreciate that. Thank you very much.

Operator

Your next question comes from the line of Benoit Laprade from Scotia Capital. Your line is open.

<Q - Benoit Laprade>: Thank you. Good morning. Going back to your Slide 9, in terms of plantation fibre, just wanted to have some color in terms of regions and product mix. And more specifically, virtually, all the sales in the quarter were standing timber, very little in terms of logs. I just wanted to know maybe some regional background and why is that. Was that a pricing issue? Was that a regional issue?

<A - David J. Horsley>: No, I mean, typically Q1 and Q2 are not a lot of logging going on in those quarters anyway. Aside from that, our preference is obviously to sell standing timber as opposed to logs. It's a low value-add process and

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that's not our expertise. So we're pre-disposed to selling standing timber, and then in Q1 and Q2 with the rainy season, there's just not a lot of logging going on. So you end up with more standing timber.

<Q - **Benoit Laprade**>: And more – sorry.

<A - **Allen T. Y. Chan**>: As for the major regions, actually, either Southwest that's closer to the earthquake rebuild areas.

<Q - **Benoit Laprade**>: Okay. And I was also looking at the average selling price for logs was down significantly from Q1 last year, yet the gross profit per cubic meter on logs was actually up. How can we reconcile that?

<A - **David J. Horsley**>: That's really just a function of the species and the size of the logs, so they were much smaller diameter, therefore much smaller unit price, but we are able to obtain the same margin because the cost that we paid for them was much lower.

<A - **Allen T. Y. Chan**>: And also the trees have increased in volume over the years, the year that we are holding. Typically, in China, that we have annual growth rate between from 5% to 16%, depending on the species. That you [indiscernible] (45:39) there's a 16.6% growth rate every year, so that is also the major reason for the margin.

<Q - **Benoit Laprade**>: And how many hectares have been replanted in the quarter?

<A - **Allen T. Y. Chan**>: Well, actually, I think that we are progressing along the program that we have [indiscernible] (46:04) that would be 200,000 over the next two years. Over that – I mean, we start [indiscernible] (46:10).

<Q - **Benoit Laprade**>: And lastly, switching to your slide 27, where we see the purchased plantation model, just curious to understand the currency side of it. So all of these transactions are in U.S. dollars?

<A - **Allen T. Y. Chan**>: All of the transactions – the transaction is in renminbi, but in slide...

<A - **Louisa Wong**>: No, on the slide, they are in U.S. dollars, because we report in U.S. dollars.

<Q - **Benoit Laprade**>: Okay. And so you have your original investment that was made in dollars, and after that, it's more of what you're exchanging fibre for new, younger plantations. Can you explain to us how you could actually take your money out of there, if you would actually stop or slow the growth at some point?

<A - **Allen T. Y. Chan**>: Yes, it's just the same as I think we have covered is that, if so we decide we can close up one of these BVIs and sell it off, and then after we pay the tax, then we can remit the money out of the country.

<Q - **Benoit Laprade**>: Okay. Thank you.

<A - **Louisa Wong**>: [indiscernible] (47:27). The thing is that when we sell, when we buy the bundle we sell, we actually sell in renminbi, but we report them in U.S. dollar.

<Q - **Benoit Laprade**>: Yes, thanks.

<A - **Louisa Wong**>: We can take the next question, operator, please.

Operator

Your next question comes from the line of Andrew Kuske from Credit Suisse. Your line is open.

<Q - **Andrew M. Kuske**>: Thank you. Good morning or good evening, as the case may be. Just in relation to the outlook, Allen, if you can just give some color on, just I guess why you believe your tree acquisitions will be adversely affected, is that just less confidence from the AI's, less confidence from the forestry bureaus or just outright prudence on the behalf of Sino-Forest.

<A - **Allen T. Y. Chan**>: It is definitely is a prudent approach. It's simply that because of the present situation that we are in, so we want to be a bit more prudent. As I said that we have the flexibility that if we want to change gear we can

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always change gear. And we still have quite some years ahead of us for us to implement the master agreements.

So in view of the market dynamics, nothing changed. The price of the wood logs is on a healthy growth and right now the price of the wood logs across the board has already surpassed the peak in '08, which was the peak in the market. So we do see a steady growth.

Last year, of course, the growth is double digits. But to date – for this year, that is more steadily growth going ahead. So that – in terms of this, the market demand, it is there. As for in terms of the government's intention and determination to convert all their commercial plantations from a slower growth of sort of lower yielding plantations into shorter cycle and high yielding plantations, the determination is even more so in the new five-year plan.

So, therefore, there are actually more than before in terms of the amount of plantations available for us to buy and then the eventual conversion into more quality plantations. So that, what I have explained earlier about that we would be a – take a more prudent, less aggressive approach in terms of expansion is simply as a matter of choice for the time being. But we have the possibility to gear if we want to.

<A - **Louisa Wong**>: Okay, operator, please?

Operator

Your next question comes from the line of Paul Quinn from RBC Capital Markets. Your line is open.

<Q - **Paul C. Quinn**>: Yes, thanks very much. Just a question related to timing, the special committee getting back, I understand the two to three months to hear back from the PwC, is that sort of the timeline? After the PwC reports, will you be able to make share repurchases or debt repurchases?

<A - **David J. Horsley**>: I think I'd like to get the report done first. The – we've been moving at a very rapid pace and I'm hopeful that the majority of the people on this line recognize that there's quite a difference in doing business and getting information in this part of the world than there is in North America.

Since this occurred on June 2, we forecast – as we've said in a lot of our releases, we formed the special committee. I flew over here on Tuesday night. I've been here since Thursday. PwC has been on the ground and met with Allen for the better part of three hours on Friday. PwC were here on Saturday, Sunday, at which time we were preserving the – all the data around the company. That has been done, they're in the process of getting independent confirmation of our banking position.

Fairly, we'll take some – a few days to get done here in Hong Kong where the majority of the funds are. However, the PRC is a different situation in the sense that, unlike a sort of a consolidated banking system, in order to get confirmation of bank balances, PwC will have to go to every single bank. So that's going to take time. So at this particular stage, PwC are just in the early stages of assessing how the information is going to be assembled, where it needs to come from, and once they're finished with that, we'll have a better time and sense of when they're going to be able to complete their first report. After which it'll certainly be presented to the board and then I think it's been indicated in the press release, will be made public.

<Q - **Paul C. Quinn**>: Okay, so just so I understand, your legal counsels advise you, you can't do any share buybacks or director purchases until that report is complete?

<A - **David J. Horsley**>: Absolutely.

<Q - **Paul C. Quinn**>: Okay. And then just on the Yunnan timber purchases that you're putting up in the data room, when do you expect to have all the data up on that – on your website?

<A - **Allen T. Y. Chan**>: Well, actually, that – we would have all the data prepared for the [ph] special (53:12) committee, and also the counsels and PwC review. As for better record we can – we are going to put all on a website; I still have to talk to our people in terms of the timeline, and also what to put on.

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<Q - Paul C. Quinn>: Okay. That's all I had. Thanks.

Operator

Your next question comes from the line of Annisa Lee from Nomura. Your line is open.

<Q - Annisa Lee>: Thanks very much for the call. I have a few questions. First of all, I just wanted to actually ask, whether the company is in compliance with all of the planting regulations within China?

<A - Allen T. Y. Chan>: Sorry? Can you repeat your question?

<Q - Annisa Lee>: Whether the company is in compliance with all the planting regulations within China.

<A - Allen T. Y. Chan>: Yes. We are in compliance of all the planting regulations in China.

<Q - Annisa Lee>: Would it be possible for the company to basically potentially uploading this compliance certificate, something like documents to support this thing, into the data room?

<A - Allen T. Y. Chan>: I'm not so sure I follow your question, but basically, in China, it is that whenever you want to do planting, you have to apply the approvals for that. And then I doubt that there's a document called a letter of compliance to be issued by Chinese government, but on the other hand, if we have done things wrong, they would have already informed us to correct. So definitely that I would tackle it and see whether that is possible that before we can come back to you on that specific document.

<Q - Annisa Lee>: Sure. Thank you.

<A - Allen T. Y. Chan>: Thank you.

<Q - Annisa Lee>: Then the other thing was what is the current cash level of the company?

<A - Allen T. Y. Chan>: Dave, you want to answer?

<A - David J. Horsley>: Well, as we reported in the March financials, \$1.1 billion. Since the March, we've operated the business in normal course, and so the cash is – has been – some of the cash has been used in normal course operations, but there's been no unusual or large or extraordinary purchases, so we'll report the June [indiscernible] (55:39) cash balance with Q2.

<Q - Annisa Lee>: Is it possible to achieve this close enough?

<A - Louisa Wong>: Sorry, Annisa, I think you have to actually re-queue because you actually had already asked three questions. Thank you. Because – we don't actually have [Inaudible] (55:50). Operator, can you check the next question, please? Hello.

Operator

So our next question comes from the line of [indiscernible] (56:04) from RBS. Your line is open.

<Q>: Hi, thanks for the call and I have a couple of questions. One, in relation to the authorities and second in relation in the authorized intermediaries. On the authorities, could you just give us the – an overview of the scope of the investigation by the Ontario Securities Commission, and also if you have heard anything from the Chinese authorities or whether the State Forestry Bureau's or tax bureaus or any of them in light of all these allegations that have been raised.

And number two, on the authorized intermediaries, just going back to the earlier discussion, you said you had to collapse the BVI structure to get the cash offshore. Have you attempted this in the past and have – are all these taxes been accounted for like in terms of – have you made provisions for these taxes or do you have to pay more taxes? And

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what is the level of taxes that you have to pay if you have to get the cash offshore that is all locked up by this AI model where you roll out the assets onshore?

<A - William E. Ardell>: It's Bill Ardell speaking. I will speak to the OSC inquiry. At this stage, counsel is in discussions with them and there's not much more to disclose other than that.

<Q>: Okay.

<A - Louisa Wong>: Can you repeat your second question then, please? [indiscernible] (57:36), can you proceed your second question?

Operator

Your next question comes from the line of Richard Kelertas from Dundee Capital Market. Your line is open.

<Q - Richard Kelertas>: Yes, just a follow up. I can appreciate the amount of work that has to be done by the independent committee. Two to three months seems to be quite a long time and again we understand. Would it be possible to give updates, however, on the progress and with some information when it's confirmed by the independent committee be able to be released on an occasional basis. At least during those two, three months so we can continue to have some news flow.

<A - David J. Horsley>: Richard, as we develop and confirm the information, I mean part of our concern is putting out information on a piecemeal basis. We would rather be in a position of providing a full report because piecemeal information just leaves itself to continuing questions. We want to be fairly well down the path, but if we find something that we think is meaningful and it would be helpful on the near term, I'm sure that we will make that public.

<Q - Richard Kelertas>: Okay. Great. Thank you.

<A - Louisa Wong>: Next question please.

Operator

Your next question comes from the line of Mathura Yogarajah from Deutsche Bank. Your line is open.

<Q - Mathura Yogarajah>: Hi. Thank you for the call. I just wanted to check like following all these allegations, do you think that your funding profile would change in the future like you would have more bank debt?

<A - Allen T. Y. Chan>: Dave?

<A - David J. Horsley>: Well, I think, we have indicated to the market that we wouldn't be going to the market for equity in the near term and that our focus is on accessing the China Development Bank, the umbrella agreement that we signed for US\$1.5 million. So our focus is to access some of those facilities, I would say, over the balance of this year and next to be used for different projects in China, replanting, and so on. So I would say that we have the capability to put certain amount of onshore debt onto our books and we will look to do that likely over the next while.

<A - Louisa Wong>: Next question please.

Operator

Your next question comes from the line of Sean Steuart from TD Securities. Your line is open.

<Q - Sean Steuart>: Thanks. Just one follow up, I guess for Dave or Bill. And maybe I'm reading too much into these, but can you talk through the indenture amendment with respect to the converts and does that speak to the Board's comfort with the company solvency and is there any read-through of plans for interest payments and principal

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payments you have on debt over the next couple of months?

<A - William E. Ardell>: No. The convert is strictly related to language that's in there. The company has the option upon maturity of the convert to settle in cash or cash and shares. Under old Canadian GAAP, it was our option and so they treated it more as a debt instrument, but because we have the option to pay cash on maturity under IFRS, the accounting treatment is different and you use fair value of the equity is sort of back into the debt.

So, it's just the existence of cash and cash or share combination. And it's at our option that the debt holders are giving up anything, we are giving up our option to pay cash on maturity, and so we will amend the language to say that we don't have the option of cash, it's shares on maturity, assuming that the [ph] CB (1:01:50) is in the money. So it has nothing to do with anything but existing language and how it's interpreted differently under old GAAP versus new GAAP, and so we will take that option of cash out and that will remove the requirement of fair value of the equity component on a quarterly basis, and we will just be back to treating it as a fixed amount, not mark-to-market.

<Q - Sean Steuart>: Got it. And then, Dave, just maybe you can confirm, you have every intention of making interest payments as they come due, obviously you have the cash, but just in light of the allegations, interest payments you have over the next few months, and the no payment in August, you're intending to go ahead with that as well?

<A - David J. Horsley>: Absolutely.

<Q - Sean Steuart>: Okay. Thanks.

Operator

Your next question comes from the line of [indiscernible] (1:02:46) from RBC – or I'm sorry, RBS. Your line is open.

<Q>: Thank you very much. I just have one question. Given the external funding has always been a very important component for your business historically, can you just give us a sense of your banking relationships now? What are – what are banks telling you now, are they expressing concerns if any banks [indiscernible] (1:03:12) any of the credit line? And also on the [Inaudible] (1:03:22)?

<A - Louisa Wong>: Well, I think it probably got cut actually. The line was quite bad. So maybe operator, can you pick the next one please?

Operator

Your next question comes from the line of Charles Chang from Credit Suisse. Your line is open.

<Q - Charles Chang>: Hi. Just a couple of quick questions from me. First off I think you mentioned in the release today that – and earlier, you mentioned that you disclosed the identity and location of the AIs to Ernst & Young for their verification purpose. Just wanted to see if you'd be able to provide a letter from Ernst & Young confirming this?

Secondly, just wanted to see if you could talk a little the bit about the class-action lawsuits, how seriously do you think this is, how long do you think it'll take, how much it could cost and then what's your strategy in dealing with it?

And lastly, a question on the independent committee members, whether they have any personal liability at stake in terms of their duty to perform the test as assigned to that committee and do you share responsibility to the shareholders and other stakeholders?

<A - William E. Ardell>: As to the personal liability issue, I don't have an answer to that question. I think our liability is the same as any other director in terms of responsibility for the stewardship of the company. We are simply designated as an independent group of the Board to perform this examination. As to the class-action lawsuit, we don't have adequate knowledge yet to the size or the extent of any of it, so it's very early to comment on that particular issue.

<A - Allen T. Y. Chan>: And the first question?

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<A - William E. Ardell>: Dave, maybe you can handle the E&Y?

<A - David J. Horsley>: Sure. I mean, we've made it known that we make available that information to E&Y, we can't comment on, on obviously, what they do with that information. I should certainly ask them if they will provide a letter, that's somewhat unusual, and I don't know what the response will be, but I can certainly ask.

We will be giving that information to, as Allen said, to PwC as well, and so, they will have full access to all of the AI information details, contacts, and so I'm not – that information will certainly be available and confirmed by them that they have received it.

<A - Louisa Wong>: Okay. Operator, maybe this is the last question, due to time constraints. Just one more, please.

Operator

And your last question comes from the line of Zhi Wei, Feng from Standard Chartered, your line is open.

<Q - Zhi Wei, Feng>: Hi, everyone, thanks for the call. I just have a quick question, maybe probably asked by other people. After this Muddy Water report, I believe it also translated onshore in different news. I just want to know whether you get questions from the local authorities on this to clarify the situation. That's all.

<A - Allen T. Y. Chan>: Okay. We have not received any kind of negative comment from this any authorities. So that's it.

<A - Louisa Wong>: So, do you have any other – do you have follow-up questions, Zhi Wei?

<Q - Zhi Wei, Feng>: No, thanks. That's all.

<A - Allen T. Y. Chan>: Okay. Thank you.

<A - Louisa Wong>: Thank you.

Louisa Wong

All right. So, given the time constraint, I think [ph] we'll end (1:07:27) this call here. A replay of this conference call will be available on our website within the next 30 minutes. A transcript of this call also will be available some time tomorrow. The MD&A and financial statement, together with Allen Chan's video that was prerecorded is actually also uploaded on the website.

Meanwhile, if you have any quick questions, you may either contact Dave Horsley or myself and we'll try to respond to them in a timely manner. On behalf of Board and management, we thank you for your continued support for Sino-Forest at this critical time. Thank you very much and have a good day.

Allen T. Y. Chan

Thank you.

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