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;
- governmental 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 decision and ability to develop and operate future forestry plantations is 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 realize 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 dependant 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.

Components of Income Statement Items

Revenue

We derive our revenue from three sources, as follows:

Standing Timber

- selling standing timber sourced from our purchased and planted forestry plantations

Wood Chips and Logs

- selling wood chips and logs sourced from PRC suppliers and receiving agency fees on the sale of wood chips

Wood-Based Products

- selling imported wood-based products such as logs, veneer, sawn timber; selling particleboard, melamine faced chipboard and sawn timber from our manufacturing plants; selling flooring and nursery products and services

Cost of Sales

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

Depletion of Timber Holdings

Timber holdings include acquisition costs for young trees and standing timber, planting and maintenance costs, which until the trees are sold are capitalized at cost in our financial statements. Planting and maintenance costs include the following: planning, operations design, site preparation, terracing, fertilization, 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.

SIGNIFICANT BUSINESS ACTIVITIES

Significant activities that have occurred during the year ended December 31, 2005 and to the date of this report were as follows:

Appointment of BDO McCabe Lo Limited

In April 2005, the Company announced that it has appointed BDO McCabe Lo Limited, a member of BDO International, as the new auditor for the Company.

Mandra Investment

In April 2005, the Company announced that it has agreed to enter into a series of agreements with Mandra Resources Limited and its subsidiaries ("Mandra"). Mandra is a start-up operation formed to acquire, grow, harvest and replant standing timber on commercial forestry plantations located in Anhui province of the PRC. The Company announced the closing of the transaction in May 2005.

Appointment of Executives

In October 2005, the Company announced the appointment of Mr. David Horsley as Senior Vice President and Chief Financial Officer and the appointment of Mr. Thomas Maradin as Vice President, Risk Management.

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 US$150 million 5 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.

Update Valuation of Forest Plantation Assets in China

In March 2006, 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, Jaakko Pöyry estimates that the existing forest plantation (single rotation only) as at December 31, 2005 had a value of approximately US$728.5 million. The consultants report states that the plantation area was approximately 324,000 hectares as at December 31, 2005.

SELECTED ANNUAL FINANCIAL INFORMATION

The following selected financial information has been derived from our consolidated financial statements for the three years ended December 31, 2005, 2004 and 2003.

Years ended December 31, (in thousands, except earnings per share and common shares outstanding)	2005 $	2004 $	2003 $
OPERATING RESULTS			
Revenue	**493,301**	330,945	265,739
Cost of sales	**(356,430)**	(229,433)	(200,835)
Gross profit[1]	**136,871**	101,512	64,904
Net income from operations	**112,607**	73,389	49,899
Net income	**81,687**	52,774	30,180
EBITDA[2]	**255,910**	124,663	81,370
Basic earnings per share[3][4]	**0.59**	0.43	0.38
Diluted earnings per share[3][4]	**0.59**	0.43	0.32
FINANCIAL POSITION			
Current assets	**277,340**	320,660	115,665
Non-current assets	**617,931**	435,389	303,189
Total assets	**895,271**	756,049	418,854
Current liabilities (including current portion of long-term debt)	**127,262**	83,795	117,929
Long-term debt (net of current portion)	**300,000**	300,000	55,953
Total shareholders' equity (net assets)	**468,009**	372,254	244,972
Cash dividends declared per share	**nil**	nil	nil
Common shares outstanding	**137,789,548**	136,589,548	96,219,548

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 has increased from $55.4 million (20,630 hectares, 20.9% of revenue) in 2003 to $105.1 million (37,369 hectares, 31.8% of revenue) in 2004 to $240.8 million (108,013 hectares, 48.8% of revenue) in 2005.

During these periods, our gross profit has increased accordingly. Gross profit margin, being the gross profit expressed on a percentage of revenue, increased to 30.7% in 2004 compared to 24.4% in 2003 as sales of standing timber enjoy a higher gross profit margin than our other business segments. However, gross profit margin declined to 27.7% in 2005 as sales of standing timber in 2005 included a higher proportion of lower yielding sales of standing timber from the Heyuan Pine Undertaking.

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

2003	176,000
2004	242,000
2005	324,000

In 2004, we issued long-term debt in the amount of $300.0 million to fund the acquisition of mature pine plantations (Heyuan Pine Undertaking), and to repay existing debts.

RESULTS OF OPERATIONS – 2005 VS 2004

Revenue

The following table sets forth the breakdown of our total revenue for the years ended December 31, 2005 and 2004:

Years ended December 31	2005		2004	
	$'000	%	$'000	%
Revenue				
Standing timber	**240,829**	**48.8**	105,126	31.8
Wood chips and logs	**155,870**	**31.6**	157,428	47.5
Wood-based products	**96,602**	**19.6**	68,391	20.7
Total revenue	**493,301**	**100.0**	330,945	100.0

Our revenue increased 49.1%, from $330.9 million in 2004 to $493.3 million in 2005. The increase in revenue was due primarily to the increase in sales of standing timber, and to a lesser extent, an increase in sales of wood-based products.

Revenue From Standing Timber

The following table sets forth revenue from standing timber sales for the years ended December 31, 2005 and 2004:

	2005			2004		
	Hectares	Sales per hectare $	Total revenue $'000	Hectares	Sales per hectare $	Total revenue $'000
Purchased plantations	**40,718**	**3,302**	**134,458**	21,907	3,709	81,255
Heyuan Pine Undertaking	**64,189**	**1,602**	**102,833**	13,569	1,586	21,527
Planted plantations	**3,106**	**1,139**	**3,538**	1,893	1,238	2,344
Total	**108,013**	**2,230**	**240,829**	37,369	2,813	105,126

Revenue from sales of standing timber increased 129.1%, from $105.1 million in 2004 to $240.8 million in 2005. In 2005, we sold 108,013 hectares of standing timber, compared to 37,369 hectares of standing timber, an increase of 70,644 hectares. The main reasons for this increase are due to the sales of an additional 50,620 hectares of standing timber from Heyuan Pine Undertaking and an increase in sales of purchased plantations of 18,811 hectares. The average selling price per hectare decreased from $2,813 in 2004 to $2,230 in 2005. The primarily reason for this decrease is due to the sales mix of standing timber (i.e. a higher proportion of standing timber sales in 2005 comprised of young trees with smaller diameter generating lower yield). Specifically, in 2005, sales from the lower yielding Heyuan Pine Undertaking comprised 59% of our standing timber sales area compared to 36% in 2004.

Standing timber sales comprised 48.8% of total revenue in 2005, compared to 31.8% in 2004.

Pursuant to a letter undertaking issued by our Heyuan PRC CJV partner, we may purchase mature pine trees of up to 200,000 hectares in Heyuan until February 2006. To December 31, 2005, we had purchased 109,824 hectares. In the first two months of 2006, we acquired approximately 15,865 hectares bringing the total to approximately 125,689 hectares of purchases under the Heyuan Pine Undertaking.

To December 31, 2005, we have sold a total of 77,758 hectares of standing timber from the Heyuan Pine Undertaking. The balance of approximately 47,931 hectares of standing timber purchased under the Heyuan Pine Undertaking are expected to be sold over the first three quarters of 2006.

As at December 31, 2005, we have a total of approximately 140,000 hectares of planted and purchased plantations in the province of Guangdong, representing approximately 43% of our total plantations. Our total plantation area in Guangdong would increase to over 60% assuming that the original plan for the Heyuan Pine Acquisition project is fully implemented. Management is of the view that having such a large proportion of its plantation base located in one province increases our plantation concentration risk and limits our resources and ability to acquire and develop plantations in other strategic provinces.

In addition to the plantation concentration risk mentioned above, we continue to experience increasing pricing pressure on acquisition of standing timber as well as leasing rates in Heyuan which are making our original acquisition model less attractive than initially planned. Accordingly, management believes that completing the Heyuan Pine Undertaking project at the increased pricing would not provide the Company the best return or option to utilize its cash resources. The Company is currently in discussions with other parties in other areas on projects that would provide us a better return.

Revenue From Wood Chips And Logs

The following table sets forth revenue from wood chips and logs for the years ended December 31, 2005 and 2004.

			2005			2004
	BDMT	Average selling price	Revenue	BDMT	Average selling price	Revenue
Wood Chips and Logs		$	$'000		$	$'000
Wood chips	1,348,840	105	142,301	1,496,920	95	142,194
Wood logs			3,829			1,224
Commission	657,830	14.8	9,740	952,500	14.7	14,010
Total			155,870			157,428

Revenue from sales of wood chips and logs decreased 1.0%, from $157.4 million in 2004 to $155.9 million in 2005 primarily as a result of lower commission income on the sale of wood chips. Despite an improvement in the selling price of approximately 10.5% from $95 per bone dry metric ton ("BDMT") in 2004 to $105 per BDMT in 2005, revenue from sales of wood chips increased only 0.1% from $142.2 million to $142.3 million. Sales volume declined 9.9% from approximately 1.50 million BDMT in 2004 to 1.35 million BDMT in 2005 as a result of a decrease in wood chips sales from an authorized intermediary in the fourth quarter of 2005, as further discussed below.

Revenue from commission income, which is included in wood chips and logs, decreased 30.5%, from $14.0 million in 2004 to $9.7 million in 2005 due to a decrease in volume shipped to customers upon which agency fees are earned, from 952,500 BDMT in 2004 to 657,830 BDMT in 2005. The agency fee rate per BDMT on the sale of wood chips in 2005 and 2004 remained relatively flat.

Wood chips and logs sales comprised 31.6% of total revenue in 2005, compared to 47.5% of total revenue in 2004.

In the fourth quarter of 2005, one of the two authorized intermediaries who processes wood chips for us was acquired and ceased to provide wood chips and logs services for us. As a result, our revenue earned during the fourth quarter of 2005 from the sale of wood chips processed by this authorized intermediary declined to nil from $21.2 million in the fourth quarter of 2004. Total revenue earned for the year ended December 31, 2005 from the sale of wood chips processed by this authorized intermediary was $55.7 million compared to $69.5 million in 2004. We are in the process of determining the best alternative to replace the lost production. These alternatives include finding another authorized intermediary to provide the chipping service or moving some or all of the volume to the remaining authorized intermediary.

Revenue From Wood-Based Products
The following table sets forth revenue from wood-based products for the years ended December 31, 2005 and 2004.

Wood-Based Products	2005 $'000	2004 $'000
Imported wood-based products	**84,136**	58,689
Others	**12,466**	9,702
Total	**96,602**	68,391

Revenue from sales of wood-based products increased 41.2%, from $68.4 million in 2004 to $96.6 million in 2005. The increase in revenue from wood-based products of $28.2 million was primarily due to an increase in shipments of imported logs of $25.4 million, representing a 43.4% increase from last year sales, and an increase of $2.8 million in other revenue.

Cost of Sales
Our cost of sales increased 55.4%, from $229.4 million in 2004 to $356.4 million in 2005. The increase in cost of sales was due primarily to an increase in the hectares of standing timber sold and an increase in sales from our wood-based products business.

Cost of Sales of Standing Timber. Standing timber cost of sales increased 210.5%, from $45.2 million in 2004 to $140.2 million in 2005. The increase in costs of sales reflected primarily the increase in the hectares of trees sold. Cost of sales per hectare of standing timber increased 7.5%, from $1,208 per hectare in 2004 to $1,298 per hectare in 2005 due to the fact that we sold almost double the hectares of purchased plantation pine (other than Heyuan Pine Undertaking) in 2005 when compared to 2004 which have a higher average cost per hectare.

Cost of Sales of Wood Chips And Logs. Wood chips and logs cost of sales increased 3.9%, from $118.3 million in 2004 to $122.9 million in 2005. The increase in cost of sales reflected the increase in the cost of wood chips despite the drop in sales volume of wood chips. The cost of wood chips has increased approximately 12.8% from approximately $78 per BDMT in 2004 to $88 per BDMT in 2005.

Cost of Sales of Wood-Based Products. Wood-based products cost of sales increased 41.5%, from $66.0 million in 2004 to $93.3 million in 2005, primarily reflecting an increase in sales of imported logs, greening and flooring projects.

Gross Profit[1]
Our gross profit increased 34.8%, from $101.5 million in 2004 to $136.9 million in 2005 due to the increased sales volume. Gross profit margin, or gross profit as a percentage of total revenue, decreased from 30.7% in 2004 to 27.7% in 2005 primarily due to the lower gross margin realized on the sales of standing timber from the Heyuan Pine Undertaking.

Standing Timber. Gross profit margin on sales of standing timber decreased from 57.0% in 2004 to 41.8% in 2005 due to sales of standing timber from the Heyuan Pine Undertaking which commanded a lower margin compared to sales of purchased plantations.

Wood Chips And Logs. Gross profit margin from sales of wood chips and logs decreased from 17.5% in 2004 to 15.9% in 2005 primarily due to the increase in the cost of wood chips.

Wood-Based Products. Gross profit margin from sales of wood-based products decreased slightly from 3.6% in 2004 to 3.4% in 2005.

Selling, General and Administration Expenses
Our selling, general and administration expenses decreased 3.8%, from $22.0 million in 2004 to $21.2 million in 2005, due primarily to a decrease in stock-based compensation of $4.3 million and lower financing costs as fees and expenses totaling $1.9 million relating to the aborted plan to list the ordinary shares of Sino-Wood Partners, Limited in Hong Kong were written-off in 2004. This decrease was offset by higher staff salaries and administrative expenses.

Depreciation and Amortization

Depreciation and amortization increased 25.5%, from $2.5 million in 2004 to $3.1 million in 2005, reflecting the increase in depreciation charges for our manufacturing plants.

Income from Operations

Our income from operations increased 53.4%, from $73.4 million in 2004 to $112.6 million in 2005, due to the factors discussed above. Our income from operations as a percentage of revenue increased from 22.2% in 2004 to 22.8% in 2005.

Interest Expense

Our interest expense increased 82.6%, from $15.9 million in 2004 to $29.0 million in 2005, due primarily to interest charged on the $300 million non-convertible guaranteed senior notes issued in August 2004.

Amortization and Write-off of Deferred Financing Costs

Our deferred financing costs decreased 69.0%, from $4.3 million in 2004 to $1.3 million in 2005 due to the write-off in 2004 of the remaining balance of deferred financing costs relating to the plantation loan and the IFC projects loans that were repaid.

Other Exchange Gains

Other exchange gains decreased 53.3%, from $2.7 million in 2004 to $1.3 million in 2005 due to stronger appreciation of the Canadian dollar against the U.S. dollar in 2004.

Interest Income

Our interest income increased 205.9%, from $1.4 million in 2004 to $4.2 million in 2005, due to increases in cash and cash equivalents and short-term deposits held throughout the year and interest earned on the loan to Mandra Holdings.

Provision for Income Taxes

In 2005, the provision for income taxes was $7.3 million compared to $5.0 million in 2004. The increase in the provision for income taxes in 2005 was due to the higher income earned.

Net Income

As a result of the foregoing, our net income for 2005 increased 54.8%, from $52.8 million in 2004 to $81.7 million in 2005. Our net profit margin increased from 15.9% in 2004 to 16.6% in 2005.

RESULTS OF OPERATIONS – Q4 2005 VS Q4 2004

The following table sets forth the selected financial information for the three months ended December 31, 2005 and 2004.

Three months ended December 31 (in thousands, except earnings per share)	2005 $	2004 $
Revenue	**170,411**	130,629
Cost of sales	**(125,618)**	(91,778)
Gross profit[1]	**44,793**	38,851
Net income from operations	**35,071**	28,228
Net income	**27,535**	20,144
EBITDA[2]	**96,108**	56,984
Basic earnings per share[3][4]	**0.20**	0.15
Diluted earnings per share[3][4]	**0.20**	0.15

The following table sets forth the breakdown of our revenue for the fourth quarters ended December 31, 2005 and 2004:

	2005 $'000	2004 $'000
Revenue		
Standing timber	**95,824**	49,486
Wood chips and logs	**39,016**	56,119
Wood-based products	**35,571**	25,024
Total Revenue	**170,411**	130,629

Revenue for the fourth quarter ended December 31, 2005 increased by 30.5% to $170.4 million compared to $130.6 million for the fourth quarter in fiscal 2004. The increase was primarily due to higher sales of standing timber and wood-based products partially offset by a decline in wood chips and logs revenue.

For the fourth quarters ended December 31, 2005 and 2004, standing timber sales were as follows:

	2005			2004		
	Hectares	Sales per hectare $	Total revenue $'000	Hectares	Sales per hectare $	Total revenue $'000
Purchased plantations	**21,807**	**2,966**	**64,688**	6,451	4,124	26,602
Heyuan Pine Undertaking	**18,103**	**1,616**	**29,262**	13,569	1,586	21,526
Planted plantations	**1,634**	**1,147**	**1,874**	1,102	1,232	1,358
Total	**41,544**	**2,307**	**95,824**	21,122	2,343	49,486

In the fourth quarter of 2005, we sold 41,544 hectares of standing timber compared to 21,122 hectares of standing timber in 2004. The increase was primarily due to increase in sales of standing timber from our purchased plantations. The decrease in the average selling price of our purchased plantations was due to the sale of 7,350 hectares of eucalyptus which commanded a lower price and the sale of 9,847 hectares of immature pine with smaller diameter and lower yield compared to the mature pine trees sold in the fourth quarter of 2004.

For the fourth quarter ended December 31, 2005, the decrease in revenue from wood chips and logs was mainly due to a 37.5% decrease in shipments to 328,510 BDMT compared to 525,530 BDMT in the corresponding period in 2004. This decrease was partially offset by an increase in price of wood chips. The average net wood chip price, in the fourth quarter of 2005 was approximately $106 per BDMT compared to $95 per BDMT in the fourth quarter of 2004. For reasons discussed above, our revenue earned from the sale of wood chips processed by one of the authorized intermediaries declined $21.2 million to nil in the fourth quarter of 2005 compared to the fourth quarter of 2004.

Revenue from commission income, decreased 63.3% from $4.7 million in the fourth quarter of 2004 to $1.7 million in the fourth quarter of 2005 as a result of a decrease in shipments to customers, from 319,900 BDMT to 115,000 BDMT in the corresponding period. Agency fees on the sale of wood chips in the fourth quarter of 2005 was approximately $15.0 per BDMT compared to $14.7 per BDMT in the fourth quarter of 2004.

For the fourth quarter of 2005, revenue from our wood-based products business amounted to $35.6 million, compared to $25.0 million in the fourth quarter of 2004. The increase was primarily attributable to the increase in sales of imported logs and greening and flooring projects.

Costs and expenses were $135.4 million in the fourth quarter of 2005, an increase of 32.2% compared to $102.4 million in the fourth quarter of 2004. The increase in cost of sales is largely attributable to an increase in sales in the fourth quarter of 2005. Selling, general and administration expenses increased 32.6% from $6.8 million in the fourth quarter of 2004 to $9.0 million in the fourth quarter in 2005 primarily due to higher compensation costs.

Net income increased 36.7% from $20.1 million to $27.5 million. Earnings per share increased 33.3% from $0.15 to $0.20.

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)	2005 $	2004 $
Cash flows from operating activities		
Net cash provided by operations[5]	**228.1**	117.7
Net change in working capital[6]	**(31.6)**	1.6
Total	**196.5**	119.3
Cash flows from financing activities	**11.5**	246.0
Cash flows used in investing activities	**(301.4)**	(171.1)
Effect of exchange rate changes on cash and cash equivalents	**0.7**	–
Net (decrease) increase in cash and cash equivalents	**(92.7)**	194.2

Cash Flows from Operating Activities

Cash flows from operating activities increased 64.6%, from $119.3 million in 2004 to $196.5 million in 2005. The increase was the result of an increase in cash provided by operations as a result of the strong results due to the increase in sales of standing timber.

Cash Flows From Financing Activities

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. In 2004, cash flows from financing activities consisted of $67.6 million net proceeds from the issuance of shares, $300 million from the issuance of the non-convertible guaranteed senior notes and $3.4 million decrease in pledged short-term deposits offset by deferred financing costs of $9.4 million, repayment of amounts due to related parties of $3.9 million, repayment of bank indebtedness and long-term debt of $10.5 million and $101.2 million, respectively.

Cash Flows Used in Investing Activities

In 2004 and 2005, 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 $159.1 million in 2004 and $265.2 million in 2005. Our cash outlays for our manufacturing facilities and other capital assets amounted to $6.1 million in 2004 and $16.6 million in 2005. Increase in non-pledged short-term deposits in 2005 amounted to $5.2 million compared to $5.8 million in 2004. In addition, we have provided a subordinated loan of $15.0 million to Mandra Forestry Holdings Limited in the second quarter of 2005.

Financing Arrangements and Contractual Obligations

As of December 31, 2005, we had secured and unsecured short-term liabilities of $41.3 million, comprising $14.1 million of short-term bank loans and $27.2 million of trust receipt loans. We had long-term debt of $300 million. Our borrowings are denominated in U.S. dollars and Renminbi.

Short-Term Borrowings. As of December 31, 2005, we had $54.1 million short-term credit facilities with banks in Hong Kong and the PRC to fund short-term working capital requirements of which $41.3 million is being utilized. Interest is payable on these short-term borrowings at rates ranging from 4.1% to 7.3% per annum, and the borrowings are either repayable on demand or due in less than one year. As of December 31, 2005, 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 $3.7 million and certain bank deposits of $6.2 million.

Other Contractual Obligations. As of December 31, 2005, we had other contractual obligations relating to: (1) approximately $25.0 million in respect of capital contributions to our WFOEs; (2) $7.8 million of capital commitments in respect of buildings, timber holdings, and plant and machinery; (3) $5.4 million of purchase commitments in respect of logs, (4) commitments under operating leases of approximately $35.8 million and (5) $300 million non-convertible guaranteed senior notes.

Scheduled Maturity of Contractual Obligations. The following table presents the scheduled maturities of our contractual obligations as of December 31, 2005.

	Actual Anticipated Payment Dates						
Contractual Obligations	Total $'000	2006 $'000	2007 $'000	2008 $'000	2009 $'000	2010 $'000	Thereafter $'000
Long-term debt[7]	300,000	–	–	–	–	–	300,000
Capital contributions	25,000	25,000	–	–	–	–	–
Capital commitments[8]	7,820	7,820	–	–	–	–	–
Purchase commitments	5,367	5,367	–	–	–	–	–
Operating leases[9]	35,811	1,720	1,173	1,001	942	943	30,032
Total contractual cash obligations	373,998	39,907	1,173	1,001	942	943	330,032

Guarantees. We also periodically issue guarantees to third parties in relation to the debt of our subsidiaries. As of December 31, 2005, we had provided guarantees of approximately $37.3 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 three months and year ended December 31, 2005.

	Three months ended December 31, 2005		Twelve months ended December 31, 2005	
(in millions)	Hectares	$	Hectares	$
Tree acquisition – Purchased plantations	35,390	66.2	95,390	180.0
Tree acquisition – Heyuan Pine Undertaking	14,424	16.3	79,824	87.6
Re-planting and maintenance of plantations		2.1		15.5
Panel manufacturing and others		10.1		16.6
Total		94.7		299.7

Capital expenditures incurred in relation to the 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, fertilization, 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 2006 are expected to exceed $250 million.

Capital expenditures in 2006 relating to the manufacturing operations are expected to be approximately $22.8 million, being $7.8 million to complete the development of our particleboard manufacturing facility in Gaoyao and oriented strand board mill in Heilongjiang and approximately $15.0 million to construct an engineered wood flooring manufacturing operation in Suzhou.

Once completed, the manufacturing operations in Gaoyao will be one of the largest particleboard mills in China. Total production capacity will be 275,000 m^3 of particleboard and 6,400,000 m^2 of melamine lamination capacity. The facility is expected to be completed by the end of the second quarter of 2006, and will be in production during the second half of 2006.

The Suzhou engineered wood flooring manufacturing operation will see the integration of the existing sawmill and kiln drying equipment with newly acquired flooring manufacturing equipment. The facility is expected to be operational in 2007 and will cost approximately $15.0 million. Once completed, the facility will have the capacity to produce 4.0 million m^2 of engineered wood flooring. The output of the facility will be sold to consumers through our retail flooring sales operations. Currently our products are sold through 107 retail outlets throughout China under the name Sino-Maple.

The 2006 capital expenditures will be funded primarily with cash generated from operations.

Independent Valuation of our Forest Assets by Jaakko Pöyry

JP Management Consulting (Asia-Pacific) Ltd. ("Jaakko Pöyry") has determined the valuation of our forest assets as at December 31, 2005 to be $728.5 million. As at December 31, 2005, the book value of our timber holdings was $513.4 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.

Jaakko Pöyry has also prepared an existing forest valuation that includes the revenues and costs of re-establishing and maintaining the plantation forests for a 50 year period (perpetual valuation). We have an option to lease the land under the purchased trees model for future rotations, the terms of which have yet to be agreed. Jaakko Pöyry has determined the valuation of our forest assets based on a perpetual rotation (including the planned expansion in Heyuan City) using a pre-tax discount rate of 11.5% to be $968.4 million as at December 31, 2005.

The complete valuation report by Jaakko Pöyry dated March 8, 2006 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 recognize 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 18 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 and 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 45 to 90 days with respect to domestic sales of imported logs and export sales of 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 2005 and 2004.

		Aging Analysis					
	Total Accounts Receivable	0–30 Days	31–60 Days	61–90 Days	91–180 Days	181–360 Days	Over One Year
	$'000	$'000	$'000	$'000	$'000	$'000	$'000
At December 31, 2005	119,989	55,216	38,695	22,546	3,030	502	–
At December 31, 2004	81,787	47,115	21,639	2,494	10,539	–	–

Inflation

Inflation in the PRC has not had a significant impact on our 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 (0.8)%, 1.2% and 3.9% in 2002, 2003 and 2004, respectively.

Taxation

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

Our tax charge for the years ended December 31, 2005 and 2004 was $7.3 million and $5 million, which represent effective tax rates of 8.2% and 8.7% respectively. Such effective tax rates are significantly lower than the applicable corporate income tax rates due to majority of income remitted to us from the authorized intermediaries have already been taxed. We believe we have made adequate tax provisions to meet our tax liabilities as they become due.

OFF-BALANCE SHEET ARRANGEMENTS

Other than a currency swap agreement with respect to interest payable over the next 5 years on the non-convertible guaranteed senior notes, we do 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, 2005. In the ordinary course of business, we enter into operating lease commitments, capital commitments and other contractual obligations. These transactions are recognized 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, we pay the salaries of certain executive officers in the form of consultancy fees to companies controlled by the executive officers. The consultancy fees incurred for the year amounted to $2,737,000 [December 31, 2004 – $1,491,000].

In addition, as at December 31, 2005, we had an aggregate amount of $2,129,000 [December 31, 2004 – $1,019,000] owed to these related companies.

In 1999, Sino-Wood entered into an agreement to issue an aggregate of $20,000,000 Guaranteed Exchangeable Redeemable Notes ("Exchangeable Notes"). The Exchangeable Notes were for a period of five years from January 29, 1999 to January 28, 2004 and bore interest at a note of 5% per annum payable semi-annually in arrears.

In 2004, the balance of the Exchangeable Notes including interest was repaid. Interest expense for the year ended December 31, 2004 was $27,000. One of our directors is an officer and shareholder in a company that provides certain advisory, management and general administrative services to the entity that ultimately held the Exchangeable Notes.

On March 5, 2003, Sino-Wood entered into an exchange agreement whereby the holder of the Exchangeable Notes exchanged $9,844,000 in principal amount of the Exchangeable Notes (having an accrued value which comprised of principal and accrued interest of approximately $15,500,000) for approximately $15,500,000 of convertible instruments ("Convertible Instruments"). The Convertible Instruments were issued at par value, bore interest at a rate of 4% per annum payable in semi-annual installments and had a maturity of 18 months. Since Sino-Wood was not listed prior to the maturity date, the Convertible Instruments were to be redeemed on the maturity date at 106.24% of the subscription price plus unpaid interest.

In 2004, the balance of the Convertible Instruments was repaid. Interest expense and redemption premium for the year ended December 31, 2004 was $433,000. One of our directors is an officer and shareholder in a company that provides certain advisory, management and general administrative services to the entity that ultimately held the Convertible Instruments.

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 desire of timber companies to take advantage of the peak growing seasons in the spring and summer before harvesting the trees, as well as 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, 2005.

			Earnings Per Share[3][4]	
	Revenue	Net Income	Basic	Diluted
(in thousands, except per share amounts)	$	$	$	$
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
2004				
December 31	130,629	20,144	0.15	0.15
September 30	94,715	14,016	0.11	0.11
June 30	64,818	12,742	0.11	0.09
March 31	40,783	5,872	0.06	0.05

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 represents approximately 57% of the Company's consolidated total assets as at December 31, 2005. Timber holdings are carried on the Company's consolidated balance sheet at cost which includes cost of young trees, standing timber and plantings 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 recognized. 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 discounted cash flows expected to result from the asset is less than the asset's carrying value, asset impairment must be recognized. 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 recognized 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 recognized.

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 2005 we engaged two third party wood dealers as our authorized intermediaries. 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 recognized when the products are processed by the authorized intermediaries on our behalf. We regularly evaluate the facts and circumstances in relation to the criteria within appropriate accounting guidelines and use our best judgment to determine whether to report on a gross or net basis for wood chips processed by authorized intermediaries. Currently, the facts and circumstances surrounding the wood chips business support the reporting of the sales on a gross basis as the Company acts as a principal to the transaction. The sales and cost of sales relating to this business reported on a gross basis was $142,301,000 and $119,208,000 respectively [2004 – $142,194,000 and $117,162,000]. 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 recognized 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 corporate income tax as a foreign investment enterprise. 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, corporate 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 the corporate income tax at an amount representing management's best estimate of the amount the PRC tax authorities might seek to recover is recognized in the financial statements each year. The yearly provision is reversed to the income statement after a period of three years based on management' best estimate of the liability. This means that the Company always maintains a three year provision for tax on the profits earned from the Authorized Sales Activities of the three most recent years.

Included in accounts payable and accrued liabilities as at December 31, 2005 is the balance of the provision for these tax related liabilities amounting to $25,379,000 [2004 – $17,936,000] 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, changes in tax treaties between various tax jurisdictions in which the Company operates. Due to the absence of a tax treaty between the PRC and Hong Kong, 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 recognized 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 recognized in the financial statements.

CHANGE IN ACCOUNTING POLICIES

Consolidation of Variable Interest Entities

Effective January 1, 2005, the Company adopted the accounting guideline for Consolidation of Variable Interest Entities (AcG-15). AcG -15 relates to the application of consolidation of certain entities which the usual condition (ownership of voting interest) of consolidation does not exist. The purpose of AcG-15 is to provide guidance for determining when a company includes the assets, liabilities and results of activities of such an entity (a "variable interest entity") in its consolidated financial statements.

An entity is classified a variable interest entity ("VIE") under AcG-15 if it has (1) equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) equity investors that cannot make significant decisions about the entity's operations, or that do not absorb the expected losses or receive the expected returns of the equity. A company must consolidate a VIE if the company is its primary beneficiary. A company is a primary beneficiary of a VIE if the company holds variable interests that expose it to absorb a majority of the expected losses or will receive the majority of the expected residual returns or both, as a result of ownership, contractual or other financial interests in the VIE.

Entities that are outside of the scope of AcG-15 or that do not meet the definition of variable interest entities are consolidated if the Company owns a majority of the entity's voting interests.

Co-operative Joint Ventures

The Company, through wholly-owned subsidiaries of Sino-Wood Partners, Limited ("Sino-Wood"), a directly wholly-owned subsidiary of the Company, entered into agreements to form four Co-operative Joint Ventures ("CJVs"). Under the terms of the agreements, the CJV partners are required to provide the CJVs with land use rights for up to 583,000 hectares of land for tree plantations. Sino-Wood's subsidiaries are responsible for providing funds to the CJVs for all planting, maintenance and harvesting costs incurred on the phased-in land. The subsidiaries are entitled to 70% of the timber harvested on the phased-in land and the CJV partners are entitled to the balance.

Since the Company provides all of the financing of the CJVs they are within the scope of AcG-15. The CJV's are not eligible for voting control assessment as there is no equity instrument that typically provides voting rights which would be used to assess voting control for purposes of consolidation. The variable interest in the CJV is the CJV agreement itself which outlines the party's rights to revenue, responsibility for costs and for providing capital to fund the operations. On the basis of the terms of the engagement, the Company is the primary beneficiary and therefore should consolidate the CJV's assets, liabilities and results of activities.

Prior to the assessment of the impact of these new standards the Company accounted for the CJV's on the proportionate consolidation basis. The Company consolidated the balance sheet of the CJV's as if it is a 100% owned subsidiary which is consistent with the current accounting treatment. The CJV records the costs associated with forestry plantation management fees and forestry plantation operation servicing fees, including the costs for forestry planning, soil preparation, planting and fertilizing as standing timber assets and then as cost of sales when the trees are sold.

Once the trees are sold the CJV records 100% of the amount of the sale and reflects the revenue obligation and records the obligation to the CJV partner. The amount is recorded in the CJV income statement as a reduction of revenue rather than as an expense. The Company is responsible for paying 70% of PRC taxes and charges and other operating expenses incurred by the CJV. The CJV records these costs as expenses in the income statement as incurred. The PRC partner is responsible for 30% of PRC taxes and charges and other operating expenses. One hundred percent of the other operating expenses are recorded by the CJV. The PRC partner then reimburses the CJV for its 30% share of the other operating expenses. The CJV partner records the reimbursement as a credit to actual expenses such that only 70% of the other operating expenses are recorded in the CJV's income statement.

The change in the accounting policy has no financial impact on the Company's financial statements.

The revenue of the CJV's recorded by the Company in its consolidated financial statements for the years ended December 31, 2005 and 2004 were $3,538,000 and $2,531,000 respectively.

Foreign Currency Translation

Management has reassessed its evaluation of the method of translation for its foreign subsidiaries and has concluded that the current rate method is more appropriate. This change resulted from a combination of the continued increase in the operational exposure in the Renminbi dollar, substantially Renminbi dollar based assets of the foreign operations and their continued growth in the business activities conducted in Renminbi dollars. The Company's reporting currency will continue to be U.S. dollars. The change did not have a material impact on the previous financial statements as the Renminbi was pegged against the U.S. dollar prior to August 2005. Accordingly, the assets and liabilities of the foreign operations are translated into U.S. dollars at the year end exchange rate. Revenue and expense items are translated at average exchange rates for the year. The resulting net translation adjustment is included in the cumulative translation adjustment account in shareholders' equity.

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

New Accounting Standards

In January 2005, the CICA issued three new Handbook sections. These new sections include CICA Handbook Section 3855 "Financial Instruments – Recognition and Measurement," CICA Handbook Section 3865 "Hedging" and CICA Handbook Section 1530 "Comprehensive Income." These new pronouncements are effective for interim and annual financial statements for a fiscal year ending on or after October 31, 2006. The Company is currently investigating the impact of these new standards on its financial position and results of operations.

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, 2005 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 debt, 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 5 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 2005 and 2004, 82.7% and 81.8% of our sales were received in Renminbi and 17.3% and 18.2% of our sales were received in U.S. dollars and Hong Kong dollars. We translate our results of 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 instrument obligations. 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 except for a revaluation against the U.S. dollar in 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, 2005, we had Renminbi denominated bank accounts of RMB298.6 million (equivalent to $37.0 million), U.S. dollar denominated bank accounts of $88.6 million, Canadian dollar denominated bank accounts of Cdn.$12.2 million (equivalent to $10.5 million), Hong Kong dollar denominated bank accounts of HK$2.2 million (equivalent to $0.3 million) and Euro denominated bank accounts of €2.0 million (equivalent to $2.4 million). We also had U.S. dollar denominated accounts receivable of $31.3 million.

We incurred foreign currency denominated debt for capital expenditures primarily relating to the development and acquisition of our forestry plantations and investment in our manufacturing plants. To the extent that the Renminbi (which has moved within a stable range in relation to the U.S. dollar since 1994), or the U.S. dollar devalues against any of these currencies, it would correspondingly increase our repayment costs on these loans.

Interest Rate Risk

We are exposed to interest rate risk resulting from fluctuations in interest rates on our debt, primarily on our bank indebtedness. Our debt consists 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. We do not currently use any derivative instruments to modify the nature of our debt 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

In 2004, the Canadian Securities Administrators ("CSA") issued Multilateral Instrument 52-109, "Certification of Disclosure in Issuers' Annual and Interim Filings." Sino-Forest's Chief Executive Officer ("CEO") and the Senior Vice President and Chief Financial Officer ("CFO") will be making certifications related to the information in the Company's annual and interim filings with the securities regulatory authorities. The CEO and CFO must certify responsibility for establishing and maintaining, design and effectiveness of 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, summarized and reported on a timely basis and is accumulated and communicated to the Disclosure Committee and Sino-Forest management.

Sino-Forest is continuing its project to document, test and evaluate disclosure controls and procedures and internal controls over financial reporting and to remediate where deficiencies are identified. An evaluation of the effectiveness of the Company's disclosure controls and procedures, as defined under the rules of the CSA was conducted as at December 31, 2005 by and under the Company's management, including the Chief Executive Officer and the Senior Vice President and Chief Financial Officer. Based on this evaluation, the Chief Executive Officer and the Senior Vice President and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective.

(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 recognized 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 amortization, 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,	
	2005	2004	2003	2005	2004
	$'000	$'000	$'000	$'000	$'000
Income from operations	112,607	73,389	49,899	35,071	28,228
Plus: depreciation	3,099	2,470	2,345	770	637
depletion of timber holdings	140,204	45,158	29,126	60,267	24,886
impairment of capital assets	–	3,646	–	–	3,233
	255,910	124,663	81,370	96,108	56,984

(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 amortization, amortization and write-off of deferred financing costs, amortization 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 debt due in 2011.

(8) Represents commitments to invest in buildings and plant and machinery for investments in the manufacturing plants in Gaoyao, Guangdong Province.

(9) These represent mainly leases of certain office premises and long-term leases of plantation land for the plantation operations and associated forestry plantations.

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

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 sheet of Sino-Forest Corporation as at December 31, 2005 and the consolidated statements of income and retained earnings and cash flows for the year 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, 2005 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

The consolidated financial statements as at December 31, 2004 and for the year then ended were audited by other auditors who expressed an opinion without reservation on these statements in their report dated February 25, 2005.

Hong Kong
March 30, 2006

BDO McCabe Lo Limited
Certified Public Accountants