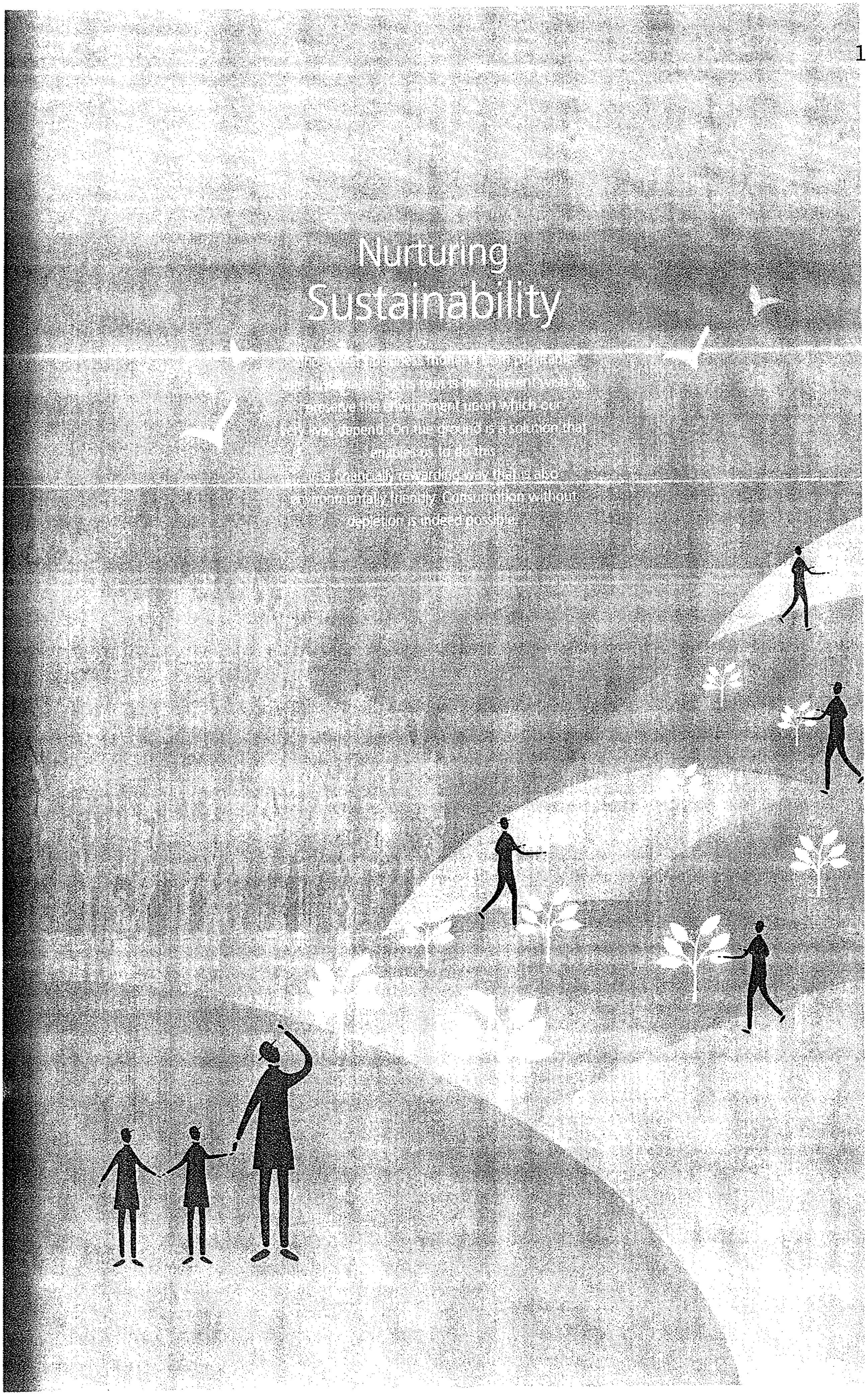
Nurturing
Sustainability
preserve the environment upon which our
very lives depend. On the ground is a solution that
enables us to do this
in a financially rewarding way that is also
environmentally friendly. Consumption without
depletion is indeed possible.

MANAGEMENT'S DISCUSSION AND ANALYSIS

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

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

FORWARD-LOOKING STATEMENTS

This MD&A contains forward-looking statements which reflect management's expectations regarding Sino-Forest's future growth, results of operations, performance, business prospects and opportunities. Words such as "expects", "anticipates", "intends", "plans", "believes", "estimates", or similar expressions, are forward-looking statements within the meaning of securities laws. Forward-looking statements include without limitations, the information concerning possible or assumed future results of operations of Sino-Forest. These statements are not historical facts but instead represent only Sino-Forest's expectations, estimates and projections regarding future events. These statements are not guarantees of future performance and involve assumptions and risks and uncertainties that are difficult to predict. Therefore, actual results may differ materially from what is expressed, implied or forecasted in such forward-looking statements. In addition to the factors Sino-Forest currently believes to be material such as, but not limited to, our ability to acquire rights to additional standing timber, our ability to meet our expected plantation yields, the cyclical nature of the forest products industry and price fluctuation in and the demand and supply of logs, our reliance on joint venture partners, authorized intermediaries, key customers, suppliers and third party service providers, our ability to operate our production facilities on a profitable basis, changes in currency exchange rates and interest rates, evaluation of our provision for income and related taxes and PRC economic, political and social conditions and government policy, other factors not currently viewed as material could cause actual results to differ materially from those described in the forward-looking statements. Although Sino-Forest has attempted to identify important risks and factors that could cause actual actions, events or results to differ materially from those described in forward-looking statements, there may be other factors and risks that cause actions, events or results not to be anticipated, estimated or intended. Accordingly, readers should not place any undue reliance on forward-looking statements. The Company does not undertake any obligation to update or release any revisions to these forward-looking statements to reflect events or circumstances after the date of this report.

OVERVIEW OF BUSINESS

About Sino-Forest

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

We began operations in 1994 as the first, foreign and privately managed company involved in forest products in China. Our principal businesses include the ownership and management of forestry plantation trees, sale of standing timber, wood chips and logs, and complementary manufacturing of downstream engineered wood products.

Strategic Business Units

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

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

Standing Timber

- we acquire, cultivate and sell standing timber from our purchased and planted trees plantations;

Wood Chips and Logs

- we source logs from PRC suppliers and process and sell them as wood chips through an authorized intermediary and earn commission income from agency services in the sales of wood chips;

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

Imported Wood-based Products

- we source logs, veneer, sawn timber and other wood-based products globally and sell them in the domestic PRC market.

Our Manufacturing & Other Operations include:

- particleboard manufactured in Gaoyao, Guangdong Province;
- engineered Wood Flooring produced in Suzhou, Jiangsu Province, and sold over 200 stores nationwide in the PRC;
- oriented Strand Board manufactured in Muling City, Heilongjiang Province;
- finger Joint Board produced in Hongjiang City, Hunan Province;
- greenery & nurseries operation based in Suzhou, Jiangsu Province.

Our Vision and Strategy

Our vision is to become the leading, commercial forestry plantation operator and preferred supplier of wood fibre to downstream consumers in the wood panel, furniture, construction, interior decoration and pulp and paper industries in the PRC.

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

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

- acquire additional forestry plantations and access to long-term supply of wood fibre in the PRC where regional markets with growing demand will be located;
- improve the yields of our forestry plantations by continued investment in research and development;
- practice environmentally responsible forestry;
- strengthen our management processes and information systems to support the growth of our multi-faceted businesses;
- strengthen our engineered wood manufacturing business to complement our plantation operations with an aim to increase value of our wood fibre;
- widen and diversify our investor base, and enhance our corporate image and profile.

Other Key Factors Affecting Our Business

Our results of operations are, and will continue to be, affected by the cyclical nature of the forest products industry. Prices and demand for logs and wood chips have been, and in the future are expected to be, subject to cyclical fluctuations. The pricing in the forestry market is affected by the prices of the ultimate wood products produced from logs in the PRC, including furniture, construction materials, interior decoration materials and pulp and paper products. The prices of wood products are also affected by the availability of wood substitutes. The market for wood products are sensitive to changes in industry capacity and output levels, general timber industry conditions and cyclical changes in the world and PRC economies, any of which can have a significant impact on selling prices of wood products. The demand for wood products is also substantially affected by the level of new construction activity, which is subject to fluctuations that may or may not correspond to overall economic trends. Decreases in the level of construction activity generally reduce demand for wood products. The demand for wood products is also affected by the level of interior design activity and the demand for wood chips in the pulp and paper markets. These activities are, in turn, subject to fluctuations due to, among other factors:

- changes in domestic and international economic conditions;
- interest rates;
- government regulations and policies;
- population growth and changing demographics; and
- seasonal weather cycles (e.g. dry summers, wet winters) and other factors.

Cyclical changes in the forest products industry, including changes in demand and pricing for our products and the other factors described above, could have a material adverse effect on our business, financial condition and results of operations.

Our decisions and abilities to develop and operate future forestry plantations are subject to various factors and uncertainties. Should we be unable to exercise our rights to obtain additional forestry plantations, our business, financial condition and results of operations could be materially and adversely affected.

The success of our business depends upon the productivity of our forestry plantations and our ability to realise our expected yields. Forestry plantation yields depend on a number of factors, many of which are beyond our control. These include damage by disease and pests and other natural disasters, and weather, climate and soil conditions. Our ability to maintain and improve our yields will depend on these factors and the results of our research and development efforts.

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

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

We are subject to regulation under a variety of PRC national and local laws and regulations. Violations of a variety of PRC laws and regulations, including PRC environmental policies and programs that apply to our forestry plantations, could result in civil and criminal penalties, including the revocation of licenses required for our business.

The forestry industry is susceptible to weather conditions, timber growth cycles and natural disasters outside of our control. The occurrence of these or other natural disasters may disrupt or reduce the supply of trees available for harvesting in the areas of the PRC where our forestry plantations are located.

Our manufacturing plants are in an early stage of development and have a short operating history. Our manufacturing plants may not be profitable or successful and are subject to the risks inherent in establishing a new business, including competitive pressures, which could have a material adverse effect on our business, financial condition and results of operations.

We report our financial statements in United States dollars, while substantially all of our revenue is denominated in Renminbi. Any significant fluctuation in the exchange rates between the Renminbi and other currencies, such as the United States dollar, Canadian dollar, and Hong Kong dollar, or in the United States dollar against the Renminbi, the Canadian dollar or the Hong Kong dollar, may have an adverse impact on our results of operations and may adversely affect the value, translated or converted into United States dollar, Canadian dollar or otherwise, of our revenue and net income.

Significant Accounting Policies and Interpretation

Cost of Sales

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

Depletion of Timber Holdings

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

EBITDA

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

SIGNIFICANT BUSINESS ACTIVITIES

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

Appointment of Director

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

Syndicated Loan Facility

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

Long-Term Wood Fibre Supply

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

Opening of Flooring Facility in Suzhou

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

Acquisition of 400,000 hectares of Plantation Trees in Hunan

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

Update Valuation of Forest Plantation Assets in China

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

SELECTED ANNUAL FINANCIAL INFORMATION

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

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

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

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

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

2004 242,000 hectares

2005 324,000 hectares

2006 352,000 hectares

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

RESULTS OF OPERATIONS – 2006 VS 2005

Revenue

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

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

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

Wood Fibre Operations Revenue

Standing Timber

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

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

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

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

Wood Chips and Logs

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

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

Revenue from sales of wood chips decreased 41.0% to $83.9 million in 2006; this decrease was due to a decline of 43.4% in the volume of wood chips sold, partially offset by a 4.2% increase in the average selling price per bone dry metric ton ("BDMT") in 2006. Sales volume declined during the year for two reasons. Firstly, in Q4 2005, one of the two authorized intermediaries who processed wood chip for us was acquired and ceased to provide wood chipping services to us. Secondly, in Q4 2006, the volume of wood chips processed by the remaining authorized intermediary decreased as the authorized intermediary's wood chipping capacity was not available to us. Management is of the view that the wood chip revenue will continue to decline over the next few quarters if we are not able to access to the wood chipping capacity. We still retain the ability to acquire the same volume of fibre that was previously processed into wood chips and we plan to utilise the fibre in our own manufacturing facilities in the future.

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

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

Imported Wood Products

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

Manufacturing and Other Operations Revenue

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

Cost of Sales

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

Wood Fibre Operations Cost of Sales

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

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

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

Manufacturing and Other Operations Cost of Sales

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

Gross Profit

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

Wood Fibre Operations Gross Profit

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

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

Manufacturing and Other Operations Gross Profit

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

Selling, General and Administration Expenses

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

Depreciation and Amortisation

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

Income from Operations

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

Interest Expense

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

Amortisation of Deferred Financing Costs

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

Other Exchange Gains

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

Interest Income

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

Provision for Income Taxes

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

Net Income

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

RESULTS OF OPERATIONS – Q4 2006 VS Q4 2005

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

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

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

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

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

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

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

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

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

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

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

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

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

LIQUIDITY AND CAPITAL RESOURCES

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

Cash Flows

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

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

Cash Flows from Operating Activities

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

Cash Flows Used in Investing Activities

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

Cash Flows From Financing Activities

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

Financing Arrangements and Contractual Obligations

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

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

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

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

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

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

Historical and Planned Capital Expenditures

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

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

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

Once completed, the manufacturing operations in Gaoyao will be one of the largest particleboard mills in China. Total production capacity will be 275,000m³ of particleboard and 6,400,000m² of melamine lamination capacity. The facility is expected to be completed by the end of the second quarter of 2007, and will be in production during the second half of 2007.

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

Independent Valuation of our Forest Assets by Pöyry

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

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

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

Aging of Accounts Receivable

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

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

Inflation

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

Taxation

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

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

OFF-BALANCE SHEET ARRANGEMENTS

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

TRANSACTIONS WITH RELATED PARTIES

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

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

QUARTERLY FINANCIAL INFORMATION

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

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

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

CRITICAL ACCOUNTING ESTIMATES

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

Asset Impairment

Timber Holdings

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

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

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

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

Capital Assets

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

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

Revenue Recognition

Standing Timber

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

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

Wood Chips

We conduct our sales of wood chips from timber supplies sourced in the PRC through domestic wood dealers who act as our authorized intermediaries to purchase timber supplies and sell processed wood chips to customers. During most of 2006, we engaged one third-party wood dealer as our authorized intermediary. The suppliers are generally state-owned or collectively-owned wood farms in the PRC and the customers are typically pulp and paper mills, as well as reconstituted wood panel mills.

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

Provision for Tax Related Liabilities

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

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

Contingencies for Tax Related Liabilities

The provision for income taxes and tax related liabilities is subject to a number of different estimates and judgment made by management. A change in these estimates and judgment could have a material effect on the Company's tax expense. The Company has operations in various countries (mainly in the PRC and Hong Kong) that have different tax laws and rates. Income tax and other taxes are subject to audit by both domestic and foreign tax authorities. The effective tax rate may change from year to year based on the mix of income among the different tax jurisdictions in which the Company operates, changes in tax laws in these jurisdictions and changes in tax treaties between various tax jurisdictions in which the Company operates. It is probable that profits already taxed by one tax jurisdiction could be taxed by another tax jurisdiction. Should the PRC tax authorities recover income tax, business tax and value-added tax directly from the BVI Subsidiaries, they might do so together with related tax surcharges and tax penalties on applicable income or profits of the Authorized Sales Activities from the BVI Subsidiaries for up to three years in practice. Under prevailing PRC tax rules, the tax surcharge is calculated at 0.05% per day on the tax amount overdue while the tax penalties can range from 50% to 500% of taxes underpaid. Under the Hong Kong tax regulations, assessments are open for up to six years in practice and tax penalties can be up to treble amount of the tax underpaid.

Significant estimates and judgment are applied by management to determine the appropriate amount of tax related liabilities and contingencies for tax related liabilities to be recognised and disclosed in the financial statements respectively. Changes in the amount of the estimates could materially increase or decrease the provision for tax related liabilities and the extent of disclosures of contingencies for tax related liabilities in a period.

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

CHANGE IN ACCOUNTING POLICIES

No changes in accounting policies during the year.

New Accounting Standards

Non-Monetary Transactions

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

Future Accounting Standards

Financial Instruments, Hedges and Comprehensive Income

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

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

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

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

Equity

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

Accounting Changes

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

Capital Disclosure, Financial Instruments Disclosure and Presentation

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

RISK AND UNCERTAINTIES

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

Market Risks

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

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

Exchange Rate Risk

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

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

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

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

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

Interest Rate Risk

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

Commodity Price Risk

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

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

DISCLOSURE CONTROLS AND PROCEDURES

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

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

INTERNAL CONTROLS OVER FINANCIAL REPORTING

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

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

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

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

MANAGEMENT'S DISCUSSION AND ANALYSIS (cont'd)

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

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

EBITDA is calculated as follows:

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

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

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

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

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

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

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

(9) These represent mainly leases of plantation land.

MANAGEMENT'S REPORT

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

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

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

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

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

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

AUDITORS' REPORT

To the Shareholders of
Sino-Forest Corporation

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

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

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

BDO McCabe Lo Limited

Hong Kong
March 19, 2007

BDO McCabe Lo Limited
Certified Public Accountants

CONSOLIDATED BALANCE SHEETS

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

See accompanying notes

On behalf of the Board:

Allen T.Y. Chan
Director

James M.E. Hyde
Director

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

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

See accompanying notes