



MADISON'S TIMBER PREVIEW

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As an aside, the mainstream press is starting to catch on to what *Madison's* has been saying since March 2010; Fortress Paper is a company to watch. With adjusted 2Q profits, reported August 9, up 60 per cent (yes, **60 per cent**, that is not a typo) company sales amounted to \$60.5 million, up from \$49.6 million in the second quarter of 2009. Fortress share prices have risen 204.21 per cent so far this year, from \$9.50 on January 1, 2010 to \$28.90 on August 12. That compares to a relatively flat S&P TSX benchmark, down 1.64 per cent over the same time period.

On to today's subject, Sino-Forest Corporation.

Madison's last wrote about Sino-Forest on June 5, 2009. Three days later the company announced it had completed a public offering, detailed by *Madison's*, of 34.5 million common shares at \$11 per share for gross proceeds of \$379.5 million. Not one to stand still for long, Sino-Forest on June 11, 2009 entered into a master Agreement for the purchase of pine and Chinese fir plantation forests with Jiangxi Zhonggan Industrial Development Company Limited. Under the Agreement, Sino-Forest will acquire between 15 million and 18 million cubic metres of wood fibre located in plantations in Jiangxi Province over a three-year period with a price not to exceed RMB300 per cubic metre.

On December 17, 2009, the company completed its previously announced convertible senior note and common share offerings, consisting of the offering of an aggregate of US\$460 million principal amount of notes, which included the US\$60 million principal amount of notes issued by the initial purchasers. The notes were to bear interest at a rate of 4.25 per cent, and mature on December 15, 2016 to then be convertible into common shares of the Company at an initial conversion rate of 47 common shares per US\$1,000 principal amount of notes. The offering of common shares consisted of a public offering of 21.9 million common shares, at a price of \$16.80 per common share for gross proceeds of \$367 million.

Less than a month later Sino-Forest announced the acquisition by one of its wholly owned subsidiaries of HOMIX LIMITED, a company engaged in research and development and manufacturing of engineered-wood products in China, for an aggregate amount of \$7.1 million. The acquisition includes the company's facilities in mainland China and its patents. The transaction was funded with cash on hand.

At the end of January Sino-Forest acquired more access to fibre, of between 10.5 million and 16.5 million cubic metres of plantations, within an area of 150,000 hectares of plantation trees that has an average yield of 70 to 110 cubic metres per hectare. That fibre acquisition will take place over a three-year period with a price not to exceed RMB300 per cubic metre.

Negotiations for the acquisition of three Asian forestry holding companies were next; Mandra Forestry Holdings Limited, an elusive subsidiary of the equally elusive Mandra Forestry Finance Ltd. ostensibly out of China; Hong Kong's Omnicorp Limited; and Omnicorp subsidiary Greenheart Resources Holdings Limited out of Suriname and also Hong Kong.

According to its website, Greenheart owns 178,000 hectares of Suriname's natural tropical forest and cutting rights, 13 per cent of all such available in the South American country. The company is building two sawmills, each capable of processing up to 250,000 cubic metres of logs annually, thus having an annual capacity of up to 50,000 cubic metres of lumber per year.

On August 3 Sino-Forest announced completion of the Omnicorp acquisition, giving the company approximately 60 per cent of the enlarged issued share capital of Omnicorp. Omnicorp, in its own

right, has a 60 per cent ownership in Greenheart, thus Sino-Forest owns a 40 per cent minority stake in Greenheart.

Sino-Forest, already a leading commercial forest plantation operator in China, is building a secure fibre base for lumber production to serve the Chinese market.

Allen Chan, newly-appointed Chair of Omnicorp said of the deal, "We are pleased to strengthen our partnership with Omnicorp, which will help us secure quality wood fibre for our customers in China." Newly-appointed Omnicorp President and CEO Judson Martin said, "Omnicorp will be able to leverage Sino-Forest's long established distribution network in China and benefit from Sino-Forest's broad experience to better service our customers in the Chinese market."

Meanwhile, on July 5 Sino-Forest completed arrangements for access to 10 billion RMB (US\$1.5 billion) from China's state bank for future company projects in China.

Is this company for real? *Madison's* can understand skepticism, little is known in Canada about operating a forest products company in China and this mysterious business out of Mississauga, ON, has been shedding minimal light on the subject. At a major timberland investment conference in New York last year an attendee asked a top asset management company representative about Sino-Forest. The cheeky reply was, "They look good but I have yet to see them pay a dividend."

From the looks of things, the progress the company has made and the business they are building, regular dividends should be forthcoming soon enough.

On August 10, Sino-Forest released 2Q 2010 results. Company revenue increased 36 per cent in 2Q 2010 to US\$305.8 million, with the largest contribution coming from a 77 per cent increase in the trading of wood logs. Revenue from sales of plantation fibre increased 18.4 per cent to US\$188.1 million in Q2 2010, mainly due to an increase in the average selling price of standing timber sales, while the average yield per hectare sold as standing timber in Q2 2010 was 251 cubic metres compared to 141 metres in the same period in 2009. The average yield per hectare sold as harvested logs in Q2 2010 was 138 cubic metres compared to 0 cubic metres in the same period in 2009.

"We continue to rate Sino-Forest as one of our top picks due to its strong long-term fundamentals based on growth of Chinese consumption," said Richard A. Kelertas, analyst for Dundee Capital Markets. "Chinese wood demand will be supported by activities such as low-income housing development, increased infrastructure investments in the inland regions, and re-construction after the recent floods."

On April 30, 2010, Poyry Consulting Company Limited, an international forestry consulting firm, estimated the value of Sino-Forest's forest assets on 491,000 hectares of area, based on a single rotation using a pre-tax discount rate of 11.5 per cent, to be approximately US\$2.3 billion as at December 31, 2009. The 40 per cent increase in appraisal value from US\$1.64 billion in 2008 to US\$2.3 billion in 2009 was largely attributable to the growth and value increment associated with the existing owned forests, and the increase in the area of owned forest through net acquisition.

Sino-Forest does indeed seem to be for real, and to be doing very many things right. It is definitely one to watch in the future.

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