

**OVERVIEW**

According to the CCPEF, we are one of the three largest, privately-held, naturally regenerated and plantation forest operators in China in terms of coverage area of owned forest right, possessing forestry rights in respect of approximately 171,780 hectares of forests as at 30 June 2009. Our naturally regenerated and plantation forests are located in Sichuan and Yunnan, which among all provinces of China, possess the second and third largest forest resources respectively in terms of forest stock volume according to China Forestry Statistical Yearbook 2007. We have been operating in the forestry industry in China since 2003, the same year when the Chinese government announced the No. 9 Policy which set out the directive for the private sector to participate in China's forestry development. Our main businesses are the management and sustainable development of forests and the harvesting and sale of logs. We are focused on the development and supply of logs to meet the increasing demand from manufacturers in the construction, furniture, interior decoration, wood product and paper industries in China.

We are a socially responsible and environmentally friendly company. Our mission statement is "using modern forestry science to achieve our goal of being a profitable yet socially responsible and environmentally friendly company". We believe in striking a balance between the increase in demand for forest resources and the preservation of ecology. Through our commitment to respect the environment as well as the communities that surround our forests, we believe that we gain local acceptance for our activities and have built a favourable reputation. This, in turn, helps us distinguish ourselves from other forestry companies and gives us a competitive advantage as we expand our operations into new geographic areas and acquire more forests.

***Our Unrealised Gains from Fair Value Change***

Our unrealised gains during the Track Record Period primarily represented the fair value change which represents the difference between the fair value and relatively low acquisition cost for our newly acquired forests. During the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our unrealised gains arising from changes in fair value of plantation assets less costs to sell were approximately RMB350.5 million, RMB798.5 million, RMB6,024.4 million and RMB518.9 million, respectively, accounting for approximately 103.1%, 101.9%, 102.4% and 120.1%, respectively, of our net profit for the corresponding periods, of which approximately RMB339.8 million, RMB783.7 million, RMB5,881.8 million and RMB432.1 million respectively were attributable to such unrealised gains.

The unrealised gains arising from changes in fair value of plantation assets less costs to sell for the year ended 31 December 2008 increased substantially. Such gains comprise of (a) an unrealised gain of approximately RMB6,635 million arising upon initial acquisition of plantation assets in Yunnan Luxi and Yunnan Wenshan, and (b) an unrealised loss of approximately RMB611 million during the year, primarily due to a revision in yield estimate and drop in log prices in the second half of 2008. Further details of such revision are set out in "Financial Information — Description of Selected Income Statement Items — Changes in fair value of plantation assets". Pursuant to IAS 41, the fair value of our plantation assets less costs to sell at each balance sheet date was reassessed and the upward change in such amount was recorded as an unrealised gain. Such unrealised gains do not generate actual cash inflow or outflow unless such plantation assets are disposed of at such revalued amounts. The increase in market prices of logs and the volume growth of forests during the

## BUSINESS

Track Record Period also contributed to such unrealised gains. Going forward, although the market price of logs is expected to rise for the years to come as China's demand for timber continues to grow, we expect that our gains, and thus our profit in the future, may not be as much as during the Track Record Period if we do not acquire new forests at relatively low acquisition costs.

We have engaged CFK, an independent forestry valuer, to determine the fair value of our forests. As there is no active market for our forests, the fair value of our forest assets is determined based on a net present value approach whereby projected future net cash flows from our forest assets were discounted at certain discount rates to provide a current market value of our forest assets. Changes in the discount rates applied by CFK result in significant fluctuations in our gain/(loss) from changes in fair value of plantation assets less costs to sell. The following table illustrates the sensitivity of our gain/(loss) from changes in fair value of plantation assets less costs to sell, to increases or decreases of 0.5% in the discount rates of 9%, 11% and 13%, applied by CFK to our Sichuan forests, the Yunnan Luxi/Shuangjiang Forest and the Yunnan Wenshan Forest respectively, for the 2008 financial year:

	0.5% Decrease	Discount Rate Applied	0.5% Increase
Discount rate (Sichuan forests) .....	8.5%	9%	9.5%
Gain/(Loss) from changes in fair value of plantation assets less costs to sell (RMB) .....	(85,277,442)	(110,277,442)	(134,277,442)
Discount rate (Yunnan Luxi/Shuangjiang Forest) .....	10.5%	11%	11.5%
Gain/(Loss) from changes in fair value of plantation assets less costs to sell (RMB) .....	4,570,917,681	4,449,917,681	4,333,917,681
Discount rate (Yunnan Wenshan Forest) .....	12.5%	13%	13.5%
Gain/(Loss) from changes in fair value of plantation assets less costs to sell (RMB) .....	1,785,723,960	1,684,723,960	1,589,723,960

Based on the above sensitivity analysis, (1) a 0.5% decrease and 0.5% increase of the discount rate applied to our Sichuan forests would result in an increase of RMB25,000,000 (or approximately 0.4% increase) and a decrease of RMB24,000,000 (or approximately 0.4% decrease), respectively, in our net profit for the year 2008; (2) a 0.5% decrease and 0.5% increase of the discount rate applied to the Yunnan Luxi/Shuangjiang Forest would result in an increase of RMB121,000,000 (or approximately 2.1% increase) and a decrease of RMB116,000,000 (or approximately 2.0% decrease), respectively, in our net profit for the year 2008; and (3) a 0.5% decrease and 0.5% increase of the discount rate applied to the Yunnan Wenshan Forest would result in an increase of RMB101,000,000 (or approximately 1.7% increase) and a decrease of RMB95,000,000 (or approximately 1.6% decrease), respectively, in our net profit for the year 2008.

We have also engaged CFK to prepare an independent technical report which is set out in Appendix V to this prospectus. In view of CFK's comments on our internal record keeping system, we have engaged Shanghai SVA Communication Co., Ltd. to implement an information management system for us, including a forestry resources management system which uses satellite for collection and transmission of data gathered from forests. It is

expected that upon completion of the system implementation by end of 2010, our forest resource recording system will be significantly enhanced.

### ***Our forests***

We believe we have developed the necessary expertise and understanding of industry practices at the local, regional and national levels to acquire relatively large areas of forests that would give us economies of scale.

Our total forest area increased at a CAGR of approximately 510.9% between 2006 and 2008. Our total forest area as at 31 December 2006, 2007 and 2008 and 30 June 2009 was approximately 4,603 hectares, 12,453 hectares, 171,780 hectares and 171,780 hectares respectively, and our total forest stock volume as at the corresponding dates was approximately 1.2 million m<sup>3</sup>, 3.4 million m<sup>3</sup>, 35.5 million m<sup>3</sup> and 35.5 million m<sup>3</sup>, respectively.

In March 2008, we acquired the Yunnan Luxi/Shuangjiang Forest in Yunnan. It was the first time we acquired forests in Yunnan. This forest includes both naturally regenerated and plantation forests and had an area of approximately 59,333 hectares and a forest stock volume of approximately 13.7 million m<sup>3</sup> based on an assessment as at 30 June 2009. The total consideration for this acquisition was approximately RMB362.5 million (being the present value of the consideration as at date of acquisition) and has been fully settled. In order to expand our forest reserve further, in July 2008, we also acquired the Yunnan Wenshan Forest in Yunnan. This forest consists of plantation forests of approximately 100,000 hectares and has a forest stock volume of approximately 19.6 million m<sup>3</sup>, based on an assessment as at 30 June 2009. Unlike the other forests of the Group, we have not yet commenced harvesting activities in the Yunnan Wenshan Forest, and therefore there is no revenue generated pursuant to the harvesting and sales of logs from this forest. However, the fair value gain at the time of acquisition and the relevant fair value changes over the Track Record Period after the acquisition will not be affected by the harvesting activities, and the acquisitions of both Yunan Luxi/Shuangjiang Forest and Yunnan Wenshen Forest contributed to the Group's profits from the Track Record Period due to their fair value gains on acquisition and their relevant fair value changes over the Track Record Period after such acquisitions. Currently the Group expects to commence harvesting of the Yunnan Wenshan Forest in 2011.

As a result of the above acquisitions, as at 30 June 2009, our forest area was 171,780 hectares, with forest stock volume of around 35.5 million m<sup>3</sup> (based on an assessment as at 30 June 2009). For each of our Sichuan Forest, the Yunnan Luxi/Shuangjiang Forest and the Yunnan Wenshan Forest, we have achieved an average wood yield (in terms of forest stock volume per hectare) of approximately 174.4 m<sup>3</sup> per hectare, 231.6 m<sup>3</sup> per hectare and 196.3 m<sup>3</sup> per hectare respectively, as at 30 June 2009. According to the China Forestry Statistical Yearbook 2007, the PRC national average wood yield in 2007 was only approximately 71 m<sup>3</sup> per hectare. In future, we will continue to seek opportunities to acquire other high quality forests in China. With the expansion in our forest reserves, we believe our sales and profitability will grow.

For the three financial years ended 31 December 2006, 2007 and 2008, we acquired forests of approximately 2,683 hectares, 7,850 hectares and 159,333 hectares respectively. The amount paid or payable for these acquisitions (excluding land use rights) was

approximately RMB29.1 million, RMB93.5 million and RMB714.9 million respectively, or RMB10,853, RMB11,913 and RMB4,487 per hectare respectively. We did not acquire any forests in the first half of 2009. The acquisitions in the year of 2008 were the Yunnan Luxi/Shuangjiang Forest and the Yunnan Wenshan Forest. Although the Yunnan Luxi/Shuangjiang Forest comprises more expensive hardwood trees, the overall acquisition cost per hectare of these two Yunnan forests was relatively lower than that of our forests in Sichuan because (i) the negotiated total purchase price reflected certain economies of scale for such a large acquisition, and (ii) we believe that the competition in the forestry industry is relatively less intense in Yunnan as compared to that in Sichuan. To our best knowledge, private sector participation in the Chinese forestry industry generally commenced earlier in Sichuan when compared to Yunnan. The consideration for our forest acquisitions during the Track Record Period was financed by our internal resources and proceeds from the completion of the First Share Agreement and Second Share Agreement and was negotiated on an arm's length basis by reference to the prevailing market price. For the two years ended 31 December 2007, all of our logging activities and sales were in Sichuan as we only began our logging operations in Yunnan in May 2008. For the year ended 31 December 2008 and the six months ended 30 June 2009, our log sales from our Sichuan forests accounted for approximately 29.5% and 18.6% respectively, and our log sales from our Yunnan forests accounted for approximately 70.5% and 81.4% respectively, of our total turnover for the corresponding periods.

As at 30 June 2009, our plantation forest and naturally regenerated forest consisted of approximately 131,247 hectares and 40,533 hectares, respectively. Over 90% of our forests are around 18-60 years old and immediately harvestable. Our major tree species is Chinese fir (*Cunninghamia lanceolata*), which accounted for approximately 71.1% of our forest area. Chinese fir is a softwood tree, and its wood is highly durable, easily worked, resistant to insects and termites, and is commercially and widely used for making wood panels, plywood, furniture and pulp. Approximately 17.7% of our total forest area is planted with birch (*Betula alnoides*), a hardwood tree, which produces strong and durable wood, and is used for producing a variety of solid wood products such as wood panels, furniture, flooring and other construction materials. Due to its superior wood properties, birch log is generally more expensive than softwood log. For example, according to the China Forestry Statistical Yearbook 2007, the average price of birch log in China for 2007 was about 1.4 times the average price of fir log. Our remaining forest area is planted with beech (approximately 5.8%), pine (approximately 5.1%) and a mix of fir, cedar, birch, pine and alder (collectively, approximately 0.3%).

### **Our operations**

Our business operations are currently focused on upstream timber activities and cover the full timber supply chain from planting of trees, the management and operation of forests and harvesting of forest resources to the sales of logs to third parties.

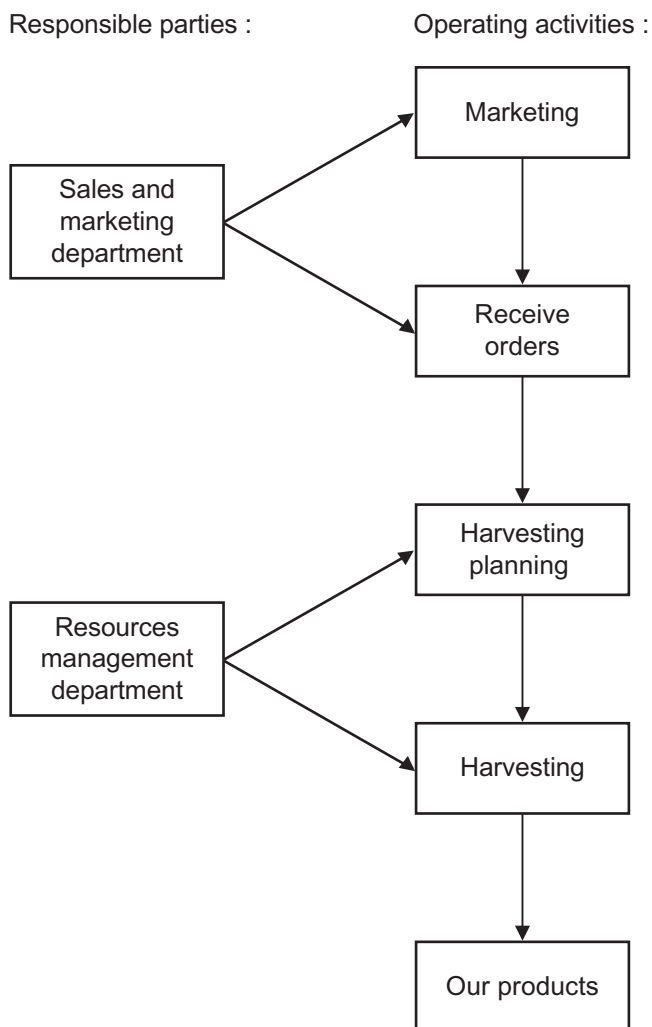
We are committed to customer service and quality products. Our sales and marketing department works closely with our resources management department to ensure that timber is processed to match each customer's request. Typically, we harvest timber only after we receive an order from customers. Our resources management department then decides where to harvest the timber, initiates the logging permit process, and instructs the harvesting villages or professional harvesting teams to arrange and organise for harvesting for the desired amount. Trees are harvested and processed into logs meeting the customer's required dimensions. When the logs are ready, our customers will then arrange for log transportation.

---

## BUSINESS

---

The following diagram shows a summary of our operations.



For the three financial years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, sales of Chinese fir logs accounted for approximately 94.5%, 96.6%, 33.9% and 22.6% of our total revenue respectively. Sales of Chinese fir logs decreased as a percentage of total sales when we began operating our Yunnan Luxi/ Shuangjiang Forest in May 2008. This forest includes Yunnan pine, beech and birch in addition to Chinese fir. For each of the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our log sales volume was approximately 76,200 m<sup>3</sup>, 169,800 m<sup>3</sup>, 520,407 m<sup>3</sup> and 321,930 m<sup>3</sup>, respectively, which represented a CAGR of approximately 161.3% between 2006 and 2008.

We have a system in place to manage and operate our forests, including our forest acquisition system. We are committed to sustainable forestry management practices. For each of the three years ended 31 December 2008 and the six months ended 30 June 2009, we harvested timber at a rate of approximately 10.0%, 7.6%, 1.5% and 1.0% respectively, in terms of the wood volume harvested during the year relative to the total forest stock volume standing at the end of that year. Our harvesting rate will change with our harvesting method and harvesting standards. During the Track Record Period, we did not experience any material

change in our harvesting rate that resulted in a material impact on our financial results. It is expected that our harvesting volume will increase by about 15-20% per year in our forests in both Sichuan and Yunnan Provinces over the next three to five years. It is our long term objective that our forests in Sichuan and Yunnan can achieve an average harvesting rate of approximately 8% to 9%. Our harvesting and replanting of trees comply with the PRC Forestry Law and the relevant rules and regulations.

We enter into contracts with the villages, which are rural economic collective organisations, located close to the forests, or professional harvesting teams to provide harvesting services for our forests depending on the operational scale and the complexity of logging.

Generally, the average area of a Yunnan forest parcel is larger than that of a Sichuan forest parcel and the logging conditions in Yunnan forest are more complex than that in Sichuan forests. Therefore, we generally engage professional teams who are better equipped and more experienced in harvesting to perform harvesting services of our Yunnan forests. The professional teams which are currently engaged by us is a private enterprise in Yunnan which provides harvesting services. To the best of our knowledge, it has been operating for about four years and its customers are primarily forestry operators in Yunnan. We believe this professional harvesting company has the necessary skills and resources for and experience in conducting harvesting for us.

For each of the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, we employed 7, 9, 10 and 10 villages, respectively, for harvesting in Sichuan. We commenced harvesting in Yunnan in May 2008, and for the year ended 31 December 2008 and the six months ended 30 June 2009, we employed 1 professional harvesting company for harvesting forests in Yunnan, respectively. During the period from 1 January 2009 to the Latest Practicable Date, we engaged 10 villages for harvesting in Sichuan and 1 professional harvesting company for harvesting forests in Yunnan.

Since we employ third parties to undertake harvesting and such parties are responsible for equipping themselves, we do not need to purchase and supply of equipment or machinery to them. We also do not need trucks for transportation as our customers arrange their own pick-up of logs from the roadsides near our forests. We do need seedlings for replanting but they are provided free of charge by the PRC government. Therefore we do not have suppliers for operating our forestry business, whether or not they are specific to our business or are required on a regular basis to operate our business.

We are also in the process of applying to The Forest Stewardship Council, being a council established in the early 1990s by group of concerned business representatives, social groups and environmental organisations following the UN Conference on Sustainable Development in 1992. Its purpose is to improve forest management worldwide. FSC is a certification system that provides internationally recognised standard-setting, trademark assurance and accreditation services to companies, organisations, and communities interested in responsible forestry. The FSC Principles and Criteria describe how the forests have to be managed to meet the social, economic, ecological, cultural and spiritual needs of present and future generations. They include managerial aspects as well as environmental and social requirements.

The FSC label provides a link between responsible production and consumption of forest products, enabling consumers and businesses to make purchasing decisions that benefit

people and the environment as well as providing ongoing business value. FSC is nationally represented in more than 50 countries around the world.

As at the Latest Practicable Date, the Company has yet to complete and obtain the FSC accreditation but expects to complete such accreditation process within the next two years.

### ***Our Environmental Controls***

#### *Our policy*

We are an environmentally friendly company and have taken various measures to minimise the possible impact of our operations to the environment, which include the following:-

- Harvesting
  - (a) Our annual average harvesting rate, in terms of the wood volume harvested during the year relative to the total forest stock volume standing at the end of that year, does not exceed the maximum logging rate advised by the local forestry bureaus in Sichuan and Yunnan, which is 10% of our total forest stock volume.
  - (b) During each year, we will not harvest trees more than once from the same area.
  - (c) Our harvesting is performed selectively in one parcel of forest rather than clear logging over an extensive area.
  - (d) To minimise the environmental impact to our forests, we assess the forest and select trees for logging according to the growth conditions of the trees.
  - (e) We only harvest those trees which have met our harvesting standards, i.e. having a stem diameter greater than 20 cm, a stem length of not less than 15 m and aged at least 20 years.
- Logistics
  - (f) As it is our policy to minimise the environmental impact of our operations, roads leading to the main roads should only be constructed when absolutely necessary. Given that our forests are relatively close to roads or routes leading to the main roads, we have not constructed any new roads connecting our forests to the main roads during the Track Record Period.
  - (g) We do not deploy heavy machines to transport our timber downhill. Instead, the villagers and the professional harvesting teams we hired make use of the natural landscape such as a nearby river or the slope of a hill to transport timber, and where necessary, they will build cables for transport. As such, we believe that the environmental impact from their operations is minimised.
- Replanting
  - (h) Our replanting rate is at least 110% of the number of trees we harvest, which is higher than the minimum 100% replanting rate as required by relevant law.

- (i) When replanting, depending on the characteristics of each specie of trees, we plan the location/position of the seedlings to ensure that there will be sufficient growing space for each seedling.
- (j) We achieve an average survival rate in the year of planting of approximately 90%, exceeding the legal requirement of 85%.
- Improvement of forest industrial structure
  - (k) Our Group and Beijing Forestry University plan to jointly establish a research centre, which will conduct research on the prediction and monitoring of the growth of trees planted in our forests, sustainable forestry management and other advanced forestry management technology and practices.

According to CFK, our operations should not materially affect the environment for the following reasons:

- (a) although some of the forests are in water supply catchments for large cities, the use of selective logging method reduces the impact of forest operations on water run-off, and therefore their location in water supply catchments will not cause a problem for harvesting or forest management;
- (b) the use of the selective logging method reduces the impact to the environment and the erosion risk associated with the alternative of clear logging method; and
- (c) the location and terrain of our forests reduces the likelihood of any chemical waste dumps being present.

Accordingly, our Directors are of the view that our operations will not materially and adversely affect the environment.

### Governmental controls on environment

Our forestry operations are subject to PRC laws and regulations relating to the protection of the environment.

All of our forests are categorized as timber stands and commercially harvestable under the PRC Laws. For more details regarding forest classification, please refer to the section headed “Regulatory Overview — Forestry management”.

Under the PRC Forestry Law, the PRC government strictly implements a quota system for logging of forest wood so as to uphold the overriding principle that the amount of consumption of timber must be less than the amount of its growth.

Each year, the forestry bureaus at the lower level (which is mainly the county level), based on their regular check on the conditions (including the maturity of trees and the forestry resources) and the forestry operation plans of all forestry lands within their respective area, prepare the proposed annual logging quota. The annual quota is reviewed by the local governments at the same level and is submitted to the forest bureau at the provincial level. The forestry bureaus at the provincial level are then responsible for compiling annual logging



quotas by adjusting the proposed logging quotas submitted by the lower level forestry bureaus and submitting them to the PRC State Council for final approval. The governmental measures to monitor logging activities (including the amounts harvested by forestry operators) mainly include (a) prior approval in the form of the logging permit system; (b) examination of the actual logging amount during logging; and (c) transportation controls by using the timber transportation permit system. For more details, please refer to the section headed “Regulatory Overview — Deforestation” and “Business — Our sustainable forestry management”.

To maintain the sustainability of the environment, the PRC laws also require the forestry operators to replant trees after logging and the number of replanted trees must not be less than the number of harvested trees. Also, we understand that the Sichuan local forestry bureau will conduct regular checks on the conditions of the forest lands within its area, including the health and growth conditions of trees, the forest resources, and the environmental conditions of the forest, checking for conditions such as soil erosion and chemical waste dumps, to ensure the environment is not adversely affected.

### Our compliance

Our PRC legal advisers advised that pursuant to the PRC Forestry Law and its implementation rules in force, in respect of the amounts which may be harvested, we are only required to comply with the log amount specified in the logging permits. We obtain approval for the amount we harvest prior to each logging. Although there are no specific PRC laws or regulations which prescribe how a local forestry bureau shall determine the logging amount of a forestry operator in a logging permit, we are advised by the local forestry bureaus in Sichuan and Yunnan that our maximum logging amount each year should be 10% of the total forest stock volume of all our forests. Since our forest stock volume changes from time to time, the local forestry bureaus in Sichuan and Yunnan have not advised on any absolute figure of our annual maximum logging amount.

In light of the position of the local forestry bureaus, our internal guidelines provide that our annual maximum logging amount should account for 10% of our total forest stock volume. Upon receiving an order from our customers, our resources management department will check (i) whether the aforesaid 10% annual logging cap has been utilized up to that moment; and (ii) the volume of logs in the order as compared to the un-utilized logging cap, to ensure our compliance with the anticipated annual logging cap. Furthermore, the relevant logging activities with a harvesting plan must be approved in advance by our chief administration officer. After selecting the appropriate forest for logging, we will apply for the logging permit with the local forestry bureau.

We apply for a logging permit before each logging. To ensure our compliance with the logging permits, during logging, our forest workers and dedicated forest team members will be present on site to monitor the logging activities and record details of harvesting (including the date, area and location of logging, and the volume of timber harvested), to ensure the quantity of timber logged does not exceed that specified in the logging permit, and the harvesting complies with other requirements as set out in the logging permit and our own harvesting requirements including the quality of logs. Such logging records are first prepared by our forest workers and then reviewed by our dedicated forest team. The volume of timber will also be re-measured by our forest workers, dedicated forest team and customers before our customers pick up the timber. In addition, our resources management department will record

---

## BUSINESS

---

and monitor all the actual logging amounts and the local forestry bureau will conduct selective examination of our logging activities.

The table below sets forth our actual logging amount and the maximum logging amount permitted under the logging permits granted to us (whether or not they have been fully utilised) for the three years ended 31 December 2008 and the six months ended 30 June 2009.

<u>Year</u>	<u>Actual logging amount (m<sup>3</sup>)</u>	<u>Maximum amount permitted under logging permits (m<sup>3</sup>)</u>
2006 .....	75,909	77,034
2007 .....	169,329	169,329
2008 .....	519,928	519,928
2009 (up to 30 June 2009) .....	356,730	356,730

Regarding replanting, we will select, within the same piece of forest where trees have been harvested, the suitable replanting areas which can provide enough space and light for the growth of seedlings. We replant trees at the rate of at least 110%, that is, for every 100 trees logged by us, we will replant at least 110 new trees within a year after the month of actual logging, which is more than what is required under the PRC laws. In addition, as part of our commitment to sustainable forestry management, we achieve an average survival rate of trees replanted by us in the year of planting of approximately 90%, exceeding the legal requirement of 85%. Therefore, our Directors are of the view that given our consequential survival rate, there is enough space for the new plants to grow healthily.

Furthermore, a transportation permit is required for transporting timber out of the forest area. As our current forestry operation does not involve transporting timber out of forest area, we do not require transportation permits. Transportation permits remain the responsibility of our customers. We will provide a photocopy of the relevant logging permit to our customers for their application for transportation permits. However, we will not check whether they applied for transportation permits, and are not liable if they fail to obtain transportation permits or breach their terms.

As part of our daily management, our forest workers inspect the forests on a daily basis for which they are responsible. They will check the conditions of tree growth, logging and replanting. They will also examine whether there is any risk of disease, pest or fire in the forests. After inspection of the forests, they will record the results. Every quarterly year, our forest workers are required to submit a report of tree growth and a report of changes in tree conditions to our resources management department. Such reports are subject to the verification and approval of our dedicated forest team.

As we have been in compliance with the above logging and replanting measures which are enforced by the PRC government, our Directors are of the view that there will not be any adverse impact on our business and operations in ensuring our compliance with these measures. Our PRC legal advisers have advised that given that: (a) we have obtained logging permits before each time of logging; and (b) the relevant local forestry bureaus in Sichuan and Yunnan have confirmed that our logging activities were in compliance with the relevant rules and regulations, our logging activities during the Track Record Period were in compliance with the applicable PRC laws and regulations in all material respects.

Our PRC legal advisers have advised that according to the PRC Environmental Protection Law, the PRC Environmental Impact Assessment Law and the relevant regulations, we are required to conduct an environmental impact assessment. However, during the Track Record Period, we had not conducted any formal environmental impact assessment for our forests, and therefore had not incurred any cost for compliance with such requirements under the PRC environmental laws.

We have consulted the national environmental bureau and was informed that an environmental impact assessment should be conducted under the PRC law. However, it is the local environmental bureau who is responsible for implementing the laws and regulations of environmental impact assessment, and the actual application for environmental impact assessment has to be made with the local environmental bureau. We have made an enquiry of the Sichuan local environmental authority. It considers that such assessment is not necessary for us because our operational activities are, in their view, not pollutive. We will continue to communicate with the Sichuan local environmental bureau in this regard. If it ultimately changes its view and decides that we should conduct an environmental impact assessment, we will proceed with the environmental impact assessment immediately. In Yunnan, we have made an enquiry to the Yunnan local environmental bureau and the response was, whilst it had not previously obliged such environmental impact assessment, to the extent we did undertake one, it would be agreeable to accepting it for review. We are in the process of selecting a suitable assessment company with the capacity or experience in performing such assessments in the forestry industry. When such assessment has been completed, we would need to submit an environmental impact report form which will be prepared with the assistance of the assessment company, to the relevant environmental bureau. This report will contain the recommendations or measures to protect the environment, which, where appropriate, will be implemented by us. We expect the related costs to be not more than RMB500,000. Upon enquiry by us of the Sichuan and Yunnan local environmental bureaus, we were informed that they, as a matter of practice, are primarily concerned with monitoring our compliance with the maximum logging amount set out in our logging permits and our replanting obligations. Under circumstances as described above, although the local environmental authorities have not confirmed that they would not take any actions against us for the non-performance of the environmental impact assessment, we believe that it is not likely that the local environmental authority would take actions against us. Our PRC legal advisers have advised that if we do not undertake an environmental impact assessment, the environmental bureau may order us to undertake one within a prescribed period, and if we fail to do so, it may impose a fine of not less than RMB50,000 and up to RMB200,000.

The local forestry bureaus in Sichuan and Yunnan where our forestry operations are primarily located have confirmed that our forestry operations are in compliance with applicable environmental and forestry laws and regulations in the PRC, and we have not been the subject of any administrative punishments due to any breach of law in respect of environmental matters or forestry operation. Our PRC legal advisers have confirmed that, besides the local environmental bureaus, these local forestry bureaus in Sichuan and Yunnan are also the appropriate competent authorities to confirm our compliance with the environmental laws and regulations in the PRC.

We are not aware of any pollution or hazardous substance problems in our forests. CFK, our independent forestry consultant, advised that based upon its experience with the identification of the presence of hazardous substances (if any) in other forested areas, hazardous substance problems are most likely to occur where (1) chemicals (herbicides or

fertilisers) were applied to the forest; or (2) there are large industrial plants in close proximity to the forests. CFK understands that no herbicides or fertilisers have been used on our forest areas, and that there are no large chemical-using industries located on the forest boundary or near to the forests themselves.

Given that (i) we are not an enterprise involved in activities which generate high pollution; (ii) we have complied with all the relevant logging laws; (iii) we have obtained written confirmations from the local forestry bureaus evidencing that we are in compliance with applicable environmental and forestry laws and regulations in the PRC; (iv) the local environmental bureau in Sichuan has refused to accept an application for environmental impact assessment; and (v) we are already in the process of arranging such assessment for our Yunnan forests, our PRC legal advisers have advised that our non-completion of such environmental impact assessment in time would not materially and adversely affect us. Furthermore, our Controlling Shareholders have agreed that, conditional upon Listing, they will indemnify us against any liabilities which may arise from or in connection with our violation or non-compliance of environmental laws and obligations to undertake environmental impact assessments under the relevant PRC laws and regulations.

### ***Our chairman***

We are led by an experienced and professional management team who are committed to our long term success. The chairman of our Company and the founder of our Group, Mr. Li Kwok Cheong, entered the forest management industry in 2003, the same year when the Chinese government announced the No. 9 Policy which set out the directive for the private sector to participate in China's forestry development, and up to now he has accumulated approximately six years' experience in forestry business. We understand that as a result of Mr. Li's forestry experience and his business profile, Mr. Li has been admitted as a council member by the CCPEF, a national non-profit association in China managed by the SFA and established for promoting the proper use of resources, protection of the environment and sustainable economic development. Mr. Li's council membership not only offers the Group a higher profile in the industry, but also allows Mr. Li to participate at national level discussions and policies about the development of the forestry industry in China. Therefore, we believe that we are in a better position to remain competitive as we would have a better understanding (having participated in the process) when such policies and initiatives are formulated and/or implemented.

### ***Our investors***

We have two institutional investors in our Company, the Carlyle Group and Partners Group. Both of them are international private equity firms.

The Carlyle Funds, being part of the Carlyle Group, made a first round investment in our Company by entering into the First Share Purchase Agreement and the Accession and Amendment Agreement on 30 December 2007 and 18 March 2008, respectively. Pursuant to these agreements, they acquired in aggregate, 4,000,000 Shares representing approximately 12.5% of the then issued share capital of our Company for a total consideration of HK\$312,044,000 (equivalent to approximately US\$40,000,000). Mr. Li Han Chun, our executive Director, and Mr. Huang Fan, our predecessor director from December 2007 to March 2008, also invested in our Company by acquiring 3,200,000 Shares and 320,000 Shares respectively (which represented 10% and 1% respectively of the then issued share capital of our Company) from Kingfly Capital on 31 March 2008 for a consideration of

US\$32,000,000 and US\$3,200,000 respectively. The consideration paid by the Carlyle Funds, Mr. Li Han Chun and Mr. Huang Fan in the above-mentioned acquisitions was, after taking into account the Capitalisation Issue, approximately HK\$1.23 per Share.

The Carlyle Funds, together with the Partners Group Funds, made its second round investment in our Company on 26 June 2009. For the second round investment, the Carlyle Funds acquired, in aggregate, 1,304,347 Shares representing approximately 4% of the then issued share capital of our Company for a total consideration of US\$14,999,990.5. The Partners Group Funds had acquired, in aggregate, 2,608,696 Shares representing approximately 7% of the then issued share capital of our Company for a total consideration of US\$30,000,004. The aforesaid consideration paid by the Carlyle Funds and the Partners Group Funds in the above-mentioned second round investment was, after taking into account the Capitalisation Issue, approximately HK\$1.42 per Share.

### ***Our customers***

Our products are mainly sold to wood processing factories in China, and our customers use our logs in the construction industry and for a wide range of consumer applications, such as furniture making, interior decorations, wood products and paper. According to CFK, the increase in China's domestic log production is not likely to meet the increasing demand. We believe that logs sourced from domestic commercial forests such as ours will become an increasingly important source of supply of timber resources in China to meet the growing demand for wood products. Furthermore, since more than two-thirds of China's forests are classified as young and middle-aged and generally not yet ready to be harvested, we believe that the size of our immediately harvestable forest resource base has positioned us well to capture China's increasing demand for timber.

For the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our five largest customers in aggregate accounted for approximately 93.9%, 85.3%, 44.8% and 56.2% respectively, of our revenue. During the same period, our largest customer in each respective period accounted for approximately 47.1%, 22.7%, 9.7% and 12.8% respectively, of our revenue. As a result of our commencement of logging operations in Yunnan in May 2008, our five largest customers, for the two years ended 31 December 2007, were all located in Sichuan, and for the year ended 31 December 2008 and the first half of 2009, were all located in Yunnan. Of our five largest customers during the Track Record Period, we understand that one is a trading company and all the rest are wood-processing factories. Of these customers, 6 are located in Sichuan, 6 in Yunnan and 1 in Hangzhou. Each of them is an Independent Third Party. Our five largest customers first became our customers between 2003 and 2008. To the best knowledge of our Directors, our five largest customers for the Track Record Period have operated for at least 3 years, their registered capital vary from RMB50,000 to RMB2,000,000, and their target customers are in construction and furniture-making industries. Payment for our products is made before delivery and none of our sales are made on credit terms.

### ***Sichuan Earthquake and Yunnan Earthquake***

On 12 May 2008, an earthquake with a magnitude 8.0 on the Richter scale hit Sichuan, killing tens of thousands of people and causing severe physical damage and following which, there were various aftershocks from the earthquake. We conducted a comprehensive

inspection of our forests from 13 May to 23 May 2008 to assess the impact of the earthquake on our Sichuan forests, which are located in Ya An City, Le Shan City and Liang Shan Zhou and are approximately 183, 189.5 and 377.7 kilometres, respectively, from the epicentre of the earthquake. Our forest workers and dedicated forest team participated in the inspection. We examined all areas of our forests in Ying Jing county, Ya An City (totalling about 2,835 hectares and with forest stock volume of approximately 788,000 m<sup>3</sup> as at 31 March 2008) because it is our forest closest to the epicentre and was more likely to suffer damage from the earthquake. We also examined, on a sampling basis, our forests in Le Shan City and Liang Shan Zhou where our other Sichuan forests (totalling about 9,612 hectares) are located. This examination covered a total of approximately 558 hectares of forests in Mei Gu Xian, Ma Bian Xian, Jin He Kou Qu, Jin Kou He Qu and Er Bian Xian. We inspected the forest and transportation conditions, and whether there were any loss or damage to our forestry assets. Based on our inspection, our Directors are of the view that the Sichuan Earthquake did not materially impact the condition of our tree stock and the roads surrounding our forests.

We have also invited the forestry bureau of Ying Jing County to assist in our inspection. The forestry bureau of the Ying Jing county has confirmed that after its detailed investigation, it was found that our forests in Ying Jing county were not affected by the Sichuan Earthquake and the forest trees and forest lands were in good condition. The relevant local forestry bureaus where our other Sichuan forests are located (namely, the forestry bureaus of Ma Bian Yi Zu Autonomous County, Mei Gu county, Jin Kou He Qu, Jin He Kou Qu, Er Bian Yi Zu Autonomous County), have also issued the same confirmation for our forests in their respective governing areas. We have received confirmations for all of our forests in Sichuan.

CFK, our independent forestry valuer, visited a sample of our forests in Sichuan in mid July 2008, and confirmed that it has not observed any damage to our Sichuan forests from the earthquake; all roads appeared in normal condition; there were no unusual or significant slips, inside or out of our Sichuan forests which CFK has visited; and there did not appear to be any material damage to properties or buildings around our Sichuan forests. CFK has further confirmed that the Sichuan Earthquake did not have any material impact on its valuation of our plantation assets as at 31 December 2008 and no adjustment to the valuation is considered necessary by CFK.

We have also confirmed with our major customers in Sichuan that they were not materially affected by the Sichuan Earthquake. We have not received any request for termination or postponement of orders or any reports of damage from our customers due to the Sichuan Earthquake, save for our customers' voluntary interruption of business ranging from about 3 to 7 days after the Sichuan Earthquake due to safety concerns. Our Directors have confirmed that we have not been subject to any claim as a result of the Sichuan Earthquake as at the Latest Practicable Date.

Immediately after the occurrence of the Sichuan Earthquake, we had, out of prudent safety concerns, voluntarily ceased logging for 4 days from 12 May 2008, but have since resumed normal logging operations. Although some of our customers had delayed their payments in May 2008 due to the Sichuan Earthquake, they had fully settled such payments by June 2008.

Based on the above, our Directors are of the view that the impact of the Sichuan Earthquake on our assets, operations and financial position is minimal and our assets and operations have not been materially affected by the subsequent aftershocks.

On 9 July 2009, an earthquake of magnitude 6.0 on the Richter scale hit Yunnan with its epicentre located in Yao An County. As a result, hundreds of people were injured and thousands of houses were damaged. Our forests in Yunnan are located in De Hong Zhou, Lin Cang City and Wen Shan Zhou which are approximately 312, 211 and 437 kilometres respectively, from the epicentre of this earthquake. We have visited our Yunnan forests after this earthquake and determined that it has caused no apparent damage to our forests and the roads surrounding our forests. We were also advised by our Yunnan customers that they were not materially affected by the Yunnan Earthquake. Accordingly, our Directors are of the view that the impact of the Yunnan Earthquake to our assets, operations and financial positions is minimal. Our independent valuer CFK has also visited selected areas of our Yunnan forests in August 2009 after such earthquake and did not observe any evidence of earthquake damage.

### ***Global Financial Crisis***

From September 2008, various leading investment banks and financial institutions in the United States and Europe have either become insolvent or have sought emergency financial support from the US government as well as various governments in Europe. Such events have impacted both the global equity and credit markets, thereby resulting in funding shortfalls and tightening of credit. This lack of credit and liquidity has not only affected the banking and financial sectors, but also the commercial sector relying on normal trade facilities and bank borrowings. Whilst stimulus packages have been introduced by various government agencies around the world, including a RMB4 trillion stimulus package announced by the Chinese government in the second half of 2008, their effects to relieve a global recession remain to be seen. The Chinese economy has been adversely affected as declines in demand from the United States and Europe have led to a fall in exports from China to these countries.

Since the beginning of this global financial crisis, our Directors have closely monitored the macro-economic environment. As at the Latest Practicable Date, we had not experienced any material reduction in the amount of purchase orders confirmed by our customers for delivery. As our products are used in a wide variety of industries (construction, furniture, interior decoration, wood product and paper) in China, we believe that this diversification reduces our risk relating to a downturn in a particular industry. Our log prices for first half of 2009 had decreased when compared with those in 2008. However, such decreases in log prices were offset by an increase in the volume of logs sold. In light of the foregoing, our Directors do not anticipate that, as at the Latest Practicable Date, revenue would drop significant as a result of the effects of the global financial crisis. Since we make our products available to our customers only after we receive payment, we do not face the risk of default on our customers' payment obligations to us. As at the Latest Practicable Date, we were not engaged in any hedging transactions.

During the Track Record Period, we did not have any borrowings or bank facilities and we relied on the financial resources generated from our business activities and shareholder funds as our sources of funding. Going forward, however, we have decided to take on some bank borrowings if necessary or desirable and in this regard, on 1 September 2008, we entered into a non-binding credit facility agreement with Shenzhen Development Bank which has agreed, in principle, to grant us a credit line of RMB1,000,000,000 for 3 years until 1 September 2011, subject to conclusion of credit facilities agreement(s). As at the Latest Practicable Date, we had not received any notification from the Shenzhen Development Bank that it would withdraw from such in-principle agreement.

In light of the foregoing, our Directors believe that our financial performance will not, in the near term, be materially and adversely affected by the current weak economic outlook. Our future plans and the proposed use of the net proceeds from the Global Offering as set forth in the section headed “Future plans and use of proceeds” will continue to be implemented as described herein.

### **COMPETITIVE STRENGTHS**

#### **We have a large, sustainable and high quality forest resource base.**

We have a large, sustainable and high quality forest resource base consisting of forests covering a gross area of approximately 171,780 hectares as at 30 June 2009, with an average ownership term of at least twenty years. We regard our forests of high quality as they possess a high forest stock volume and are immediately harvestable. All our forests can be commercially harvested in accordance with the relevant government rules as they are classified as timber stands under the functional categorisation of forest by the SFA.

As at the Latest Practicable Date, our forests possessed a forest stock volume of approximately 35.5 million m<sup>3</sup> (based on an assessment as at 30 June 2009). For each of our Sichuan Forest, the Yunnan Luxi/Shuangjiang Forest and the Yunnan Wenshen Forest, we have achieved an average wood yield (in terms of forest stock volume per hectare) of approximately 174.4 m<sup>3</sup> per hectare, 231.6 m<sup>3</sup> per hectare and 196.3 m<sup>3</sup> per hectare, respectively, as at 30 June 2009. According to the China Forestry Statistical Yearbook 2007, the PRC national average wood yield in 2007 was only approximately 71 m<sup>3</sup> per hectare.

Our major tree species is Chinese fir (*Cunninghamia lanceolata*), which accounts for approximately 71.1% of our forest area. Chinese fir is a softwood tree, and its wood is highly durable, easily worked, resistant to insects and termites, and is commercially and widely used for making wood panels, plywood, furniture and pulp. Approximately 17.7% of our total forest area is planted with birch (*Betula alnoides*), a hardwood tree, which wood is strong and durable, and is used for producing a variety of solid wood-based products including wood panels, furniture, flooring and construction materials. Due to its relative hardness, birch log is generally more expensive than softwood log. For example, according to the China Forestry Statistical Yearbook 2007, the average birch log price in China for 2007 was about 1.4 times of the average fir log price.

While over two-thirds of China's forests are classified as young and middle-aged, over 90% of our forests are around 18-60 years old and immediately harvestable. We have implemented and will continue to implement various practices that embrace and adopt sustainable forest management. For every 100 trees that we harvest, we replant at least 110 new trees within a year after the month of actual logging. Our replanting rate is at least 10% higher than what is required under the relevant PRC law, which stipulates that the replanting area and quantity cannot be lower than the harvest area and quantity. Our long-term investment in our forest resources and our commitment to sustainable forest management enable us to secure an increasing and sustainable supply of timber.

#### **Our forests are strategically located.**

Currently all of our forests are strategically located in Yunnan and Sichuan Provinces. According to the China Forestry Statistical Yearbook 2007, these two provinces possessed approximately 15.6 million hectares and 14.6 million hectares of forest respectively and ranked



third and fourth largest respectively in terms of forest area. Each of Sichuan and Yunnan Provinces possesses forest stock volume of 1,495.4 million m<sup>3</sup> and 1,399.3 million m<sup>3</sup> respectively, and is the second and the third largest respectively in terms of forest stock volume in China. Under the current logging quota regime in China, the State Council sets a national logging quota every five years and approves the annual logging quota for each province. According to China's national logging quota during the 11th five-year plan period (2006-2011), Yunnan has obtained the largest logging quota among all provinces, which is approximately 31.5 million m<sup>3</sup> and represents approximately 12.7% of the national logging quota. Sichuan's annual logging quota for the same period is approximately 13.2 million m<sup>3</sup> and represents approximately 5.3% of the national logging quota. The location of our forests in Yunnan and Sichuan Provinces enables us to possess some of the most timber-rich and commercially harvestable forest areas in China.

Furthermore, the GDP of Yunnan province grew at an average rate of approximately 10.6% per annum between 2003 and 2007. According to CFK, the strong growth in both GDP and population in the southwest region of China (which include Sichuan, Chongqing, Yunnan, Guizhou and Tibet) supports the demand for additional housing and increased timber consumption, and we believe that this growth in the regional economy will continue. In addition, new highways or railways leading to city centres are being built around Ya An City and Luxi, De Hong Zhou where our current forestry operations are primarily located. We believe that the improvement of transportation in these areas will lead to an increase in the demand for our products.

### **We have a good track record of forest acquisition and prospects for future acquisitions.**

We have grown primarily through acquisitions of high quality forests in Sichuan and Yunnan Provinces. Our forest reserve has been growing over the years and our total forest area increased at a CAGR of approximately 510.9% between 2006 and 2008. Our total forest area as at 31 December 2006, 2007 and 2008 was approximately 4,603 hectares, 12,453 hectares and 171,780 hectares respectively, and our total forest stock volume as at 31 December 2006, 2007 and 2008 was approximately 1.3 million m<sup>3</sup>, 3.5 million m<sup>3</sup> and 35.5 million m<sup>3</sup> respectively. In March 2008, we acquired the Yunnan Luxi/Shuangjiang Forest in Yunnan. This forest includes both naturally regenerated and plantation forests and has an area of approximately 59,333 hectares. To further expand our forest reserve, we further acquired the Yunnan Wenshan Forest in Yunnan in July 2008. This forest is plantation forests of approximately 100,000 hectares. Although the purchase price has not been fully settled, the forestry rights have already been transferred to us as a matter of PRC law, and we have already obtained the relevant forestry right certificates for this forest. Therefore we now own the forest trees and the usage rights of the forest trees and forest land, in respect of this forest. For the six months ended 30 June 2009, we have not acquired any new forests. As at 30 June 2009, our forest area was 171,780 hectares, and our forest stock volume was around 35.5 million m<sup>3</sup> (based on an assessment as at 30 June 2009). We believe that our current experience to date in the expansion of our forest resources will help us achieve our goal of becoming a leading privately-held forestry operator in the Asia Pacific region.

According to the SFA's Major Results of the Six National Forest Resources Survey, China has timber stands of approximately 78.6 million hectares. With China's supportive policy of encouraging private enterprises to participate in forestry, we believe there are good opportunities for us to further expand our forest reserve by acquiring additional high quality forests in China.

We were one of the first enterprises to take advantage of the PRC government's No. 9 Policy in 2003 which set out the directive for the private sector to participate in China's forestry development, and our management has built up broad experience in China's forestry. The fact that our forest area increased at a CAGR of approximately 510.9% between 2006 and 2008, our sales increased over seven fold between 2006 and 2008 and our profit for the year had also increased, demonstrates our management's ability in identifying suitable targets, complying with related state and local regulations and effectively integrating newly acquired forests into existing operations. We have also established a network with our business partners, the forestry bureaus, our consultants and the CCPEF. Being the only privately-held member company and a council member of the CCPEF, we are better able to obtain, easily and quickly, the first-hand information on the latest development of the forestry industry in China. We identified suitable forests for acquisition based on the information we obtained from the forestry industry. We believe our experience and knowledge will allow us to compete effectively, and more easily identify acquisition targets and consummate acquisitions in a timely and cost efficient manner, especially in Sichuan and Yunnan Provinces.

We have established a system for acquisition of forestry resources. We go through the stages of sourcing acquisition targets, on-site inspection by our dedicated forest team, valuation by an independent forestry valuer and management discussion before we decide to purchase a new forest. We believe that our policy of inviting the individuals who previously owned the forest to work in our forests is unique in China's forestry sector. This policy has won us the reputation of being socially responsible within the local communities and the local governments, making us more competitive in our acquisition of new forests.

### **Our harvesting rate has a large growth potential.**

Under the PRC Forestry Law, the PRC strictly implements a quota system for the logging of forest trees. We have been advised by the local forestry bureaus in Sichuan and Yunnan that our maximum logging amount each year is 10% of the total forest stock volume of all our forests. For each of the three years ended 31 December 2008 and the six months ended 30 June 2009, we harvested timber at a rate of approximately 10.0%, 7.6%, 1.5% and 1.0% respectively, in terms of the wood volume harvested during the year relative to the total forest stock volume standing at the end of that year. In that regard, there is ample room for us to increase our harvesting rate before reaching the 10% maximum logging amount as advised by the local forestry bureaus in Sichuan and Yunnan.

### **We have an operating system in place and are a socially responsible and environmentally friendly company.**

Our standard of forestry operations was recognised by our award of the Authentication Certificate of Quality Management System (GB/T19001-2000 idt ISO9001:2000), Environmental Management System (GB/T24001-2004 / ISO14001:2004) and Occupational Health and Safety Management System (GB/T28001-2001) issued by Beijing NGV Certification Centre, an approved accreditation body in China.

We have an operating system in place for managing and operating our forests, and the harvesting and sales of our products. To ensure the quality of our products and the sustainability of our forest resources, we have established a set of harvesting rules and standards which comply with our logging permits and the relevant harvesting regulations as

set by the PRC Forestry Law and relevant government regulations. We only harvest trees meeting our specified requirements of stem diameter, stem length and age. To ensure the long-term supply of timber from our forest resources, we have also established a set of rules and standards for replanting, such as replanting trees at the rate of at least 110% after logging, exceeding the 100% minimum legal requirement and requiring the survival rate of new saplings in the year of planting be not less than 85%.

Being committed to sustainable forest management, we employ systematic forest management practices and adopt prudent environmental management of our forests. The daily management of our forests is carried out by our local forest workers who are supervised by our dedicated forest team. Our dedicated forest team regularly visits our forests to monitor and report conditions and to ensure regulatory compliance. Our information system enables us to effectively record and monitor logging, tree replanting, changes in forest stock volume, forestry operations and forest health. We have also set up procedures for pest control and fire prevention.

We are also a socially responsible and environmentally friendly company. We believe in striking a balance between the increasing demand for forest resources and the preservation of ecology. Through our commitment to respect the environment as well as the communities that surround our forests, we believe that we gain local acceptance for our activities and build upon our favourable reputation. We believe that this helps us distinguish ourselves from other forestry companies and gives us a competitive advantage as we expand our operations into new areas and acquire new forests.

**We have a strong team of professional managers and consultants and an internationally well-known institutional investor.**

The Chinese government's No. 9 Policy in 2003 set out the directive for the private sector to participate in China's forestry development. Our Group was one of the first enterprises to take advantage of this policy and have been building our forest reserve through acquisitions since 2003. Throughout the years, we have developed extensive local forestry and management expertise in the China market. We have built up an experienced executive team committed to our long term success. The chairman of our Company and the founder of our Group, Mr. Li Kwok Cheong, is a council member of the CCPEF. Mr. Li Han Chun, our executive Director and general manager, is also experienced in business management and is a council member of the CCPEF. Our management team has customised our operations to serve the China market, including adopting our policy of engaging previous forest owners to be our forest workers, which we believe, is unique in China's forestry industry.

To further capture the business opportunities and improve our operations, we have retained two forestry consultants, namely Mr. Meng Fan Zhi and Mr. Ma Lu Yi. Mr. Meng is the secretary of the CCPEF, and Mr. Ma is a professor at the Beijing Forestry University. We have entered into consultancy agreements with each of them, pursuant to which they are to provide us with information and advice on the State's forestry policies as well as on our business proposals.

The Carlyle Funds, as part of the Carlyle Group, and the Partners Group Funds, which are advised by Partners Group, both being international private equity firms, are institutional investors in our Company. The Carlyle Funds and the Partners Group Funds have agreed to use their best efforts to assist the Company with corporate governance, recruitment of

management, and development of international and domestic markets. We believe that their international management experience in various industries will help us enhance our corporate governance and management as well as help us expand our markets.

In particular, with the assistance of Carlyle Funds, the Company is currently seeking to engage a management consultancy firm to improve the Group's internal controls system with an aim to enhance the Group's corporate governance. The Carlyle Funds have also assisted the Company in searching and recruiting qualified and experienced management personnel through their global network. For example, Mr. Wong Tak-jun, the independent non-executive director, was introduced to us by the Carlyle Funds. Although the Carlyle Funds do not have any management experience in forestry industry, they have invested in the forestry upstream business, wood-processing business and other forestry downstream businesses and are now assisting the Group to broaden its customer base domestically and internationally by introducing potential customers to the Group.

### **INDUSTRY OPPORTUNITIES**

We believe that we are well positioned to benefit from the following industrial opportunities:

#### **Tight global supply for wood**

According to the FAO's Global Forest Resources Assessment 2005, global forest area continued to decrease during 1990-2005, although the rate of net loss slowed. Forest area in the world was decreasing at a rate of 7.3 million hectares per year during the period of 2000–2005. Thus, the global supply of wood continues to be tight. We believe that our existing forest resource base, together with our ability to acquire additional forests, positions us to benefit from the tight global supply for wood.

#### **High demand for wood in China**

China's domestic wood supply is insufficient to meet its increasing demand. The ITTO 2008 Report forecasted that China would have a shortage (domestic consumption exceeding production) of 29.5 million m<sup>3</sup> logs and 6.2 million m<sup>3</sup> sawnwood in 2008. The WWF's report, entitled "China's Wood Market, Trade and the Environment", projected that by 2010 China's domestic industrial wood supply would be 114 million m<sup>3</sup> and the import volume needed to match its demand would be 125 million m<sup>3</sup>. We have a large reserve of forests which amounted to a gross area of approximately 171,780 hectares as 30 June 2009, over 90% of which are around 18-60 years old and immediately harvestable. Our large sustainable forest resources position us well to benefit from the shortage in supply and the high demand for wood in China.

#### **Supportive government policies in China**

The Decision of the Central Committee of the Communist Party of China and the State Council on Accelerating the Development of Forestry (中共中央、國務院關於加快林業發展的決定(中發[2003]9號)) promulgated on 25 June 2003 ("No. 9 Policy"), sets the legal framework for developing a forestry industry which allows individuals, private enterprises and even foreign investors to participate. The No. 9 Policy also sets out directives for improving the forest assets ownership system and promoting the transfer of rights to use forest trees and forest land. The Outline of Policy on Forest Industry (關於印發《林業產業政策要點》的通知

林計發 (2007) 173號) jointly announced by seven state bureaus of the PRC including the SFA in 2007 further strengthened the No. 9 Policy and encouraged local and foreign investment in forestry, use of forest resources as security for bank loans, financing of forestry enterprises through initial public offerings and tax concessions for forestry enterprises. We have captured the opportunity made available under these policies by being one of the first private enterprises to acquire forests in 2003. On 8 June 2008, the Central Committee of the Communist Party of China and the State Council issued an Opinion on Comprehensively Promoting the Reform of the System of Collectively-owned Forestry Rights (中共中央國務院關於全面推進集體林權制度改革的意見). Pursuant to this, the State will promote the reform of the system of collectively-owned forestry rights to enable the villagers to more easily obtain the ownership of forest trees, the use right of forest land and the management right of the forests. It will simplify the legal formalities for management of logging activities and the approval procedures, and will support the establishment of leading forestry enterprises and promote the large-scale forestry production and standardisation of the forestry management. We expect that if the above was fully implemented, we would be in a better position to manage our forests and acquire new forests from the villagers. We believe that our business model and our ability to access information on State forestry policies and future developments of the forestry industry have placed us in an excellent position to continue to take advantage of China's supportive policies in China's forestry industry. To the best knowledge of our Directors, the PRC government has not announced any material measures for implementing the policies of supporting the use of forest resources as security for bank loans and financing of forestry enterprises through initial public offerings, however the tax concessions have been implemented for forestry enterprises by exempting their enterprise income tax and providing a preferential VAT of 13% compared with a standard VAT of 17%.

### **Lower proportion of immediately harvestable forests in China**

According to the SFA's Major Results of the Sixth National Forest Resources Survey, the young and middle-aged forests represent a larger proportion in China's forests, and account for approximately 67.9% of national forest area and approximately 38.9% of national forest stock volume. The young and middle-aged forests are generally not harvested until they become mature. In our forests, however, over 90% of our trees are around 18-60 years old and immediately harvestable and the logs we sell are harvested from selected trees with average stem diameter of 20 cm. The quality and age of our forests position us well to capture the demand for high quality timber and large-diameter logs.

### **Favourable pricing environment for timber resources**

According to the SFA's Analysis of 2007 National Forestry Industry Statistics Annual Report, the log average price in 2007 was RMB638 / m<sup>3</sup> which represented an approximately 5.28% increase from 2006. The ITTO 2008 Report forecasted that China would have a shortage (namely the domestic consumption exceeds its production) of 29.5 million m<sup>3</sup> logs and 6.2 million m<sup>3</sup> sawnwood in 2008. We expect the shortage of supply of timber in China will continue to drive a positive price environment and lead to increase in timber price over the coming few years. We believe that our good quality timber allows us to take advantage of such favourable pricing environment.

### **OUR FUTURE PLANS**

Our aim is to build on our strengths to become a leading player in the privatisation process of the forest industry and a leading integrated forest resources company in the Asia

Pacific region. We are seeking opportunities to acquire other high quality forests in China. With the expansion in forest reserves, we believe our sales and profitability will increase. At the same time, we plan to further improve our business management and operations to cope with our rapid expansion, by recruiting experienced talent in the forestry industry, recruiting qualified university graduates specialised in forestry and forestry science, and engaging forestry consulting firms to work for us. Our Directors are of the view that the amount and timing of our capital expenditure plans in the near future will be highly dependant on the net proceeds from the Global Offering and cash flow generated from our operations.

Under the current PRC laws and regulations, the proceeds of the Global Offering may be used to fund our PRC business activities by means of (i) increasing the registered capital of our PRC subsidiaries; (ii) providing shareholder's loan to our PRC subsidiaries; and (iii) establishing new foreign invested companies in the PRC, provided that the above means comply with the relevant PRC laws and regulations. We may adopt any or all of the above means to fund our PRC business activities.

### **Seek rapid and sustainable growth through the acquisition and expansion of our forest reserves**

We have achieved rapid growth primarily through strategic acquisitions of forest resources at relatively low costs. Since 2003 we have acquired forests of approximately 171,786 hectares, which includes the Yunnan Luxi/Shuangjiang Forest we acquired in March 2008 and the Yunnan Wenshan Forest we acquired in July 2008. The Yunnan Luxi/Shuangjiang Forest consists of naturally regenerated and plantation forests and has an area of approximately 59,333 hectares and a forest stock volume of approximately 13.7 million m<sup>3</sup> based on an assessment as at 30 June 2009. Approximately 73.9% of this forest is at least twenty years old and immediately harvestable. The Yunnan forests have expanded our tree species to cover hardwood trees such as birch (*Betula alnoides*) and beech (*Fagus spp.*), which represent approximately 17.7% and 5.9% respectively of our total forest area and which logs are more expensive than softwood trees.

To expand our forest reserve, we further acquired the Yunnan Wenshan Forest in July 2008. This forest is plantation forests and has an area of approximately 100,000 hectares and a forest stock volume of approximately 19.6 million m<sup>3</sup> based on an assessment as at 30 June 2009. The present value of the total consideration for this acquisition was RMB551.6 million of which approximately RMB508.29 million has been paid as at the Latest Practicable Date and the unpaid balance plus interests accrued thereon amounted to approximately RMB103.4 million, of which RMB65.2 million will be settled with proceeds from the Second Share Purchase Agreement while the remaining RMB38.2 million will be settled with the Group's internal resources. Although the purchase price has not been fully settled, the forestry rights have already been transferred to us as a matter of PRC law, and we have already obtained the relevant forestry right certificates for this forest. Therefore we now own the forest trees and the usage rights of the forest trees and forest land, in respect of this forest. As at 30 June 2009, our forest area was 171,780 hectares, and our forest stock volume was around 35.5 million m<sup>3</sup> (based on an assessment as at 30 June 2009). This forest is planted with Chinese Fir, and is aged around 17-22 years and immediately harvestable. Its forest stock volume, as assessed as at 30 June 2009, is approximately 19.6 million m<sup>3</sup>.

On 16 July 2008 and 21 July 2008, we entered into non-binding memoranda with the governments of Ning Lang Xian and Liang He Xian, respectively, to confirm our interest in acquiring 200,000 hectares in Ning Lang Xian, Li Jian City, Yunnan, and approximately 66,667

hectares of forest in Liang He Xian, De Hong Zhou, Yunnan respectively. Pursuant to these memoranda, (1) the government of Ning Lang Xian will assist us to secure our possible acquisition of 200,000 hectares of forest in Ning Lang Xian, with transfer priority given to us; and (2) the government of Liang He Xian will assist us to secure our possible acquisition of approximately 66,667 hectares of forest in Liang He Xian, with transfer priority given to us. Our PRC legal advisers have advised that these memoranda are not legally enforceable.

In respect of Ning Lang Xian, Kunming Ultra Big has entered into a framework agreement with the people's government of Ning Lang Xian on 17 September 2009 which is legally binding to the extent the people's government of Ning Lang Xian as a contracting party will assist the Group to acquire 800,000 mu (approximately 53,000 hectares out of the 200,000 hectares of forests as prescribed in the non-binding memorandum) of forests at a price no more than RMB600 per mu from the relevant owners of such forest (which, as at the date of the framework agreement, the identities of such owner(s) have not been identified). There is no capital commitment in respect of the forest acquisition prescribed under this framework agreement during the period of this framework agreement (that is, 30 years from the date of this agreement), the people's government of Ning Lang Xian shall not approve other forestry companies to acquire forests in Ning Lang Xian. The Group will fund this acquisition by using the listing proceeds and expects to complete such acquisition by 30 June 2010. The Group shall employ local forest workers to form its harvesting teams which shall be responsible for management, plantation and harvesting of these forests. In carrying out its operations, Kunming Ultra Big shall observe and strictly adhere to national laws and regulations as well as policies issued by the people's government of the local county. In the event Kunming Ultra Big undergoes reorganisation, liquidation or where there is material adverse change to the financial position of Kunming Ultra Big, or it is sanctioned as a result of contravention of relevant national laws or regulations, Kunming Ultra Big shall report the same to the people's government of Ning Lang Xian and Kunming Ultra Big shall solely be responsible of such liabilities. Kunming Ultra Big shall also report to the people's government of Ning Lang Xian the status of its investment pursuant to such agreement. The consideration for such forests shall be paid by cash to relevant forest workers. The Group is also expected to construct a sapling cultivation centre. Based on the due diligence carried out by the Group, forestry teams of the Group collected some sample data. The forest type is natural forest and is approximately 53,000 hectares with an estimated stock volume of about 9,565,000 cubic metres. The tree type in this forest includes, amongst others, Yunnan pine, cold spruce, high pinus Montana, oak tree and larch. The aforesaid data is not part of any formalised valuation and represents the Group's findings on due diligence. Depending on the negotiations with the local forest workers, the Group expects to complete its acquisition of the 800,000 mu forest by 30 June 2010. As the Company has not decided on which particular forest to be acquired in Liang He Xian as at the Latest Practicable Date, no such information is available in respect of Liang He Xian at this stage. We are still in the process of obtaining and assessing details of the other forests referred to in the above mentioned memoranda and the final terms of our cooperation with these governments are not yet been concluded.

Our turnover increased from approximately RMB70.1 million in 2006 to approximately RMB160.3 million in 2007 and further increased to approximately RMB544.9 million in 2008. Our turnover for the six months ended 30 June 2009 was approximately RMB373.2 million. We have historically been able to achieve timely and relatively low cost expansion of our forest resources and business operations through strategic planning of our acquisitions and will continue to pursue a similar strategy in the near future. In order to become a leading upstream supplier of timber and logs to downstream users in China in the construction, furniture, interior

décor materials, wood products and paper industries, we will continue to invest in additional sustainable, high quality, immediately harvestable forests in our existing geographic locations.

In view of the relatively high quality of forests in Yunnan and Sichuan as compared to the rest of the forests in China, currently our primary forest acquisition targets are in these two provinces. However, we will also consider to acquire forests in other provinces of China if we can find high quality forests there and they meet our acquisition criteria.

### **Increase our harvesting rate**

We expect to increase our harvesting rate in the next three to five years while we continue to practise sustainable forestry management. We replant new trees when existing trees are logged at the rate of at least 110%. We also perform selective logging to reduce the impact to the environment. Therefore our forestry operation is sustainable, even if we do not make any further forest acquisitions. We expect to increase our harvesting rate in both Sichuan and Yunnan. Consistent with our policy of ensuring sustainability in our forest and minimal environmental impact, it is expected that our harvesting volume will increase by about 15-20% per year in our forests in both Sichuan and Yunnan Provinces over the next three to five years. It is our long term objective that our forests in Sichuan and Yunnan can achieve an average harvesting rate of approximately 8% to 9%.

We expect to maintain the harvesting rate in our Sichuan forest at around 8% to 9%. On the other hand, as soon as we complete the full integration of the newly acquired the Yunnan Luxi/Shuangjiang Forest into the Group, we intend to gradually increase the harvesting rate in such forest from approximately 2.5% in 2008 to approximately 4.4% in 2010. It is also expected that we will commence harvesting in the Yunnan Wenshan Forest which we acquired in July 2008 in 2011. Although the Yunnan Wenshan Forest was acquired in July 2008, the Company has been progressing its harvesting plan for the purpose of optimising the utilisation of the Yunnan Wenshan Forest in consultation with the local forestry bureaus across a number of counties responsible for the Yunnan Wenshan Forest. In light of the large size of the forest and the number of local forestry bureaus involved, the Company expects to complete its discussions with the local forestry bureau in respect of its harvesting plans by end of 2009 or early 2010. As such the Company will only apply (currently expected to apply in 2010) for 2011 logging permits to commence harvesting after such harvesting plan is finalised.

The Directors has confirmed that save for the time necessary to come to agreement with the forestry bureaus on its harvesting plans, it is not anticipated for there to be any material impediment in commencing its harvesting activities in the Yunnan Wenshan Forest. As the Group has not yet commenced harvesting activities in the Yunnan Wenshan Forest, there is no revenue generated pursuant to the harvesting and sales of logs from this forest. However, the fair value gain at the time of acquisition of the Yunnan Wenshan Forest and the relevant fair value changes over the Track Record Period after the acquisition of the Yunnan Wenshan Forest contributed to the Group's profits from the Track Record Period. Currently the Group expects to commence harvesting of the Yunnan Wenshan Forest in 2011.

We plan to increase our harvesting rate by expanding our sales team and network in Sichuan and Yunnan Provinces as well as strengthening our overall management and information management systems (please refer to the section headed "Business — Our Future Plans — Further strengthen our overall management and information systems" for details). It is our long term objective that our forests in Sichuan and Yunnan can achieve an average harvesting rate of approximately 8% to 9%.



### **Carry out research and development on sustainable forest management and quality tree seedlings**

To cope with the expansion of our business operations, we plan to carry out research and development on sustainable forest management, improvement of tree seedlings, breeding, growth monitoring and silvicultural operations. We have established a good relationship with professional bodies in forestry industry such as the CCPEF and Beijing Forestry University. We intend to cooperate with these professional bodies for our research and development. Beijing Forestry University, which was established by the Ministry of Education and the SFA in China, is one of the key institutions of higher education in China for conducting research and providing higher education in the studies of forestry and ecological environment.

On 2 April 2008, we entered into a cooperation memorandum with Beijing Forestry University regarding research and development and professional recruitment. According to the memorandum, we have agreed to recruit their qualified graduates to work for us, engage the university to provide forestry training for our staff, and provide internship opportunities to their qualified graduates. We and Beijing Forestry University also plan to jointly establish, by end of 2010 (i) a research centre, which will conduct research on the prediction and monitoring of the growth of trees planted in our forests, sustainable forestry management and other advanced forestry management technology and practices. The aggregate capital expenditure for the research centre of RMB3 million is expected to incur in the second half of 2010; and (ii) a seedling centre (which is different from saplings centres to be established by the Group in Sichuan and Yunnan) to nurture seedlings and conduct research on nurturing and improvement of seedlings, and other technology for speeding up tree growth. The aggregate capital expenditure of RMB12 million are expected to be incurred when such sapling centres are constructed in the second half of 2010. However, details of the above cooperation are yet to be finalised. Please refer to “Financial Information — Indebtedness — Contractual Obligations” for details.

We expect that research and development proposals will be prepared by our chief executive officer and submitted to our Board for approval. Our chief resources officer will be responsible for their implementation, and one of our joint chief financial officers will be responsible for monitoring the relevant expenditure. Regular reports on the progress of the research and development will be submitted to our Board for review.

We will continue to seek to improve the quality of our products through such research and development efforts. We believe that products of higher quality usually command higher prices in the market, and the development and production of higher quality products is important in maintaining our competitive advantage. By investing in research on faster growing trees, we can increase harvesting rates of mature trees and our timber production.

### **Further strengthen our overall management and information systems**

We plan to further improve our business management and operations to cope with our rapid expansion by engaging professionals with experience in and knowledge of the forestry industry and by adopting international management systems. We anticipate that we will make additional investment in personnel, management and technology in order to improve our management and information systems. We plan to establish a professional forestry management team by recruiting qualified graduates from Beijing Forestry University and other experienced professionals. We expect to spend approximately RMB0.6 million for professional recruitment during 2009. We also plan to engage forestry consulting firms to improve our management and operation of forests.

---

## BUSINESS

---

As we expand our forest base, we will seek to develop additional management systems to achieve greater planning and operational control of our forests. We will seek to develop a more robust data capturing and recording system to record log removals by location, changes in growing stock, forestry operations and forest health. This will allow us to conduct more frequent sampling checks of our timber resources, monitor the condition of the forest and provide an auditable record of activities undertaken, and would, in turn, allow us to analyse planting statistics, including growth conditions and forest quality more quickly.

As part of our effort to strengthen our information system, on 21 May 2008, we entered into a consulting agreement with a consulting company, which is an Independent Third Party, for the provision of information management system consulting services. Pursuant to this agreement, the consulting company has conducted, at a fee of RMB1 million, a full examination of our existing information management system and issued a proposal to us. It recommended that we establish an information management system which consists of (1) a fundamental information management system for centrally processing the information of different application systems; (2) a sales management system for managing the sales plans, sales orders and tracking the performance of sales contracts; (3) a logistics management system for managing inventory and distribution of products; and (4) a resources management system for managing the activities of logging and replanting. The consulting company also recommends us to install advanced information processing technology such as GIS and GPS in our information management system. In view of these recommendations, we have engaged Shanghai SVA Communication Co., Ltd. ("SVA"), an Independent Third Party and to our best knowledge, which is not connected with the above-mentioned consulting company, to implement the information management system.

SVA has provided us a proposal ("SVA Proposal") for implementation of information management. According to this proposal, we will implement the information management system in three phases: (1) preliminary phase with estimated cost of RMB 10 million to provide a basic setup and functioning of a platform for information management; (2) intermediate phase with estimated cost of RMB19.4 million to enhance the information management system; and (3) final phase with estimated cost of RMB14.4 million to provide a comprehensive information management system.

On 17 July 2008, we and SVA entered into agreements for the implementation of the preliminary phase of the SVA Proposal. SVA will install the following systems for us:

- (i) ORACLE ERP (Enterprise Resources Planning) system, which consists of various modules for management of general ledger, payable, receivable, fixed assets, cash, purchasing, inventory and order, and hence establishes a fundamental information management system, with a sales management system and a logistics management system as recommended; and
- (ii) a forestry resources management system, which uses satellite with technology such as GIS/GPS, for collection and transmission of data gathered from forests for managing the activities of logging and replanting as recommended. Such data can be classified into two types: (i) digital data, such as the records of inspection of forest prepared by our forest workers; and (ii) visual image, such as the video image of a specific location of our forest or its activities.

In addition, we have agreed to purchase from SVA related software and hardware including a satellite portable station which contains, among other things, a GPS receiver,

which cost approximately RMB2.8 million and RMB1.4 million respectively, payable as to 70% within 12 working days from the date of the relevant agreement and as to the remaining 30% within 12 working days from the receipt of the software and the installation of the hardware respectively. SVA will install the software and hardware for us and provide training to our staff on their use. In light of the large volume of data to be subject to such systems management and the internal reorganisation which SVA had been carrying out, the internal resources designated by SVA to our Group's project means that the implementation of these systems is expected to be completed by end of 2010.

In addition to the purchase price of the above software and hardware, we are required to pay SVA a sum of approximately RMB4.8 million for the implementation of ORACLE ERP system and a sum of approximately RMB1 million for the implementation of the forestry resources management system.

We paid and expect to pay the following amounts for the implementation of the preliminary phase of the SVA Proposal:

1. approximately RMB6.2 million already paid in the second half of 2008; and
2. approximately RMB3.8 million to be paid by end of 2009.

We expect to enter into agreements with SVA for implementing the intermediate and final phase of the SVA Proposal around end of 2009 and August 2010 respectively. As at the Latest Practicable Date, the Group has completed the general hardware implementation of the ORACLE ERP system, office automation system as well as the GPS system. As the software of such systems are still being fine tuned to meet the requirements of the Group, SVA is in the process of further improve such software systems. Once the implementation of the software system is completed, the Group will then move forward to the intermediate phase of implementation of the information systems. The Group has designated its assistant administrative officer to liaise with and supervise the implementation carried out by SVA so as to ensure that the information system could be timely completed by end of 2010. The administrative officer reports to the general manager of the Group on a weekly basis regarding progress of the implementation of the information systems, and the Directors will also closely monitor the status and progress of the implementation of such information systems.

The installation of the above systems will enable us to use satellite to monitor our forests and more timely and effectively manage our forestry operations. By using portable station to transmit the data with the satellite, we can monitor the forest environment and condition including the third parties activities, in real time. Upon completion of the implementation of the above systems, our information management system and our ability of surveillance of the conditions for third party activities and environmental problems of our forests, is expected to be significantly improved.

We will continue to invest in improving our information management system.

### **Continue practising responsible environmental forestry**

We believe that environmentally sound management practices will ensure the sustainable development of forest resources and provide greater predictability in plantation management. Our forestry management practices follow a set of internal environmental principles, which are aimed at the sound management of natural resources. We intend to follow these management

practices for additional forests to be acquired in the future. We will continue to implement and improve our environmental management, including but not limited to, where appropriate, following the international environmental best practice, to help improve the ecological and social environment of our forests. We are still looking for a suitable assessment company with the capacity or experience in performing the environmental impact assessment for forestry industry. When we have found it, we will complete our environmental impact report form in Yunnan and then implement the suggestions or measures contained in such report, where appropriate.

### OUR FORESTRY ASSETS

#### Overview

As at 30 June 2009, we owned forests covering a gross area of approximately 171,780 hectares of forests located mostly in Yunnan and Sichuan Provinces, which includes the Yunnan Luxi/Shuangjiang Forest we acquired in March 2008 and the Yunnan Wenshan Forest we acquired in July 2008. The Yunnan Luxi/Shuangjiang Forest consists of naturally regenerated and plantation forests and has an area of approximately 59,333 hectares. The consideration for acquiring this forest has been fully settled. The Yunnan Wenshan Forest is plantation forests and has an area of approximately 100,000 hectares. The total consideration for acquiring this forest is RMB551.6 million. As at the Latest Practicable Date, approximately RMB508.29 million has been paid for this acquisition and the unpaid balance plus interests accrued thereon amounted to approximately RMB103.4 million, of which RMB65.2 million will be settled with proceeds from the Second Share Purchase Agreement while the remaining RMB38.2 million will be settled with the Group's internal resources. Although the total purchase price of this forest has not been fully settled, its forestry rights have already been transferred to us as a matter of PRC law, and we have already obtained its relevant forestry right certificates. Therefore we now own the forest trees and the usage rights of the forest trees and forest land, in respect of both the Yunnan Luxi/Shuangjiang Forest and the Yunnan Wenshan Forest. As at the Latest Practicable Date, our forest stock volume was around 35.5 million m<sup>3</sup> in aggregate (based on an assessment as at 30 June 2009).

All our forests can be commercially logged in accordance with the relevant government rules. We have the necessary legal rights over our forests in the PRC and the relevant forestry right certificates to evidence our ownership of the trees, our rights to use the forest land and our rights to use the forest trees. As advised by our PRC legal advisers, our forest land use rights, forest trees use rights, and forest trees ownership rights are transferable as long as the transfer is conducted in accordance with PRC law (including the requirement that a forest land cannot be converted into a non-forest land). We currently have no intention to transfer its forestry rights as we expect China's demand for timber will continue and there is a good prospect for China's timber industry. Our PRC legal advisers further advised that our legal rights over our forests in the PRC are not subject to any mortgage or any third party rights.

## BUSINESS

The following table sets forth a summary of our owned forest resources as at 30 June 2009, by location and nature of forest.

<u>Location</u>	Area (hectares)		
	Plantation Forest	Naturally Regenerated Forest	Total
Sichuan Province .....	12,447	0	12,447
Yunnan Province .....	118,800	40,533	159,333
<b>Total</b> .....	<b>131,247</b>	<b>40,533</b>	<b>171,780</b>

The following table sets forth a summary of our owned forest resources as at the Latest Practicable Date, by year of forest establishment/formation and tree species.

<u>Year of forest establishment/formation</u>	Area (hectares)						
	Birch	Fir	Beech	Pine	Fir Cedar Birch Mix	Pine Alder Mix	Total
<b>Sichuan Forests</b>							
1983 .....					80	187	267
1984 .....		760			62	88	910
1985 .....		737					737
1986 .....		2,683					2,683
1987 .....		7,765			85		7,850
<b>Total</b> .....		<b>11,945</b>			<b>227</b>	<b>275</b>	<b>12,447</b>
<b>Yunnan Luxi/Shuangjiang Forest</b>							
1947-1966 .....				5,781			5,781
1967-1976 .....				1,586			1,586
1977-1988 .....				1,014			1,014
1989- .....				286			286
Up to 1982 .....	21,280	7,093	7,093				35,466
After 1982 .....	9,120	3,040	3,040				15,200
<b>Total</b> .....	<b>30,400</b>	<b>10,133</b>	<b>10,133</b>	<b>8,667</b>			<b>59,333</b>
<b>Yunnan Wenshan Forest</b>							
1986-1991 .....		100,000					100,000
<b>All Total</b> .....	<b>30,400</b>	<b>122,078</b>	<b>10,133</b>	<b>8,667</b>	<b>227</b>	<b>275</b>	<b>171,780</b>

All our forests were acquired directly from forest owners who are Independent Third Parties. The transferors were the villagers (individuals), the villages (rural collective economic organisations) or a company who owned the relevant (i) forest land or land use right; and (ii) the forest. During the Track Record Period, our forest acquisition (except the acquisition of the Yunnan Wenshan Forest) was entirely financed by our internal resources. In March 2008, we acquired the Yunnan Luxi/Shuangjiang Forest for a total consideration of approximately RMB385 million which has been fully settled.

In July 2008, we acquired the Yunnan Wenshan Forest for a present value total consideration of RMB551.6 million. As at the Latest Practicable Date, approximately RMB508.29 million has been paid for this acquisition and the unpaid balance plus interests accrued thereon amounted to approximately RMB103.4 million, of which RMB65.2 million will be settled with proceeds from the Second Share Purchase Agreement while the remaining RMB38.2 million will be settled with the Group's internal resources. On 1 September 2008, we entered into a non-binding credit facility agreement with Shenzhen Development Bank which

---

## BUSINESS

---

has agreed, in principle, to grant us a credit line of RMB1,000 million for 3 years until 1 September 2011, subject to conclusion of credit facilities agreement(s). Our PRC legal advisers have advised that this non-binding agreement is not legally enforceable. We will enter into binding credit facilities agreement(s) with the bank on specific terms when we apply for credit facilities but this would be subject to the bank's final agreement at that time.

The terms of these acquisitions were negotiated on an arm's length basis and the consideration for each of these acquisitions was determined with reference to the then prevailing price. As advised by our PRC legal advisers, the forest right transfer agreements entered by us for acquisition of our forests, are valid, binding and enforceable, and Kunming Ultra Big has legally obtained the forestry right certificates, and the rights thereof have been legally registered and will be protected by the PRC laws.

The table below shows the changes of our forest resources by area up to the Latest Practicable Date.

<u>Period</u>	<u>Area of forest acquired during the period (hectares)</u>	<u>Our total forest area at the end of the period (hectares)</u>
2003 .....	267	267
2004 .....	916	1,183
2005 .....	737	1,920
2006 .....	2,683	4,603
2007 .....	7,850	12,453
2008 .....	159,333	171,780 <sup>1</sup>
2009 (up to the Latest Practicable Date) ..	0	171,780

*Note 1: Approximately 6 hectares in Anhui province were sold to an Independent Third Party on 2 April 2008.*

As part of the Reorganisation, on 19 March 2008 and 17 April 2008, Kunming Ultra Big entered into a forestry right transfer agreement and a supplemental agreement respectively with Beijing Zhaolin. Pursuant to the said agreements, Beijing Zhaolin transferred all its forestry rights in Sichuan forests to Kunming Ultra Big for a consideration of RMB122,428,723 which was determined on arm's length negotiation and after having taken into account the valuation report issued by a PRC certified assets valuer in March 2008. The consideration was settled in May 2008. Prior to this transfer, Beijing Zhaolin had paid, in full, the consideration due from it in respect of the forests acquired.

## BUSINESS

The following table sets forth details of the forests we acquired before 31 December 2007.

Forest location	Area (hectares) <i>(Note 1)</i>	Forest stock volume (m <sup>3</sup> ) <i>(Note 2)</i>	Issue date of forestry right certificate <i>(Note 3)</i>	Expiry date of forestry right certificate	Term of forestry right certificate (years)	Date of acquisition agreement <i>(Note 4)</i>	Purchase price (RMB) <i>(Note 4)</i>
<b>Sichuan Forests</b>							
1 Xiao gou 6 zu, Gaoshan village, Maoping, E'bian,	80	9,501	25 March 2008	23 April 2016	8	July 2003	599,500
2 Watuo village, Bapu, Meigu,	187	32,077	25 March 2008	30 September 2036	28	August 2003	1,121,600
3 Watuo village, Bapu, Meigu,	88	11,537	25 March 2008	30 September 2036	28	May 2004	528,000
4 Yingxin village, Heping Yizu xiang, Jin He Kou district, Leshan,	17	3,965	24 March 2008	23 October 2021	13	July 2004	130,624
5 Liaogongwa zu, Qunli village, Yiping xiang, E'bian,	45	6,190	25 March 2008	1 September 2034	26	August 2004	354,640
6 Wannian village, Shizi xiang, Yingjing, Ya'an,	104	9,262	24 March 2008	30 December 2032	24	October 2004	795,600
7 Taiping village, Honghua xiang, E'bian,	145	15,453	25 March 2008	30 November 2036	28	December 2004	1,111,800
8 Dagang village, Jinhe zhen, Jinhekou district, Leshan,	511	70,886	24 March 2008	25 December 2036	28	December 2004	3,679,680
9 Jifeng village, Jinhe zhen, Jinhekou district, Leshan,	333	36,679	24 March 2008	9 July 2036	28	July 2005	2,400,000
10 Wannian village, Shizi xiang, Yingjing, Ya'an,	65	2,564	24 March 2008	30 August 2036	28	August 2005	509,600
11 Sale village, Bapu zhen, Meigu,	338	48,887	24 March 2008	27 November 2036	28	November 2005	4,008,460
12 Gaoshan village, Maoping zhen, E'bian,	150	21,385	25 March 2008	20 January 2036	28	January 2006	1,909,440
13 Wannian village, Longcanggou xiang, Yingjing, Ya'an,	143	17,530	24 March 2008	27 February 2036	28	February 2006	1,827,500
14 Taiping village, Honghua xiang, E'bian,	137	30,474	25 March 2008	27 February 2036	28	February 2006	1,742,500
15 Waluo village, Baiyang xiang, E'bian,	107	24,931	25 March 2008	27 March 2036	28	March 2006	1,370,200
16 Wannian village, Longcanggou xiang, Yingjing, Ya'an,	104	23,938	24 March 2008	30 April 2036	28	March 2006	1,326,000
17 Xiangbi village, Gong'an xiang, Jinkouhe,	100	22,815	24 March 2008	30 April 2036	28	April 2006	1,320,000
18 Meizikan village, Yanfeng xiang, Mabian,	69	16,248	24 March 2008	30 April 2036	28	April 2006	900,640
19 Qunli village, Yiping xiang, E'bian,	69	15,715	25 March 2008	27 May 2036	28	May 2006	897,870
20 Qunli village, Yiping xiang, E'bian,	833	133,947	25 March 2008	27 September 2036	28	September 2006	11,375,000
21 Jifeng village, Jinhe zhen, Jinhekou district, Leshan,	970	175,566	24 March 2008	29 October 2036	28	October 2006	13,240,500
22 Meizikan village, Yanfeng xiang, Mabian,	600	74,166	24 March 2008	29 January 2037	29	January 2007	8,550,000
23 Xiangbi village, Gong'an xiang, Jinkouhe,	779	115,613	24 March 2008	12 March 2037	29	March 2007	11,131,993
24 Wannian village, Longcanggou xiang, Yingjing, Ya'an,	2,333	437,850	24 March 2008	17 July 2037	29	July 2007	34,125,000
25 Yingxin village, Heping Yizu xiang, Jinhekou district, Leshan,	2,667	582,313	24 March 2008	22 August 2037	29	August 2007	39,200,000
26 Qunli village, Yipingxiang, E'bian,	1,386	227,304	25 March 2008	21 October 2037	29	October 2007	20,787,400
27 Heping village, Xinjian xiang, Yingjing.	85	3,825	24 March 2008	31 March 2072	64	October 2007	1,272,600
<b>Total</b>	<b>12,447</b>	<b>2,170,621</b>					<b>166,216,147</b>
<b>Anhui Forest</b>							
28 Daba zu, Youfang Village, Shahezhen <i>(Note 5)</i>	6	1,806	10 October 2006	11 July 2032	26	September 2004	48,400
<b>Total</b>	<b>6</b>	<b>1,806</b>					<b>48,400</b>
<b>All total</b>	<b>12,453</b>	<b>2,172,427</b>					<b>166,264,547</b>

## BUSINESS

Notes:

- (1) The areas of the individual forests in Sichuan have been rounded to integers, and therefore their sum is slightly different from the total figure of 12,447 as set out in the row of subtotal.
- (2) The forest stock volume was assessed as at 30 June 2009.
- (3) On 19 March 2008 and 17 April 2008, Kunming Ultra Big entered into a forestry right transfer agreement and a supplemental agreement respectively with Beijing Zhaolin, pursuant to which Beijing Zhaolin transferred all its forestry rights in Sichuan forests to Kunming Ultra Big. Consequently, new forestry right certificates were issued to Kunming Ultra Big on 24 and 25 March 2008. For the Anhui forest, it was disposed by Beijing Zhaolin directly to an Independent Third Party on 2 April 2008, and its forestry right certificate before the disposal was dated 10 October 2006.
- (4) These are the date of acquisition agreement and purchase price in respect of the acquisition of forests by Beijing Zhaolin from Independent Third Parties.
- (5) Due to the low quality of the wood contained in this forest and our strategy to focus our operations on Yunnan and Sichuan forests, on 2 April 2008, we sold this forest in Anhui to an Independent Third Party.

The following table sets forth details of the Yunnan Luxi/Shuangjiang Forest we acquired in the first half of 2008.

	Forest location	Area (hectares)	Forest stock volume (m <sup>3</sup> ) (Note 6)	Issue date of forestry right certificate	Expiry date of forestry right certificate	Term of forestry right certificate (years)	Date of acquisition agreement	Contractual purchase price (RMB)
<b>Yunnan Forests</b>								
<b>Shuangjiang, Lin Cang City</b>								
1	Mangan Shuangjiang county	8,667	1,607,240	21 March 2008	12 April 2038	30	March 2008	52,000,000
<b>Luxi, De Hong Zhou</b>								
2	Mangxuan village, Mengyang xiang, Luxi county	13,333	3,116,218	27 March 2008	11 April 2038	30	March 2008	86,000,000
3	Gongling village, Zhefang xiang, Luxi County	101	27,168	26 March 2008	13 March 2038	30	March 2008	699,752
4	Bangdian village, Santaishan xiang, Luxi county	6,000	1,433,190	25 March 2008	16 March 2038	30	March 2008	39,600,000
5	Pingliangzi village, Fengping zhen, Luxi county	6,000	1,452,171	25 March 2008	17 March 2038	30	March 2008	39,600,000
6	Wandan village, Wuchalu xiang, Luxi County	6,000	1,459,378	25 March 2008	18 March 2038	30	March 2008	40,500,000
7	Dazhupo village, Zhongshan xiang, Luxi County	9,504	2,272,323	28 March 2008	20 March 2038	30	March 2008	61,299,768
8	Dazhupo village, Zhongshan xiang, Luxi County	1,840	445,216	18 March 2008	9 April 2038	30	March 2008	11,868,000
9	Gongling village, Zhefang xiang, Luxi County	585	146,214	24 March 2008	10 March 2038	30	March 2008	3,860,824
10	Wandan village, Wuchalu xiang, Luxi county	1,247	314,085	21 March 2008	13 March 2038	30	March 2008	8,415,000
11	Gongling village, Zhefang xiang, Luxi County	56	15,313	24 March 2008	10 March 2038	30	March 2008	389,436
12	Gongling village, Zhefang xiang, Luxi County	6,000	1,452,910	28 March 2008	19 March 2038	30	March 2008	40,500,000
	<b>Total</b>	<b>59,333</b>	<b>13,741,426</b>					<b>384,732,780</b>

Note (6): The forest stock volume was assessed as at 30 June 2009.



## BUSINESS

The following table sets forth details of the Yunnan Wenshan Forest we acquired in the second half of 2008.

	<b>Forest location</b>	<b>Area (hectares)</b>	<b>Forest stock volume (m<sup>3</sup>) (Note 7)</b>	<b>Issue date of forestry right certificate</b>	<b>Expiry date of forestry right certificate</b>	<b>Term of forestry right certificate (years)</b>	<b>Date of acquisition agreement</b>	<b>Contractual purchase price (RMB)</b>
<b>Yunnan Forests</b>								
1	Ma Guan	34,667	6,949,399	30 July 2008	22 July 2038	30	July 2008	208,000,000
2	Ma Li Po	23,333	3,919,944	30 July 2008	22 July 2038	30	July 2008	147,000,000
3	Xi Chou	16,667	3,683,407	31 July 2008	23 July 2038	30	July 2008	102,500,000
4	Fu Ning	14,667	3,388,077	1 August 2008	24 July 2038	30	July 2008	90,200,000
5	Yan Shan	10,667	1,685,386	31 July 2008	23 July 2038	30	July 2008	64,000,000
	<b>Total</b>	<b>100,000</b>	<b>19,626,213</b>					<b>611,700,000</b>

Note (7): The forest stock volume was assessed as at 30 June 2009.

The following table sets forth details of the movement of forest stock volume by forest:

### Sichuan

m <sup>3</sup>	Year ended 31 December			Six months ended 30 June
	2006	2007	2008	2009
Beginning	478,585	1,151,390	3,373,962	2,212,267
Acquisition	724,785	2,334,331	—	—
Harvested	(75,909)	(169,329)	(179,728)	(116,000)
Growth	23,929	57,570	169,033	74,534
Revision in yield	—	—	(1,151,000)*	—
Ending	<u>1,151,390</u>	<u>3,373,962</u>	<u>2,212,267</u>	<u>2,170,801</u>

\* Yield estimate has been reduced from 3,907,000 m<sup>3</sup> to 2,756,000 m<sup>3</sup>.

### Yunnan Luxi

m <sup>3</sup>	Year ended 31 December	Six months ended 30 June
	2008	2009
Beginning	—	13,815,025
Acquisition	17,691,822	—
Harvested	(340,200)	(240,730)
Growth	334,403	167,131
Revision in yield	(3,871,000)*	—
Ending	<u>13,815,025</u>	<u>13,741,426</u>

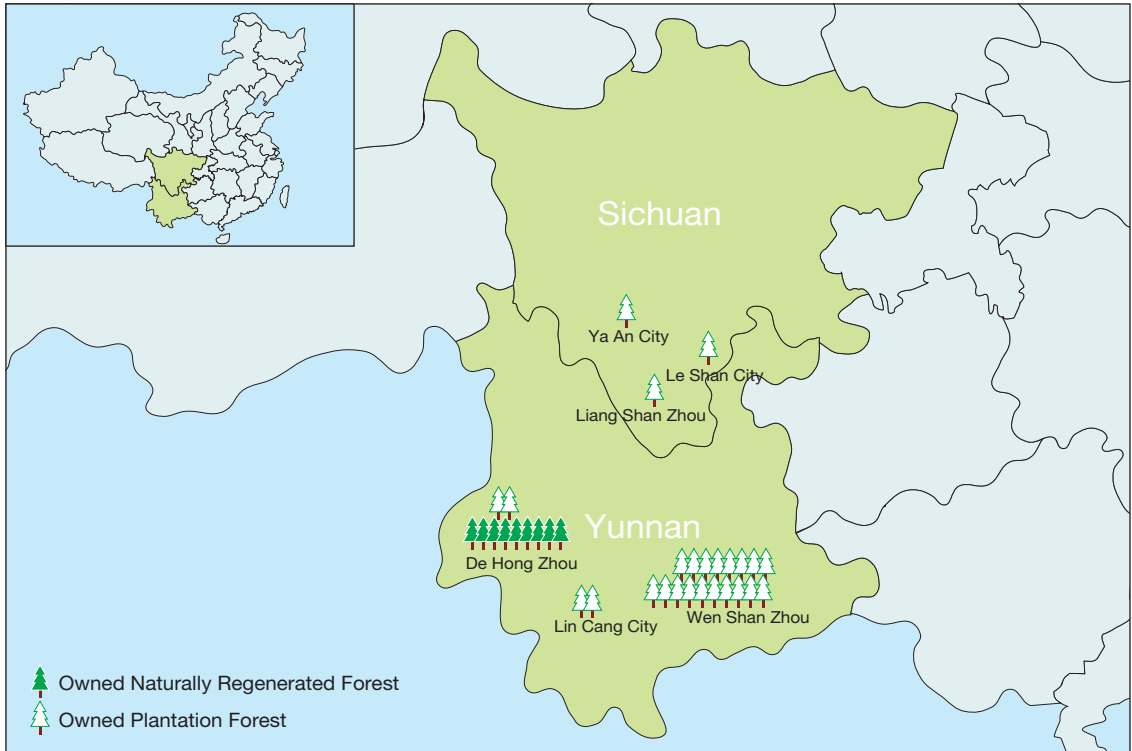
\* Yield estimate has been reduced from 16,945,000 m<sup>3</sup> to 13,074,000 m<sup>3</sup>.

### Yunnan Wenshan

m <sup>3</sup>	Year ended 31 December	Six months ended 30 June
	2008	2009
Beginning	—	19,476,211
Acquisition	19,176,208	—
Harvested	—	—
Growth	300,003	150,002
Ending	<u>19,476,211</u>	<u>19,626,213</u>

### Location of our forestry resources

The following map illustrates the locations of our forests. Currently all of our forests are located in Yunnan Province (in Lin Cang City, De Hong Zhou and Wen Shan Zhou) and Sichuan Province (in Ya An City, Le Shan City and Liang Shan Zhou).



### Forests in Sichuan Province

Our forests in Sichuan Province are all plantation forests. As at the Latest Practicable Date, they covered a gross area of approximately 12,447 hectares. Approximately 96% of such area is planted with Chinese fir (*Cunninghamia lanceolata*), and the remaining area is covered with a mixture of species including cedar (*Cryptomeria japonica*), Yunnan pine (*Pinus yunnanensis*), birch (*Betula spp.*) and alder (*Alnus glutinosa*). Chinese fir is a softwood tree and their logs are commercially and widely used for making wood panels, plywood, furniture and pulp.

Our Sichuan forests are situated in 3 main centres — Ya An City, Le Shan City and Liang Shan Zhou, and located on steep terrain. According to CFK, the average slope of the forests is estimated to be about 40 degrees. The altitude ranges from about 800 m above sea level to about 3000 m above sea level for the forests in the more mountainous regions. Such altitude range is within the range considered to be suitable for growing Chinese fir, but growth rates are likely to be lower at the higher elevations above 1200 m.

## BUSINESS

The following table sets forth the distribution of our Sichuan forest by age class and tree species.

Age class (years) as at 31 December 2008	Fir	Fir Cedar Birch Mix	Pine Alder Mix	Area (hectares)
25 .....	—	80	187	267
24 .....	760	62	88	910
23 .....	737	—	—	737
22 .....	2,683	—	—	2,683
21 .....	7,765	85	—	7,850
<b>Total</b> .....	<b><u>11,945</u></b>	<b><u>227</u></b>	<b><u>275</u></b>	<b><u>12,447</u></b>

All our forests in Sichuan are at least 20 years old and were already immediately harvestable when they were acquired by us. As at 30 June 2009, our Sichuan forests possessed an aggregate forest stock volume of approximately 2.2 million m<sup>3</sup>, and as at 31 December 2008, were valued at RMB1,067 million by CFK, our independent forestry valuer, in compliance with IAS 41.

### Forests in Yunnan Province

Currently our forests in Yunnan Province are situated in 3 main centres — Shuangjiang of Lin Cang City, Luxi of De Hong Zhou and Wen Shan Zhou. The forest in Shuangjiang and Wen Shan Zhou consists entirely of plantation forests, and the forest in Luxi consists of approximately 80% naturally regenerated forest and approximately 20% plantation forests by area. As at the Latest Practicable Date, our Yunnan forests covered a gross area of approximately 159,333 hectares. Based on an assessment as at 30 June 2009, our Yunnan Luxi/Shuangjiang Forest and Yunnan Wenshan Forest possessed a forest stock volume of approximately 13.7 million m<sup>3</sup> and 19.6 million m<sup>3</sup> respectively. According to the valuation by CFK, our independent forestry valuer, in compliance with IAS 41, our Yunnan Luxi/Shuangjiang Forest and Yunnan Wenshan Forest were valued at RMB4,466 million and RMB2,114 million respectively, as at 31 December 2008. Over 90% of the trees in our forests in Yunnan Province are around 18-60 years old and immediately harvestable.

The main species of trees in our Yunnan forests is Chinese Fir (*Cunninghamia lanceolata*), occupying approximately 69.1% of the area. Birch (*Betula alnoides*), beech (*Fagus spp.*), and Yunnan Pine (*Pinus yunnanensis*) make up the balance which represent approximately 19.1%, 6.4% and 5.4% of the area respectively. Both Chinese Fir and Yunnan Pine are softwood trees. Their logs are commercially and widely used for making wood panels, plywood, furniture and pulp. Our other tree species, birch and beech, are hardwood trees. Since they generally have better wood properties than softwood trees, they are generally more expensive than the softwood trees. Logs from birch and beech trees are used to produce a variety of solid wood products such as wood panels, furniture, flooring and construction materials.

Our Yunnan forests are located on moderately steep terrain. According to CFK, the altitude ranges from about 50 m above sea level to about 2000 m above sea level for the forests in the more mountainous regions. Such altitude range is within the range considered to be suitable for growing birch, beech, Chinese Fir and Yunnan Pine which are present in our Yunnan forests, but their growth rates are likely to be lower at higher elevations of above 1200 m.

## BUSINESS

The following table sets forth the distribution of tree species and age class of our owned Yunnan forests.

<u>Location</u>	<u>Species</u>	<u>Age class (years) as at 31 December 2008</u>	<u>Area (hectares)</u>
<b>Yunnan Luxi/ Shuangjiang Forest</b>			
Shuangjiang, Lin Cang City .....	Yunnan Pine	42-61	5,781
		32-41	1,586
		20-31	1,014
		0-22	286
<b>Sub-total .....</b>			<b>8,667</b>
Luxi, De Hong Zhou ...	Birch	26	21,280
		0-26	9,120
	Beech	26	7,093
		0-26	3,040
	Chinese Fir	26	7,093
		0-26	3,040
<b>Sub-total .....</b>			<b>50,666</b>
<b>Total .....</b>			<b>59,333</b>
<b>Yunnan Wenshan Forest</b>			
Wen Shan Zhou .....	Chinese Fir	17-22	100,000
<b>Total .....</b>			<b>100,000</b>

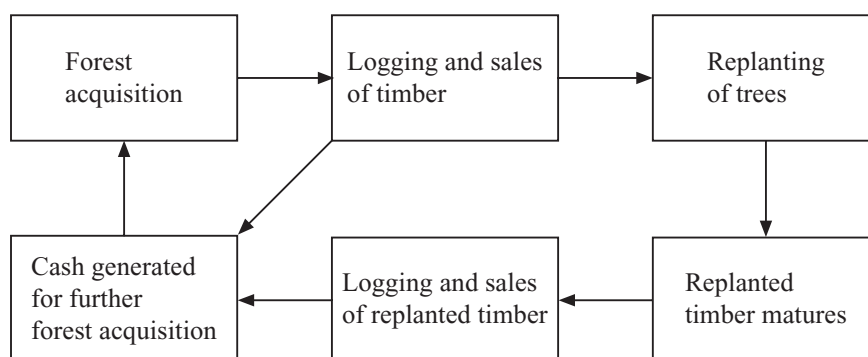
### Forest in Anhui Province

During the Track Record Period, we owned a small plantation forest in Anhui Province, which occupied approximately 6 hectares, but no logging had been performed in and no contribution of sales and revenue were derived from this forest. Due to the low quality of the wood contained in such forest and our current strategy to focus our operations on forests in Yunnan and Sichuan and other productive forests which we may acquire in future, on 2 April 2008, we disposed of this forest to an Independent Third Party at a consideration of RMB74,800 which was negotiated at arm's length and determined with reference to the local prevailing price. The disposal would represent a gain of approximately RMB26,400, being the difference between the acquisition cost we paid in September 2004 and the consideration we received on the disposal in April 2008.

### OUR SUSTAINABLE FORESTRY MANAGEMENT

We are a socially responsible and environmentally friendly company. We are committed to the sustainable development of forest resources. The cash generated from our operations are used for acquisition of forest resources which after being harvested are regenerated by our plantation of new trees.

The diagram below sets forth the flow of our sustainable development of forest resources:



### **Forest acquisition**

All our forests were acquired directly from forest owners who are Independent Third Parties. The transferors were the villagers (individuals), the villages (rural collective economic organisations) or a company who owned the relevant (i) forest land or land use right; and (ii) the forest. Before entering into forest land/trees transfer agreements, our dedicated forest team will be primarily responsible for the initial assessment of potential forests for our acquisition. They will visit and inspect the target forest and measure, record or calculate the number of trees, the forest stock volume, the stem length, the stem height, tree species, tree age, altitude, location, area, nature of forest, tree spacing, etc. If the forest verification report prepared by our dedicated forest team after such visit and the small parcel survey report (or, if not available, the sampling survey report) obtained from the relevant local forestry bureau which contains details of forest prepared by the government are substantially consistent, we will engage an independent forestry valuer to issue a valuation report for that forest. Otherwise, our dedicated forest team will revisit the forest and verify the forest data again. Our management will then assess the conclusions of all these reports. If all of them are substantially consistent and that forest has met our acquisition criteria, we will negotiate in with the intended transferor on the final terms and conditions in order to enter into a definitive forest land/trees transfer agreement.

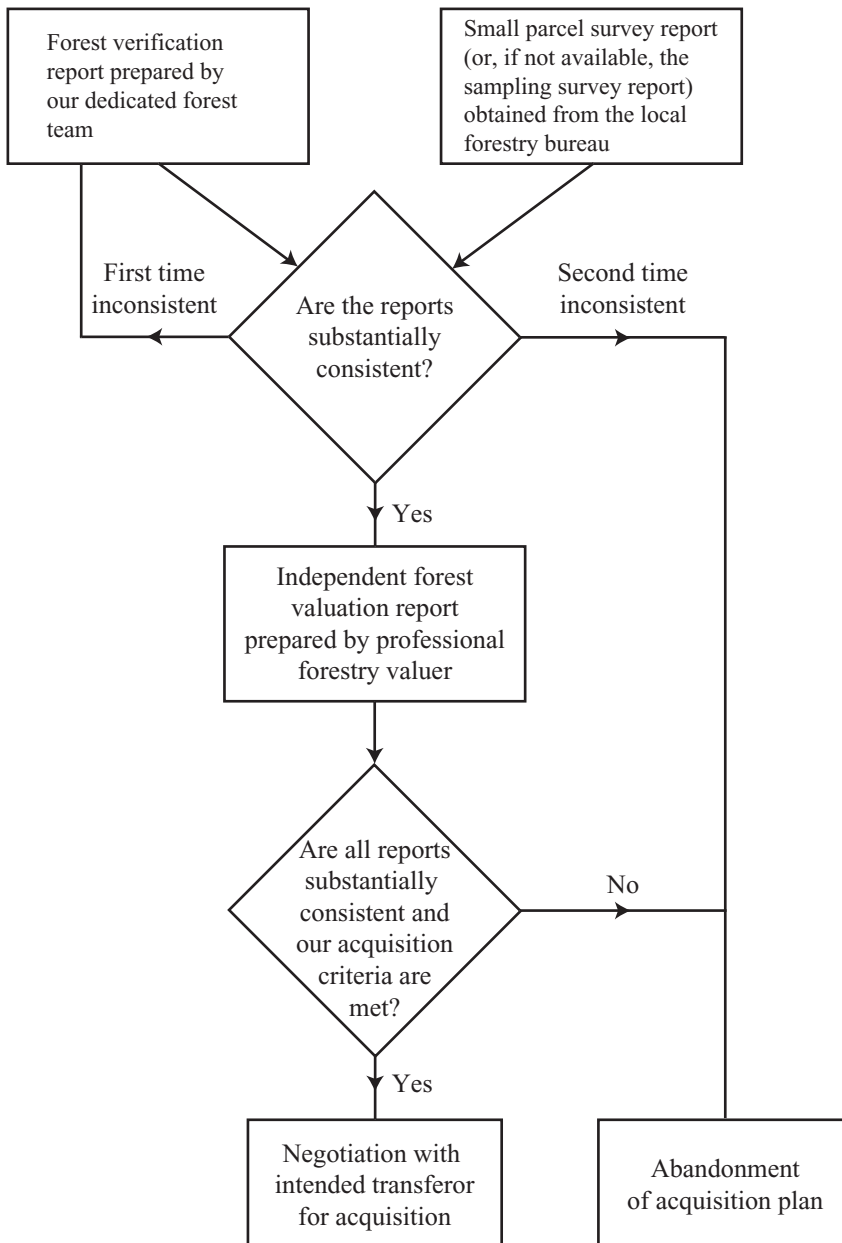
Our acquisition criteria include the following:

- (1) there must not be less than 110 trees per mu (that is, 1,650 trees per hectare);
- (2) the trees must have an average diameter of not less than 14 cm (measured 1.3 m above ground level);
- (3) the forest stock volume based upon the government survey must be not less than 225 m<sup>3</sup> per hectare;
- (4) the forestry right ownership must be clear; and
- (5) the forest must be easily accessible.

For each of our Sichuan forests, PRC forestry valuers were engaged to issue a valuation report before each forest acquisition. The relevant engagement agreements set out, among other things, the scope of valuation, the time the valuation report is required to be issued, the date of valuation and the amount of service fee which is due on delivery of the valuation

report. The PRC forestry valuers inspected the forest and prepared their valuation report according to PRC valuation principles. For our Yunnan Luxi/Shuangjiang Forest and Yunnan Wenshan Forest, we had engaged CFK to issue valuation reports. The relevant engagement agreement sets out, among other things, the scope of valuation, the time the valuation report is required to be issued and the amount of service fee. CFK inspected our forests in Sichuan and Yunnan on various occasions in 2008 and in March and August 2009 and prepared the valuation reports in compliance with IAS 41. Apart from the valuation reports for our forests in Sichuan and Yunnan, we also engaged CFK to issue an independent technical report on our forestry operations which is set out in Appendix V to this prospectus. The estimated total fee payable to CFK in relation to these engagements is US\$673,000. The terms of all the aforesaid engagement agreements were negotiated on an arm's length basis.

The diagram below sets forth the flow of our process of acquisition of forests.



As the plantation forests had been planted by villagers in response to a governmental afforestation initiative, and were essentially left untended until purchased by us, we normally do not have to conduct further silviculture until felling except that the seedlings will require weed control in the first year. Furthermore, we have established a set of rules to ensure that the trees are protected from pests and disease. For more details, please refer to the section “Business — Our Sustainable Forestry Management — Forestry Management” below.

### *Acquisition of Sichuan forests*

Between 2003 and 2007, we acquired a total area of approximately 12,447 hectares of forests in Sichuan, all of which are plantation forests. For each acquisition of plantation forests in Sichuan province, we have entered into a forest land/trees transfer agreement with the relevant owner of the plantation forest who agreed to transfer the plantation forest to us and we would have the right to receive benefits from, to deal with, and to operate and manage the relevant plantation forest after such transfer. Under such agreement, the transferor represented and warranted that there must be not less than 110 trees per mu (that is, 1,650 trees per hectare), the trees must have an average diameter of not less than 14 cm (measured 1.3 m above ground level) and the forest stock volume must be not less than 225 m<sup>3</sup> / hectare. Such warranty was intended to provide protection to us regarding the quality of the forest. As confirmed by our PRC legal advisers, these forest land/trees transfer agreements are valid, regardless whether the aforesaid warranty is breached or not. If we were satisfied with our due diligence on the conditions and the quality of the forest, we would complete the acquisition in accordance with the agreement. As at the Latest Practicable Date, we were not aware of any breach of such warranty by the transferors, and hence, did not make any relevant claim for compensation. In the event that breach of the warranty was found, the legal consequences for the breach will be determined under the PRC Contract Law.

All of our forests in Sichuan have been duly registered and have the relevant forestry right certificates. Our forestry right certificates for these forests have an average term of not less than 20 years. Approximately 99% of the area of our Sichuan forests have the expiry date of forestry right certificates falling in or after 2036. For more details of the term of our forestry right certificates, please refer to the section headed “Business — Our Forestry Assets — Overview”.

For each of our forests in Sichuan, we own the forest trees, the rights to use the forest land and the rights to use the trees. Our rights are evidenced in the relevant forestry right certificates and are protected under the PRC Forestry Law. Pursuant to the PRC Forestry Law, all forest lands belong to either the State or the collectives. However, the trees, the rights to use the trees, and the rights to use the forest lands can be owned by individual entities. Our PRC legal advisers have confirmed that we have the right to sell the trees for these forests, apart from our right to use the forest land and our right to use the trees.

For the two financial years ended 31 December 2006 and 2007, we acquired plantation forests of approximately 2,683 hectares and 7,850 hectares respectively, all of which are located in Sichuan, and the amount paid for the acquisition was approximately RMB35,909,650 and RMB115,066,993 respectively. Since 1 January 2008, we have not acquired any forest in Sichuan.

### *Acquisition of Yunnan forests*

In March 2008, we acquired the Yunnan Luxi/Shuangjiang Forest and this was our first forest acquisition in Yunnan. This forest has a total area of approximately 59,333 hectares, of

which, approximately 8,667 hectares are located in Shuangjiang, Lin Cang City and the remaining approximately 50,666 hectares are in Luxi, De Hong Zhou.

In respect of the forests of approximately 8,667 hectares in Shuangjiang, Lin Cang City, we entered into a pre-purchase agreement on 12 December 2007 with an Independent Third Party to secure our exclusive right in acquiring these forests from it. Pursuant to this pre-purchase agreement, we paid RMB5 million as deposit to the intended seller, in return for its agreement not to transfer these forests to any other person. On 13 March, 8 April and 20 April 2008, we entered into a formal forest land / trees transfer agreement and supplemental agreements respectively with the same party. Pursuant to these agreements, we agreed to purchase these forests at a total consideration of RMB49 million. The amount of RMB5.1 million we paid earlier was treated as our first instalment payment for the total purchase price. The second instalment of approximately RMB10 million was settled in March 2008, and the remaining balance of approximately RMB33.9 million was settled in March 2009. On 21 March 2008, we obtained the forestry right certificate in our own name for these forests.

In respect of the forests of approximately 50,666 hectares in Luxi, De Hong Zhou, we entered into formal forest land / trees transfer agreements and supplemental agreements with Independent Third Parties for acquiring these forests. The total purchase price for these forests was RMB313,537,511. Pursuant to these transfer agreements, we paid the first instalment of approximately RMB32.7 million, equivalent to 10.4% of the total purchase price, in June 2008. The second instalment of RMB64.2 million, equivalent to approximately 20.5% of the total purchase price, was paid during the third quarter of 2008, and the remaining balance of RMB216.7 million, equivalent to approximately 69.1% of the total purchase price, was paid by March 2009. In March 2008, we obtained all the relevant forestry right certificates in our own name for these forests. For details of the issue dates of these forestry right certificates, please refer to the section headed “Business — Our Forestry Assets — Overview” in this prospectus.

On 23, 24 and 25 July 2008, we entered into forest land / trees transfer agreements with Independent Third Parties to acquire the Yunnan Wenshan Forest, which is located in Wen Shan Zhou, Yunnan and has an area of approximately 100,000 hectares. We have completed due diligence on the conditions and quality of these forests through our dedicated forest team, and will engage a professional party to verify our due diligence results. The total purchase price is RMB551.6 million. Pursuant to these transfer agreements, we paid the first instalment of 11% of the total purchase price within one month from the date of the agreements. The second instalment of 30.8% of the total purchase price was paid within six months after our dedicated forest team completed their due diligence. The balance of 58.2% of the total purchase price, that is RMB321.05 million, will be payable within six months after that professional party completed its verification of our due diligence results. On 30 and 31 July and 1 August 2008, we obtained all the relevant forestry right certificates in our name for this forest. As at the Latest Practicable Date, unpaid consideration of Yunnan Wenshan forest amounted to approximately RMB103.41 million, of which RMB65.2 million will be settled with proceeds from the second Share Purchase Agreement while the remaining RMB38.2 million will be settled with the Group’s internal resources.

In each of the above forest land / trees transfer agreements, the transferor agreed to transfer the forest to us and we would have the right to receive benefits from, to deal with, and to operate and manage the relevant forest after such transfer. Under such agreement, the transferor represented and warranted that there must be not less than 110 trees per mu (that



is, 1,650 trees per hectare) and the trees must have an average diameter of not less than 14 cm (measured 1.3 m above ground level) and the forest stock must be not less than 225 m<sup>3</sup> / hectare. Such warranties were intended to provide protection to us regarding the quality of the forest. Our PRC legal advisers advised that the warranties under these forest land/trees transfer agreement will not expire until these agreements expire or are terminated. Our PRC legal advisers further confirmed that these forest land/trees transfer agreements are valid, regardless any of whether the aforesaid warranties is breached or not. If we are satisfied with our due diligence on the conditions and quality of the forest, we will complete the acquisition in accordance with the agreements. As at the Latest Practicable Date, we did not find any breach of such warranty by the transferors, and hence, did not make any relevant claim for compensation. In the event there is any breach of the warranty, the legal consequences for the breach will be determined under the PRC Contract Law. However, unless otherwise prescribed by law, the civil claims to a people's court are generally subject to the 2 years of limitation period for instigating an action under PRC law.

The terms of all the above-mentioned agreements were determined after arm's length negotiations.

For all our Yunnan forests, we have obtained the relevant forestry right certificates and own the trees, the rights to use the forest land and the rights to use the trees. Although the purchase price of the Yunnan Wenshan Forest has not yet been paid in full, we currently are the registered owner of the forest rights to this forest and may use its resources as needed. Our rights in both the Yunnan Luxi/Shuangjiang Forest and the Wenshan Forest will expire in 2038. For details of the term of our forestry right certificates, please refer to the section headed "Business — Our Forestry Assets — Overview" to this prospectus.

Being one of the first privately-owned enterprises to take advantage of the PRC government's No. 9 Policy in 2003 which set out the directive for the private sector to participate in China's forestry development, the Group has developed extensive local forestry and management expertise in the Chinese market. The Directors are of the view that although the Group had no previous experience in operating forests in Yunnan Province prior to the acquisition of these forests, the senior management of the Group possesses sufficient experience and knowledge in managing forests in China, including in Yunnan. As set out in the paragraphs under the section headed "Business - Our Future Plans - Further strengthen our overall management and information system" of this prospectus, we intend to further improve our business management and operations to cope with our rapid expansion, by recruiting experienced talent in the forestry industry, engaging forestry consulting firms as well as recruiting qualified graduates from Beijing Forestry University to work for us. Therefore, we do not believe that the acquisition of the Yunnan forests will have any material adverse effect on the management resources or financial resources of the Group. As at 31 August 2009, our confirmed but unperformed sales order of Yunnan logs for the year 2009 amounted to not less than approximately 191,440 m<sup>3</sup>. The Directors are of the view that the acquisition of the Yunnan forests will have a positive effect on the financials results of our Group.

After acquiring the forests from the villages/villagers, we have offered such villagers the opportunity to work for us as forest workers on daily forestry maintenance work.

### Forestry management

Our management formulates our environmental protection policies and measures and oversees their implementation, and our dedicated forest team and resources management department implement such measures. Our dedicated forest team is separate from our resources management department which manages our forest workers. The reports of tree growth and changes in tree conditions prepared by our forest workers are subject to verification and approval by our dedicated forest team. Each dedicated forest team member is responsible for verifying the reports prepared by, on average, 6 to 8 forestry workers.

We have established a resources management department which is principally responsible for the maintenance and monitoring of our forests and the management and supervision of our forest workers. We also have a dedicated forest team which regularly visits our forests to monitor our forest workers and the conditions of our forests. Our forest workers who are stationed in our forests also regularly inspect our forests and report to our resources management department to ensure continuing compliance with forestry regulations. We also provide regular training to our forest workers on forest conservation and compliance with forestry regulations. As at 30 June 2009, there were 46 people in our forest management team and we had 317 forest workers. As at 30 June 2009, approximately 20% of our dedicated forest team members had received formal school education in forestry, all of them have received forestry training provided by us and approximately 57% have been engaged in the forestry business for over 5 years.

To record and monitor the health and growth of our trees, we have established a recording system. Each day, our forest workers inspect the forest of which they are responsible for taking care. They will check the conditions of tree growth, logging and replanting. They will also examine whether there is any disease, pest or fire danger in the forests. After inspection of the forest, they will record the results. Every quarter, they are required to submit a report of tree growth and a report of changes in condition of the trees to our resources management department, setting out details of our trees and forests, such as location, area, species, stem diameter, tree spacing, growth condition, number of trees per mu, tree height, forest stock volume per mu, number of trees logged, number of trees replanted, number of trees survived after replanting and any finding of fire, pest and illegal logging. We have provided training to our forest workers, including teaching them what information needs to be collected, the method of collecting such data and how to fill up the forms of report, on a regular basis. Accordingly regardless of their education levels, our forest workers are sufficiently competent to complete the forms of report. The reports prepared by our forest workers are subject to the verification and approval by our dedicated forest team, which will also inspect the forests quarterly, or monthly if necessary. Each dedicated forest team member is responsible for verifying the reports prepared by, on average, 8 forestry workers.

We use a stratified random sampling method for calculation of our forest resources. Under a stratified random sampling, a population of trees will be divided into different strata and the population in each stratum consists of homogeneous trees in terms of species and age, but each stratum contains trees which are significantly different in terms of tree species and age from the other stratum. Then, samples from each stratum will be taken to obtain a representative sampling. Although our forests are located in different places, a forest can be divided into a certain number of forest zones or strata with trees which are different in planting time and/or species. When a batch of trees in a forest zone or stratum has the same planting

time and species, the quality of the trees in that forest zone can be regarded as very similar, and therefore trees in that forest zone can be regarded as homogenous and form a stratum. When we conduct sampling, we will collect samples from different forest zones, or strata so that a representative sample of our forest can be obtained.

Our forest is generally divided into 5 to 15 forest zones, depending on the area of such forest. The larger the area of the forest, the more zones such forest is divided into. Each quarter, our forest workers will generally take 20 to 50 tree samples from each forest zone with an average sample size of 400 trees in each piece of forest, and submit a report to our resources management department. For forests with large area, a sample size of over 2,000 trees will be collected by our forest workers. Thus, for the quarterly reports prepared by our forest workers in the first quarter of 2008, approximately 10,000 tree samples from approximately 1,400 mu (equivalent to 93.3 hectares) were taken from our 28 pieces of forest in Sichuan. The number of trees per hectare depends on the individual area but on average, there are approximately 110 trees per mu (that is, 1,650 trees per hectare).

At the end of each year, we also engage an independent forestry valuer to conduct valuation for all our forests.

The PRC forestry valuers employed by us during the Track Record Period were Yunnan Hua Yi Assets Valuation Co., Ltd. (雲南華益資產評估有限公司), Yunnan Hua Yi Jing Cheng Assets Valuation Co., Ltd. (雲南華益精誠資產評估有限公司) and Beijing Asia Accounting Firm Co., Ltd. (北京亞洲會計事務所有限公司). All of them are certified PRC assets valuer and provide service of assets valuation. We understand that each of them has experience in forestry assets valuation of about 6 years, 3 years and 6 years respectively.

Our recording and reporting system for monitoring our forests and operations involves verification by our dedicated forest team and cross-checking against the independent valuation report issued at the end of each year. We have never found any major discrepancies between our records of forestry assets and those of the independent valuation reports, and hence, our Directors consider that our recording and reporting system is adequate.

We recognise the importance of sustainable forest management practices to ensure the long-term supply of our forest resources. We have implemented and will continue to implement various practices that embrace and adopt sustainable forest management.

To minimise the environmental impact on our forests, we assess the forest and select trees for logging according to the growth condition of the trees. For example, we only harvest those trees which have met our harvesting standards, which are trees:

- having a stem diameter greater than 20 cm;
- having a stem length not less than 15 m; and
- aged at least 20 years.

The yield from the forests depends on a variety of factors, including:

- the quality of planting seedlings;

- the soil and climate conditions;
- the topography of the land;
- the planting density and spacing between trees; and
- the quality of the management of the forest.

Our overall management objective is to manage our forests on a sustainable basis, which means that the volume of timber harvested over time will not generally exceed the volume of wood growth over the same period. We believe this will maintain and enhance the long-term health of our forests, which in turn should help ensure sustainable harvests.

We also arrange our logistics operations in such a way to minimise the environmental impact. Currently our forests are generally close to roads or routes leading to the main roads. Thus we do not need to construct new roads connecting our forests to the main roads. Furthermore, we do not require heavy machines to transport our timber downhill. Instead, we make use of the natural landscape such as a nearby river or the slope of a hill to transport timber, and in necessary cases we will build cables for transport use. As such, the environmental impact from our operations is minimised.

To maintain our forests in good condition, we have established a set of procedures for pest control and fire prevention.

The procedures for control of pests include the following:

- our forest workers must regularly inspect the forests under their care, record any pests found, make suggestions for pests control, and follow the directions on pests control from the local forestry bureau;
- before introducing any new plants to our forests, testing of such plants must be made to prevent pest attack;
- we must avoid using chemical pesticides in pests control; and
- when our forest workers discover any pests, they need to report to our resources management department and the local forestry bureau immediately.

The rules for fire prevention include the following:

- our forest workers form fire-prevention teams;
- the fire-prevention team identifies high risk periods due to dry conditions and during such periods the setting of any fire in the forests is prohibited or strictly controlled;
- cooking, smoking and lighting fires in forests are prohibited except in specified places and fire extinguishing equipment should be made available; and
- when our forest workers discover a fire in the forest, they need to report to the local fire service department, our resources management department and the local forestry bureau immediately.

Our local forest workers who are supervised by the dedicated forest team, regularly visits our forests to monitor and report the conditions of our forest and to ensure regulatory compliance and compliance with our procedures for pest control and fire prevention.

In addition, to cope with the expansion of our forestry operation, we intend to recruit more people to monitor and maintain our forests. As at 31 December 2007, we had 198 forest workers and 33 forest management team members. During the year ended 31 December 2008 and in view of our acquisition of the Yunnan Luxi/Shuangjiang Forest in March 2008 and the Yunnan Wenshan Forest in July 2008, we hired 120 additional forest workers and 13 additional forest management team members. As at 30 June 2009, we had 317 forest workers and 46 forest management team members. As at 30 June 2009, approximately 20% of our forest management team members had received formal school education in forestry, all of them have received forestry training provided by us and approximately 57% have been engaged in the forestry business for over 5 years.

Since we commenced our forestry operation in 2003, we have been implementing the sustainable management measures mentioned in the section headed “Business — Our Sustainable Forestry Management” (including the various measures to minimise the possible impact to the environment as set out above) and have not experienced any environmental problems or noticed any material adverse consequences to our forests and the environment due to our operation. Accordingly, as at the Latest Practicable Date, our Directors are of the view that it is unlikely that we would be subject to liabilities based on any past non-compliance under current PRC environmental laws and regulations that we have not disclosed, which would have a material adverse effect on our business, financial condition or results of operation.

### **Harvesting**

All our forests can be commercially harvested in accordance with the relevant laws and regulations as they are classified as timber stands under the functional categorisation of forest by the SFA. Although the PRC laws and regulations do not specify the age of the trees which are not allowed to be logged, it is provided that logging of saplings (which refer to trees with the diameter of less than 5cm) is prohibited.

### ***Harvesting plan***

We harvest and sell logs to our customers. To ensure the quality of our products and the sustainability of our forest resources, we have established a set of harvesting rules and standards. Our harvesting rules require strict compliance with the logging permits and the relevant harvesting regulations as required by the PRC Forestry Law and the relevant government regulations. We only harvest those trees which meet our harvesting standards, which are trees:

- having a stem diameter greater than 20 cm;
- having a stem length not less than 15 m; and
- being at least 20 years old.

We engage the villages for harvesting in Sichuan forests and professional harvesting teams for harvesting in Yunnan forests. Our forest workers and dedicated forest team

members monitor the activity of harvesting on site and record details of plantation assets (such as the date and volume of logging) upon logging to make sure the trees we harvested have met our harvesting standards.

### ***Harvesting activities***

Upon receiving an order from our customers, we will select an appropriate forest close to our customers and apply for logging permits from the relevant local forestry bureau specifically for that order. For more details of logging permit, please refer to the sub-section headed “Permits and quotas” below.

Forests are divided into small parcels by their different locations. Given that (i) the average area of a Sichuan forest parcel is much smaller than that of a Yunnan forest parcel; and (ii) the logging condition of a Sichuan forest parcel is generally simpler than that of a Yunnan forest parcel as the former is closer to roads, rivers or slopes, thereby making the terrain easier for logging, the operational scale and the complexity of logging will be greater for a Yunnan forest parcel than a Sichuan forest parcel. Accordingly, we engage the villages close to the forests (who are ordinary farmers) to provide a simple harvesting service in a smaller area in Sichuan, and engage the professional harvesting teams (which are engaged in the business of provision of harvesting services and better equipped and more efficient in harvesting) for harvesting in a greater area in Yunnan.

For our forests in Sichuan, we engage the villages, which are close to the relevant forest where harvesting is to be performed, for harvesting and enter into a framework harvesting agreement (“Sichuan Harvesting Agreement”) with the relevant village committees (on behalf of those villages). Those villages are Independent Third Parties consisting of people who are ordinary farmers with the necessary skills and equipment for harvesting logs in forests, and our PRC legal advisers have confirmed that they have the authority to enter into the Sichuan Harvesting Agreement with us. As advised by our PRC legal advisers, according to the PRC Organic Law of the Village Committees, the village committee shall be composed of three to seven members, including the chairman, the vice-chairman and the members, all of which are elected directly by the villagers. The village committee shall, among other things, manage the public affairs of the village, and administer the affairs concerning the land and other property owned collectively by the villagers of the village in accordance with the provisions of laws.

The Sichuan Harvesting Agreement provides for the general rights and obligations of the contracting parties such as (i) our rights to own the logs after harvesting, devise the harvesting plans and our obligations to apply for and obtain the relevant logging permits and (ii) the village’s right to receive a harvesting fee from us (to be agreed from time to time) and their obligations include harvesting trees in accordance with our instructions. Before each harvesting, we will issue a written confirmation to the villages which will set out the specific terms of harvesting service, including the time, volume, location of the logging and the harvesting fee. The harvesting fee is negotiated with such villages on an arm’s length basis with reference to the market conditions at that time. We settled the harvesting fee to the engaged villages (through their village committees) in cash after the logging job is completed. The Sichuan Harvesting Agreement does not provide for an expiry date. During the Track Record Period, there has been no disputes between the villages and us regarding the Sichuan Harvesting Agreement. In the event the villages fail to provide the services to us in accordance with the Sichuan Harvesting Agreement, we will first try to resolve the dispute by amicable negotiation with the relevant village, and if the negotiation fails, we will then consider to take legal action to claim for damages based on breach of contract.

For our Yunnan forests, we engage professional harvesting teams, who are Independent Third Parties, for harvesting. The professional team which is currently engaged by us is a private enterprise in Yunnan which provides harvesting services. It is equipped with necessary tools for logging, such as saws, chain saws, cranes for lifting timber, interlocking skidder for forest harvesting and logs peeling machines. If the forest location makes the harvesting difficult, it may set up the cableways and chutes to facilitate transport of timber. To the best of our knowledge, it has been operating for about three years and its customers are primarily forestry operators in Yunnan. We believe this professional harvesting company has the necessary skills, resources and experience for harvesting for us. We have entered into a framework harvesting agreement (“Yunnan Harvesting Agreement”) with this harvesting company in substantially the same terms as the Sichuan Harvesting Agreement except for the payment terms. Pursuant to the Yunnan Harvesting Agreement, the harvesting fee will be payable in three instalments: (1) 20% of the total harvesting fee is payable within 10 working days after we have issued a written confirmation to the harvesting company which sets out the specific terms of harvesting service; (2) 40% of the total harvesting fee is payable after completing half of the harvesting volume required; and (3) the remaining balance of 40% is payable upon completing of all the harvesting volume required.

According to the Sichuan Harvesting Agreement and the Yunnan Harvesting Agreement, the villages or the professional harvesting teams are required to comply with the national forestry harvesting safety rules and regulations, and are responsible for equipping themselves for logging when performing such services. Apart from the harvesting fee, we are not responsible for any costs incurred by the villages or the professional harvesting teams during the logging process.

We have taken the following measures to monitor our harvesting activities and the quality of our harvest:-

- (a) all harvesting activities with a harvesting plan must be approved in advance by our chief administration officer;
- (b) all harvesting people must strictly follow our harvesting rules and standards; and
- (c) in the process of harvesting, our forest workers and the members of our dedicated forest team will be on site to monitor the logging and record details of harvesting (including the date, area and location of logging, and the volume of timber harvested), to ensure the quantity of timber logged does not exceed that specified in the logging permit, and the harvesting complies with other requirements as set out in the logging permit and our own harvesting requirements including the quality of the harvest.

The timber, after harvesting, will then be processed into log lengths, primarily 2 m and 4 m in length and our customer will pick up their logs. The turnaround time from customer order to contacting customer for log pickup is typically one week.

For each of the three years ended 31 December 2008 and the six months ended 30 June 2009, we harvested timber at a rate of approximately 10.0%, 7.6%, 1.5% and 1.0% respectively, in terms of proportion of wood volume harvested during the year to total forest stock volume at the end of that year. Our harvesting rate is much lower than the 10% maximum harvesting rate currently allowed by Sichuan and Yunnan forestry bureaus because

we set our harvesting rate at such level to ensure the quality of our timber which are harvested from selected trees reaching our specified stem diameter and stem length. Another reason for our relatively lower harvesting rate is that there is a time lapse between forest acquisition and logging, and some forests which are acquired during a specific year are not harvested during that year. Despite that we are capable of achieving a 10% harvesting rate without prejudicing the sustainability of our forests, it is our general policy to take into account the quality of our timber.

We review our harvesting rate each year and determine it after taking into account our forest reserve, the growth cycle of different species of trees, the impact to the sustainability of forests, the allowable logging amount and the appropriateness of logging for specific forests (including their accessibility). At any time of a year, we will not harvest trees more than once on the same spot.

For each of the financial years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our log sales, in terms of log volume, amounted to 76,200 m<sup>3</sup>, 169,800 m<sup>3</sup>, 520,407 m<sup>3</sup> and 321,930 m<sup>3</sup> respectively.

### ***Permits and quotas***

Under the PRC Forestry Law, the PRC government strictly implements a quota system for logging of forest wood so as to uphold the overriding principle that the amount of consumption of timber must be less than the amount of its growth. Details of the logging quota system is set out in the section headed "Regulatory Overview" of this prospectus.

Our PRC legal advisers advised that pursuant to the PRC Forestry Law and its implementation rules in force, in respect of the amounts which may be harvested, we are only required to comply with the log amount specified in the logging permits. We obtain approval for the amount we harvest prior to each logging. Although there are no specific PRC laws or regulations which prescribe how a local forestry bureau shall determine the logging amount of a forestry operator in a logging permit, we are advised by the local forestry bureaus in Sichuan and Yunnan that our maximum logging amount each year should be 10% of the total forest stock volume of all our forests. Since our forest stock volume changes from time to time, the local forestry bureaus in Sichuan and Yunnan have not advised on any absolute figure of our annual maximum logging amount.

In light of the position of the local forestry bureaus, our internal guidelines provide that our annual maximum logging amount should account for 10% of our total forest stock volume. Upon receiving an order from our customers, our resources management department will check (i) whether the aforesaid 10% annual logging cap utilised up to that moment; and (ii) the volume of logs in the order as compared to the un-utilised logging cap, to ensure our compliance with the anticipated annual logging cap. Furthermore, the relevant logging activities with a harvesting plan must be approved in advance by our chief administration officer. After selecting the appropriate forest for logging, we will apply for the logging permit with the local forestry bureau. In addition to the application form, we are also required to present the relevant forestry right certificates to the local forestry bureau for inspection when we apply for a logging permit.



---

## BUSINESS

---

In practice, the PRC government controls our Group's logging amount through the use of logging permit. A logging permit must be obtained from the local forestry bureau of the PRC government at the county or higher level for each logging and logging activities must be conducted in accordance with the requirements of the logging permit.

Based on our experience, it usually takes about a week to obtain a logging permit. When the local forestry bureau issues a logging permit to us, it will specify in the permit, among other things, the period of time, the maximum area or number of trees permitted for logging. As at the Latest Practicable Date, we have not experienced any rejection of our application for logging permits.

The table below sets forth our actual logging amount and the maximum logging amount permitted under the logging permits granted to us (whether or not they have been fully utilised) for the three years ended 31 December 2008 and the six months ended 30 June 2009.

<u>Year</u>	<u>Actual logging amount (m<sup>3</sup>)</u> <small>(note)</small>	<u>Maximum amount permitted under logging permits (m<sup>3</sup>)</u>
2006 .....	75,909	77,034
2007 .....	169,329	169,329
2008 .....	519,928	519,928
2009 (up to 30 June 2009) .....	356,730	356,730

*Note:*

*For each of the three years ended 31 December 2008 and the six months ended 30 June 2009, the actual log sales were 76,200 m<sup>3</sup>, 169,800 m<sup>3</sup>, 520,407 m<sup>3</sup> and 321,930 m<sup>3</sup> respectively.*

We apply for a logging permit before each logging. To ensure our compliance with the logging permits, during logging, our forest workers and dedicated forest team members will be present on site to monitor the logging activities and record details of harvesting (including the date, area and location of logging, and the volume of timber harvested), to ensure the quantity of timber logged does not exceed that specified in the logging permit, and the harvesting complies with other requirements as set out in the logging permit and our own harvesting requirements including the quality of logs. Such logging records are first prepared by our forest workers and then reviewed by our dedicated forest team. The volume of timber will also be re-measured by our forest workers, dedicated forest teams and customers before our customers pick up the timber. In addition, our resources management department will record and monitor all the actual logging amounts and the local forestry bureau will conduct selective examination of our logging activities.

Our Directors confirmed that we followed our internal guideline for 10% annual logging cap and complied with the logging permits during the Track Record Period. Our PRC legal advisers advised that given that: (a) we have obtained logging permits before each time of logging; and (b) the relevant local forestry bureaus in Sichuan and Yunnan have confirmed that our logging activities were in compliance with the relevant rules and regulations, our logging activities during the Track Record Period were in compliance with the applicable PRC laws and regulations in all material respects.

Our forest workers prepare reports on the conditions of the forests and maintain the records of logging activities. Such reports and records will be verified and approved by our dedicated forest team before being accepted by our resources management department for record.

### Forest maintenance fee

When applying for the logging permits, we are also required to pay a Forest Maintenance Fee which is contributed to a forest maintenance fund established by the PRC government and the rate of the Forest Maintenance Fee is determined by local forestry bureau (currently this rate is set at RMB55 per m<sup>3</sup> by the Sichuan forestry bureau and RMB45 per m<sup>3</sup> by the Yunnan forestry bureau). The Forest Maintenance Fee paid or payable by us during each of the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009 was RMB4.1 million, RMB9.3 million, RMB25.2 million and RMB15.3 million respectively, and as at the Latest Practicable Date, they have been fully settled in cash.

According to the Administrative Rules for Levy and Use of Forest Maintenance Fund (《育林基金徵收使用管理辦法》) jointly promulgated by Ministry of Finance and the State Forestry Administration on 25 May 2009, the Forest Maintenance Fund shall not exceed 10% of the revenue from sales of the forestry products, detailed standards shall be stipulated by provincial level government by considering the affordability of the forestry production enterprises or individuals. We shall pay the Forestry Maintenance Fund in accordance with the requirement of the local government.

### Replanting

To ensure the sustainability of our forests, we plant new trees to replace the ones that we cut down. We have established a set of rules for replanting, including the following:

- the replanting must comply with the PRC Forestry Law and the relevant regulations;
- the replanting must be conducted during or after the year of harvesting; and
- the survival rate in the year of planting must be not less than 85% and the survival rate after 3 years of planting must be not less than 80%.

In our Sichuan forests, we usually replant seedlings between March and April, which according to our experience, is the optimum season for planting seedlings. In Yunnan, we replant seedlings throughout the year as the season for planting seedlings is all year round. We will select, within the same piece of forest where trees have been harvested, the suitable replanting areas which can provide enough space and light for the growth of seedlings. The trees we replant are of the same species as those we harvest. After planting seedlings, we will monitor their growth and do grooming when needed.

All the seedlings we use are provided by the government for free. The seedlings first planted by the villagers, before we acquired the relevant forests, were also provided by the government for free. We apply for seedlings from the local forestry bureau about one or two months before replanting (which means, in Sichuan, in January or February). The local forestry bureau has maintained records of our harvesting activities and by reference to these records, they will determine whether to approve the amount of seedlings applied for. After we have obtained the approval of the amount of seedlings, which according to our experience, will usually takes about a week, we will collect the seedlings from the designated locations. We will then organise the replanting. We understand that the local forestry bureaus will keep records of our application for seedlings and the amount of seedlings granted to us.

According to the PRC Forestry Law, new trees are required to be planted when trees are cut and the number of or the area covered by new trees must not be less than the one for felled trees. As part of our commitment to sustainable forest management, we exceed this minimum legal requirement by replanting trees in our forests at the rate of at least 110% (that is, for every 100 trees we cut, we will replant at least 110 new trees within a year after the month of actual logging). For each of the three financial years ended 31 December 2006, 2007 and 2008, our replanting rate was approximately 115%, 112% and 112% respectively.

Furthermore, the PRC governmental regulations require the survival rate of seedlings in the year of planting to be not less than 85% and the government authorities regularly visit forests to check the survival rate of seedlings. As part of our commitment to sustainable forestry management, we have outperformed the minimum legal requirement by having achieved an average of at least 90% survival rate in the year of planting.

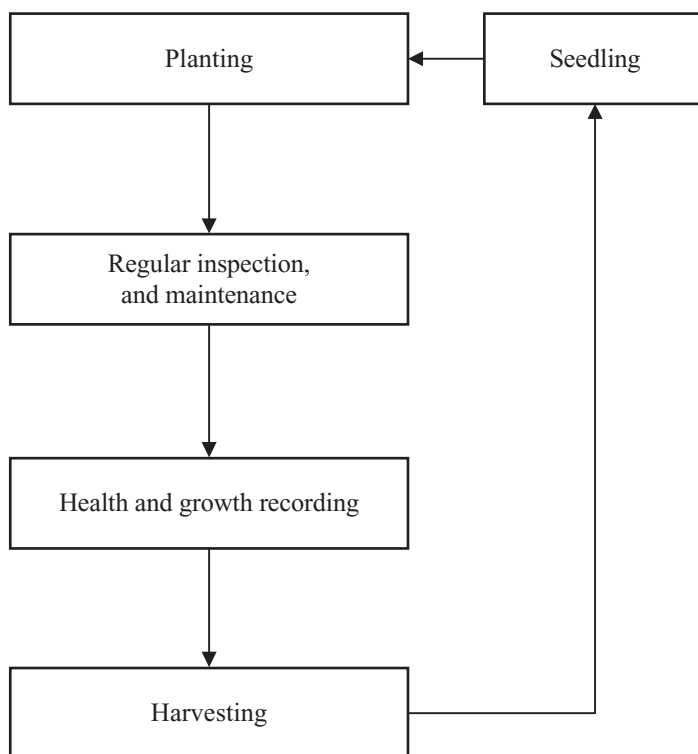
The PRC government will examine our replanting activities annually and will issue a written confirmation after examination and investigation. According to the annual written confirmations issued by the competent forest authorities in Sichuan and Yunnan, our replanting activities, in our Sichuan forests during the period from 2004 to 2008, and in our Yunnan Luxi/Shuangjiang Forest in 2008, were in compliance with the relevant laws.

To optimise the yields on our planted trees, we engage in a variety of plantation management practices as follows:

- choice of the site for planting trees, which usually is close to the place of logging to ensure trees are properly spaced;
- planting at optimal times of the year with proper spacing to enhance the survival rate;
- taking measures of fire prevention and pests control (please refer to the section headed “Business — Our sustainable forestry management — forestry management” for more details); and
- monitoring the plantation sites daily by our forest workers and quarterly by our dedicated forest team.

The above practices are designed to produce fast growing, high quality sustainable forestry resources, optimise yields, improve resistance to disease and fire, enhance environmental conservation, and increase harvesting efficiency.

The diagram below sets forth our plantation management process:



### **Relationship with local forest workers**

Some of our forests were owned and planted by local farmers prior to their acquisition by our Group. Upon acquisition, we invite these farmers, who are Independent Third Parties, to join our Group as forest workers in exchange for a monthly stipend. Based on the Group's understanding and knowledge of the forestry in China and as confirmed by CCPEF, we believe that such arrangement is unique in the forestry industry in China. To the best of our knowledge, there are two types of arrangements with forest workers in the market which are different from our practice. One practice is that after acquisition of a forest from the forest farmers, the forestry company will have no more relationship with these forest farmers, and they will engage other people other than these forest farmers to maintain the forest. The other practice is that the forestry company invites the forest farmers to use their forestry rights as their contribution to the forestry company and they will then receive dividends as a shareholder of the forestry company.

As our forest worker, the farmer, in addition to his own farming activities, is responsible for taking care of our forests and keeping a detailed record for the growth of our trees and the conditions of our forests. These farmers have strong experience in tree planting and harvesting which enable us to maintain the stability and quality of our operations.

We provide the farmers with a stable and regular income and enhance their living standards. We pay monthly salary to these forest farmers and their salary is determined with reference to the prevailing remuneration level at the local labour market. Since June 2008, we commenced making contribution to the social insurance fund for our forest workers in compliance with the relevant PRC laws. Prior to that, we had agreed with them that they would use part of their salary to make these contribution on their own and we had included the

amount of contribution in their salary. However, as our PRC legal advisers have advised that this arrangement breached the PRC labour laws and regulations, since June 2008, we and these forest workers have entered into new labour contracts which comply with the new PRC Labour Contract Law and the PRC labour laws and regulations. The new labour contracts provide, among other things, that we shall fully pay the social insurance contributions which include the basic pension, basic medical insurance, unemployment insurance, work injury insurance and the birth insurance, for the employees in compliance with the national and local social insurance laws and regulations in the PRC. As advised by our PRC legal advisers, other than its obligation to make contribution to the social insurance and housing fund for its employees, in PRC, the Group does not have any social responsibilities within the local communities as imposed by the local governments and/or stipulated by the relevant laws and regulations.

We believe that our policy of paying local farmers as forest workers has won us the reputation of being socially responsible within the local communities and the local governments and has made us more competitive in our acquisition of new forests.

### **OUR OPERATIONS**

#### **Overview**

Our business operations are currently focused on upstream timber activities and cover the full timber supply chain from the planting of trees, the management and operation of our forests and harvesting of our forest resources to the sales of our logs to third parties.

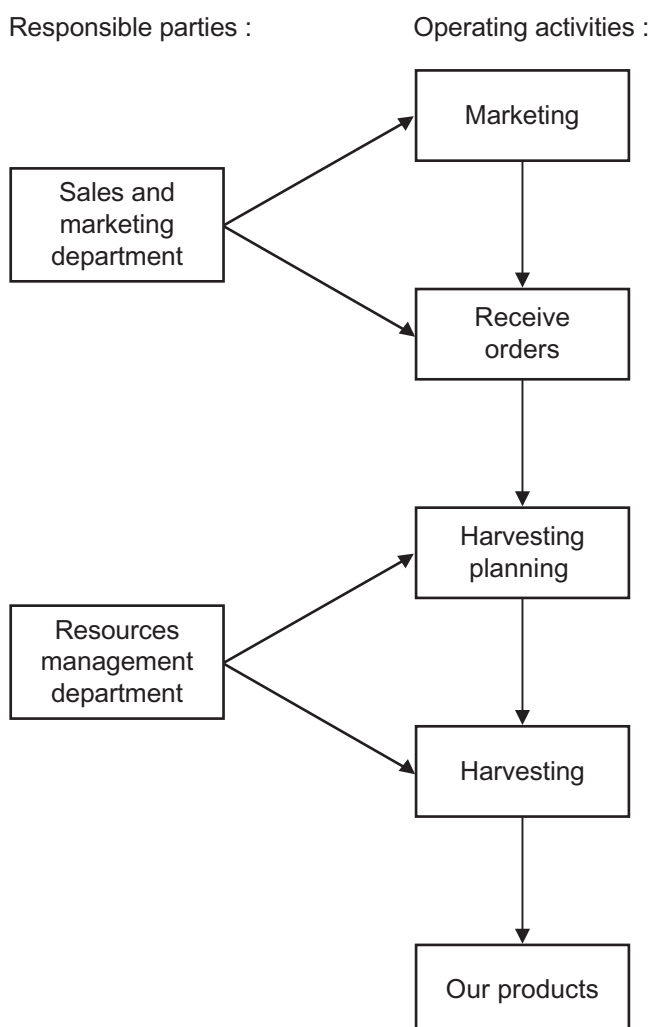
We are committed to customer service and quality products. Our sales and marketing department works closely with our resources management department to ensure that timber is processed to match each customer's request. We harvest timber only after a customer puts in an order. Our resources management department then decides where to harvest the timber, initiates the logging permit process, and instruct the harvesting villages or professional harvesting teams to arrange and organise for harvesting for the desired amount. Trees are harvested and processed into logs meeting the customer's required dimensions. When the logs are ready, our customers will then arrange for log transportation.

---

## BUSINESS

---

The following diagram shows a summary of our operations.



### Sales and marketing

We sell logs produced from our forests. All our products are sold direct to our customers in China. The sales activity is controlled by our national sales manager as supported by our sales team. Our sales department is located in Beijing but our sales team travel frequently to our forests.

All of our revenue came from our sales of logs during the Track Record Period. During the three financial years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our revenue amounted to approximately RMB70.1 million, RMB160.3 million, RMB544.9 million and RMB373.2 million respectively.

For the three financial years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, the sales of Chinese fir logs accounted for approximately 94.5%, 96.6%, 33.9% and 22.6% of our total revenue. The balance of our revenue came from the log sales of Yunnan pine, beech and birch. Sales of Chinese fir logs decreased as a percentage of total sales when we began operating our Yunnan Luxi/Shuangjiang Forest in May 2008. This

## BUSINESS

forest includes Yunnan pine, beech and birch in addition to Chinese fir. Below is the breakdown of our sales volume and revenue by log species for the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009.

	Year ended 31 December									6 months ended 30 June 2009		
	2006			2007			2008			Volume (m <sup>3</sup> )	Revenue amount (RMB)	% of total revenue
	Volume (m <sup>3</sup> )	Revenue amount (RMB)	% of total revenue	Volume (m <sup>3</sup> )	Revenue amount (RMB)	% of total revenue	Volume (m <sup>3</sup> )	Revenue amount (RMB)	% of total revenue			
Chinese												
fir logs . . . . .	72,100	66,277,885	94.5%	164,100	154,929,807	96.6%	208,207	184,827,178	33.9%	98,700	84,212,039	22.6%
Yunnan pine												
logs . . . . .	4,100	3,844,712	5.5%	5,700	5,388,462	3.4%	36,000	30,953,208	5.7%	20,400	17,112,233	4.6%
beech												
logs . . . . .	—	—	—	—	—	—	115,000	131,165,094	24.1%	88,330	113,407,864	30.4%
birch logs . . . . .	—	—	—	—	—	—	161,200	198,002,264	36.3%	114,500	158,515,777	42.4%
<b>Total: . . . . .</b>	<b>76,200</b>	<b>70,122,597</b>	<b>100%</b>	<b>169,800</b>	<b>160,318,269</b>	<b>100%</b>	<b>520,407</b>	<b>544,947,744</b>	<b>100%</b>	<b>321,930</b>	<b>373,247,913</b>	<b>100.0%</b>

As at 31 August 2009, our confirmed but unperformed sales orders of Sichuan and Yunnan logs for the year 2009 were approximately 34,800 m<sup>3</sup> and approximately 156,640 m<sup>3</sup> respectively. Such unperformed sales orders are expected to be performed and delivered by 31 December 2009. We will continue our efforts to broaden and diversify our customer base by looking for sales to large wood-processing factories through our sales team or introduction by our business partners.

For each sale, we enter into a timber sales agreement with our customer. However, for our long-term customers, each year we enter into a master timber sales agreement with them setting out the annual sales volume of timber for the next year, the volume for each time of delivery and in some cases, also the base price (which may be adjusted subsequently after parties' negotiation). The master timber sales agreement also provides for the quality of the logs (i.e. with stem diameter of 20 cm), the delivery point, the obligation of the purchaser to transport the logs from the delivery point, the term of payment (i.e. payment before delivery) and the consequences for breach of contract. If we are unable to deliver the products on time, we have to pay to the customer a compensation calculated on the basis of 0.03% of the product value for each day overdue, up to 30% of the total product value. If the customer is unable to make payment on time, it has to pay to us a compensation calculated on the basis of 0.3% of the product value for each day overdue. The price of our logs, if not set out in the master timber sales agreement, will be notified to these customers in our subsequent written notification. Before each delivery, we issue a delivery note to our customers confirming the amount of our delivery and the price of our logs. Payment for our products is made before delivery. We do not have goods return policy. There are a total of 3, 6, 17 and 17 customers for the 3 years ended 31 December 2008 and six months ended 30 June 2009 which have signed such yearly master timber sales agreement with the Group, the sales of which accounted for 86.60%, 92.90%, 99.84% and 100% of the turnover of the Group during the same period.

As at 30 June 2009, we had a sales force of 15 people. We deploy a direct sales strategy to develop our customer base. The main responsibility of our sales and marketing team is to closely monitor market development, provide after-sales services (which refer to our follow-up service with our customers after sale, such as getting feedback from our customers on the quality of our products and their future requirements and orders) and other promotional work. Our sales team regularly visits our customers to promote our products and maintain a close relationship with our customers. We closely study the forestry markets in China and have a thorough understanding of our customers' needs and the timber market in China. Through our efforts, we have a well established customer base. We plan to continue to enlarge our

customer base by way of (1) referral by existing customer as we have established a reputation among the peers; (2) exploring new and potential customers through the approach of potential customers by our sale and marketing staff; and (3) self introduction of customers in newly acquired forest after we have established reputation in the area. While we are committed to continue to serve our existing customers with our high quality products and good customer service, we will capture every opportunity to expand our clientele.

### Pricing

We determine the selling prices for sales of logs with reference to the following factors:

- perceived market trends;
- market price levels;
- the sales volume;
- required delivery schedules; and
- our relationship with the specific customer.

For the two years ended 31 December 2007, we only sold logs of Chinese fir and Yunnan pine harvested in Sichuan. For the year ended 31 December 2008 and the six months ended 30 June 2009, in addition to Chinese fir and Yunnan pine, we also sold beech and birch, which we harvested in Yunnan, as we commenced logging operations there in May 2008. As at the Latest Practicable Date, Chinese fir, birch, beech, pine, and a mix of fir, cedar, birch, pine and alder, accounted for approximately 71.1%, 17.7%, 5.8%, 5.1% and 0.3% respectively of our total forest area. Our selling price of Chinese fir and Yunnan pine (including VAT) are substantially the same in the same market, and our selling price (including VAT) of beech and birch are approximately 30% and 40% higher than that of Chinese fir and Yunnan pine (including VAT), respectively. Furthermore, since June 2008, the difference between our selling prices of Chinese fir sold in Sichuan and those sold in Yunnan has been approximately 2%, with prices slightly higher in Sichuan in light of increased demand due to the Sichuan Earthquake on 12 May 2008. Because the Sichuan and Yunnan markets are geographically close to each other, we expect that the price difference of logs of same species in these two provinces, if any, will continue to be minimal in the near future. Accordingly, our Directors believe that the log price differentials in these two provinces will not materially affect our results of operations (excluding fair value changes).

### Customers

Currently all of our logs are sold to customers in China. All of our customers are wood processing factories, which accounted for 100% of our customer base by turnover for the year ended 31 December 2008 and the six months ended 30 June 2009. They produce wood panels and wood-based products which are cut from logs. Their products are used for furniture making, flooring, house building and infrastructure. Some of such products are exported overseas. With our acquisition of approximately 159,333 hectares of forest in Yunnan in 2008, we have expanded our customer base to wood-processing factories in Yunnan, and have entered into master sales agreements with some of them.



## BUSINESS

Below is the breakdown of our customer base by nature of their business.

<u>Business nature of our customers</u>	<u>% of total turnover</u>	
	<u>for the year ended 31 December 2008</u>	<u>for the 6 months ended 30 June 2009</u>
Wood processing factories .....	100%	100%
Others .....	—	—
Total: .....	<u>100%</u>	<u>100%</u>

The end-users of our logs fall into three main categories: (1) contractors who use our products for house building and infrastructure; (2) furniture makers; and (3) paper manufacturers.

Approximately 29.5% and 18.6% respectively of our customers by revenue for the year ended 31 December 2008 and the six months ended 30 June 2009 were located near our forests in Sichuan. The following table illustrates the geographical breakdown attributable to our revenue during the financial year ended 31 December 2008 and the six months ended 30 June 2009.

<u>Location of customers</u>	<u>% of total revenue</u>	
	<u>for the year ended 31 December 2008</u>	<u>for the 6 months ended 30 June 2009</u>
Sichuan .....	29.5%	18.6%
Yunnan .....	70.5%	81.4%
Total: .....	<u>100%</u>	<u>100%</u>

For the three years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, we had a total of 10, 16, 19 and 17 customers respectively, which had purchased and received our logs during these respective periods, and the five largest customers of our Group in aggregate accounted for approximately 93.9%, 85.3%, 44.8% and 56.2% respectively, of our Group's revenue. During the same period, our Group's largest customer in each respective period accounted for approximately 47.1%, 22.7%, 9.7% and 12.8% respectively, of our Group's revenue. Our five largest customers during 2006 and 2007 were purchasers of our logs harvested in Sichuan. For the year 2008 and the first half of 2009, our five largest customers were all located in Yunnan. We understand that, among our five largest customers during the Track Record Period, one is a trading company, and all the rest are wood-processing factories. Of these customers, six of them are located in Sichuan, six in Yunnan and one in Hangzhou. Each of them is an Independent Third Party. Our five largest customers first became our customers between 2003 and 2008. To the best knowledge of our Directors, our five largest customers for the Track Record Period have operated for at least 3 years, their registered capital vary from RMB50,000 to RMB2,000,000, and their target customers are in construction and furniture-making industries, save for the aforesaid trading company which is engaged in trading business of various products (including timber). Furthermore, we are not aware of any relationship among these customers. We never encountered any customers who have imposed any certification and/or other specific requirements on our products other than the details of orders for timber nor any material delays in product delivery to our customers or defaults in payment by our customers.

The Directors are of the view that the demand for wood products in China exceeds and it is expected that it will continue to exceed their supply in the coming years, and therefore we

will be able to easily find other customers to replace the five largest customers should they terminate their business relationship with us. As at the Latest Practicable Date, none of our Directors, their associates, or any Shareholders holding more than 5% of the issued share capital of our Company had any interest in any of our five largest customers for the three years ended 31 December 2008 and the six months ended 30 June 2009.

### **Transportation**

Our customers are responsible for transporting our products from our forests to their ultimate destination.

According to the PRC Forestry Law, any entity which needs to transport the forest trees (except those forest trees which can only be removed by the State) out of the forest zones must apply for a timber transportation permit issued by the forestry department at the county level or above. According to the PRC Forestry Law and the Implementation Regulations of PRC Forestry Law, after the entity obtains the timber logging permit, the forestry bureaus shall issue a timber transportation permit to the entity for transporting the timber out of the forest zone. Our customers are responsible for applying for timber transportation permits and we will give them the relevant logging permits for processing. The local forestry bureau also sets up check points on the roads connecting the forested area to ensure all logging and transport out of the forested areas are legal.

### **Suppliers**

We engage the village of the relevant forest and professional Independent Third Parties for harvesting our Sichuan and Yunnan forests respectively. As they are required to equip themselves, we do not supply any equipment or machinery. Therefore we do not have capital expenditure for equipment or machinery for harvesting. We also do not need trucks for transportation as our customers arrange the pick-up of timber from the roadsides near our forests. We do need seedlings for replanting but they are provided free by the PRC government. Therefore other than the professional harvesting companies engaged by the Group for harvesting services, we do not have suppliers for operating our forestry business, whether or not they are specific to our business or are required on a regular basis to enable us to continue to supply products to our customers.

The professional harvesting company in Yunnan was the only service provider we engaged during the Track Record Period. As at the Latest Practicable Date, none of our Directors, their associates, or any Shareholders holding more than 5% of the issued share capital of our Company had any interest in our only service provider for the three years ended 31 December 2008 and the six months ended 30 June 2009. Our Directors have confirmed that there is no contractual arrangement between our Group and the PRC government regarding the supply of tree saplings. Given that the planting of forest trees are encouraged by the PRC government, we do not consider that there is any risk regarding a shortage in the supply of tree saplings and/or seedlings for re-plantation.

### **INVENTORY CONTROL**

As at 30 June 2009, we had log inventories of approximately RMB20.4 million. This is higher than our average level of inventory at the end of a year as we harvest more logs in Sichuan during the second quarter in advance of the rainy season in Sichuan (which occurs in

July through September), during which we cease logging in Sichuan. Since timber will usually be taken away by our customers within 7 days from delivery day, we do not need warehouses to store timber for the long term, thereby reducing our warehouse costs.

We adopt inventory control that allows us to closely monitor the level of inventories of logs. Our resources management staff at the delivery point takes record of the amount of the logs delivered to the customer and another staff verifies the record. The logs inventory is recorded by species, grade and stem diameter. Our resources management department conducts inventory count at the end of each year and our finance department cross-checks the inventory count record against its accounts record. We prepare for the logs inventory according to the amount of our confirmed sales order, our expected sales in the coming months and our logging capacity. For example, we prepare more inventory from our Sichuan forests from April to June in anticipation of the rainy season of Sichuan which lasts from July to September each year, during which period we discontinue logging due to safety concerns.

### **QUALITY CONTROL**

The Company is committed to providing high quality products. The Directors believe that product quality is vital in enhancing our competitiveness, market position and reputation.

Our quality control is divided into two phases:

#### **Acquisition phase**

Before we decide to purchase a forest, we will go through a strict procedure for assessment and selection. Our dedicated forest team will conduct on-site assessment of the potential forest. In the event the assessment is positive, an independent and external valuer will also be engaged for valuation. All valuation reports and assessment results will be taken into account, and all of our acquisition criteria must be met before we make a final decision on acquisition.

#### **Operation phase**

Our resources management department is principally responsible for the maintenance and monitoring of our forests as well as the management and supervision of our forest workers. We also have a dedicated forest team which regularly visits our forests to monitor our forest workers and forest conditions. Our forest workers who are stationed in our forests also regularly inspect our forests and report to our resources management department to ensure continuing compliance with forestry regulations. They are responsible for daily management and maintenance of our forests and are required to submit to our resources management department regular maintenance reports and special reports for any unusual events. At the end of each year, we also engage an independent professional valuer to assess and evaluate our forests and issue a valuation report to us.

### **COMPETITION**

The Group's competition mainly comes from various market participants in the PRC. There are large forestry operators in the PRC, most of which are state-owned enterprises and possess a large amount of forest reserve. Although our forest reserve is relatively less than these state-owned enterprises, we have a forest acquisition system and an operation system in place and therefore our Directors believe that we can compete with and have an advantage

---

## BUSINESS

---

over these state-owned enterprises in terms of efficiency and flexibility. Furthermore, given that the PRC government has different objectives in forestry management at a macro level and profit-making may not be the sole objective set by the state-owned forest operators, our Directors are of the view that competition from the state-owned forest operators may not be material to us.

Besides large forestry operators, there are also a number of smaller forest owners which are located in different provinces of China. As our current operation is focused in Sichuan and Yunnan, compared with the forest farmers in other provinces, we may be less competitive as compared to them when selling our logs to customers in other provinces as their transportation cost will be lower. We understand that there is no large scale forest operator in Sichuan province and the competition in Sichuan province is not keen and that in Yunnan province, the core business of the Group's competitors is paper manufacturing, and therefore there is relatively less competition among forestry operators. We understand that save for some timber import from Myanmar in Yunnan, there is only a small amount of import of timber in Sichuan and Yunnan.

Many forestry operators in China are focused on acquiring land to establish fast growing plantations of eucalyptus (for the pulp and paper industry), Chinese fir and pine. These companies have largely focused on the southern provinces such as Guangdong, Guangxi, Hainan Island, Shandong and Henan. However, as land suitable for plantation forests with reasonable price is becoming scarce, particularly in Guangxi and Guangdong provinces, it is likely that some of these locally and foreign owned pulp and paper companies will locate to other provinces to expand their forest base. This may drive up the cost of acquiring forest in the provinces where these companies are active.

The market for our products in the PRC is highly competitive in terms of price and quality. In addition, wood-based products are subject to increasing competition from a variety of substitutes, including non-wood and engineered wood-based products, as well as import competition from other worldwide suppliers.

We believe the principal barrier to acquiring a larger market share of the timber industry in China is the ability to secure high quality forests, forestry management know-how and the capital expenditure required to acquire forests and develop the infrastructure to carry out the harvesting operations. Throughout the years, we have developed the necessary expertise and understanding of practices at local, regional and national levels to acquire relatively large areas of forest land. We believe such expertise represents a key barrier to acquiring significant forest ownership in China and should give us a competitive edge against our competitors.

## RESEARCH AND DEVELOPMENT

In connection with the expansion of our business operations, we plan to carry out research and development on sustainable forest management, tree improvement, breeding, growth monitoring and silvicultural operations. We have established good relationships with professional bodies in forestry industry such as the CCPEF and Beijing Forestry University. We will seek to cooperate with these professional bodies for our research and development.

On 2 April 2008, we entered into a cooperation memorandum with Beijing Forestry University regarding research and development and professional recruitment. We have agreed

with Beijing Forestry University to jointly establish a research centre which will conduct research on the prediction and monitoring of the growth of trees planted in our forests, sustainable forestry management and other advanced forestry management technology and practices. We also plan to jointly establish a seedling centre to nurture seedlings and conduct research on nurturing and improvement of seedlings, and other technology for speeding up tree growth. The goal of our research and development efforts is to improve forest yields and tree quality.

### **REAL PROPERTIES**

As at the Latest Practicable Date, our Group leased one property in Hong Kong and six properties in China — three in Yunnan, two in Sichuan, and one in Beijing. Except one property in Yunnan which is used for staff quarters, all of these properties are for office use. We also own the rights to use the forest land in our forests in Sichuan and Yunnan Provinces.

#### **Leased properties without titles and registration**

As at the Latest Practicable Date, we have leased 4 properties without titles and registration. Details of these properties are set out in Numbers 37, 39 and 41-42 in the section headed “Group III — Property interests rented by the Group” in Appendix IV to this prospectus. The lessors of the relevant leases have not provided us with the relevant building ownership certificates or other relevant documents evidencing that the lessors have the requisite titles or rights to lease the properties to us and the relevant tenancy agreements have not been registered with the relevant PRC authorities. As advised by our PRC legal advisers, if the lessors do not have title to the properties, or the legal and unfettered rights to lease the properties to us, the validity of the tenancy agreements is uncertain under the PRC laws and regulations and therefore these tenancy agreements may be subject to challenge by third parties. As advised by our PRC legal advisers, we are entitled to claim loss and damages against the lessors for any loss and damages under such a circumstance. Our Directors believe that these properties are not crucial to our operation as we have the right to claim loss against the lessors and there is no difficulties to look for new offices to replace the existing leased properties.

#### **Leased properties without registration**

As at the Latest Practicable Date, we have leased 2 properties with titles but without registration. Details of these properties are set out in Numbers 38 and 40 in the section headed “Group III — Property interests rented by the Group” in Appendix IV to this prospectus. As at the Latest Practicable Date, the lessors have obtained the relevant building title certificates, however, the tenancy agreements had not been registered with the relevant PRC authorities. As confirmed by our PRC legal advisers, the non-registration of the properties during the term of the tenancy would not affect the validity of the tenancy agreements. However, the tenancy agreements will not have priority over bona fide third parties who may exercise the right to take possession of the properties so long as the relevant tenancy agreements remain unregistered.

For all aforesaid leased properties without titles and/or registration (“Defective Properties”), they are currently occupied by us for staff quarters or office purposes and therefore are not crucial to our forestry business and operations. During the Track Record Period, no revenue and profit of the Group was contributed by the Defective Properties. As

---

## BUSINESS

---

advised by our PRC legal advisers, because of the defects in the titles of the Defective Properties, we may be unable to use such Defective Properties freely or may be required to move out from the Defective Properties. Given that all of the Defective Properties are currently for staff quarters or office purposes and there is no limitation on the location of such offices, our Directors consider that as there are lots of alternative premises readily available for our use, they do not anticipate any difficulties in looking for new offices in case we are required to vacate from the Defective Properties. Therefore, other than finding alternative premises if necessary, no remedial actions would be taken by us. In case we need to relocate another premise, the estimated time for relocation will be less than one month and the estimated costs and loss of profits due to relocation will be not more than RMB100,000. Therefore, the relocation (if it happens) will not have any material adverse impact on our Group's operation or profitability. The Controlling Shareholders have agreed to provide an indemnity to our Group in respect of the losses and damages arising from the properties with defective titles. We will, in the future, select the leases with title certificate of the properties and register the leases.

### INTELLECTUAL PROPERTY

We have registered three trademarks, applied for the registration of four applied trademarks and registered two domain names in Hong Kong and the PRC. For details, please refer to the section headed "Further Information about our Business — Intellectual Property Rights of our Group" in Appendix VII to this prospectus.

We understand from our PRC legal advisers that the time required for the registration of a trade mark in the PRC varies on a case-by-case basis. In the PRC, if the respective trademark office approved the marks for registration, the marks will then be advertised for 3 months for third parties to oppose our applications. Our PRC legal advisers advised that, in the PRC, sometimes it may take several years for the trademark office to review an application before it can proceed to advertisement. If no opposition is filed during the opposition period, our applications will then proceed to registration.

If we fail to register these trademarks in PRC we applied for, we will not be entitled to the exclusive use of these trademarks in the PRC (as the case may be), save for the costs to be incurred for re-printing of some corporate brochure, we do not expect our business would be materially or adversely affected or the Group's sales would be affected since our sale of logs are not branded with our trademarks.

### INSURANCE

It is our policy to maintain an insurance coverage on all our forests (including all newly acquired forests), subject to the terms and conditions of the insurance policies, for loss of trees arising from fire, hail, floods, snow, pests and theft. The term of our insurance policies is generally 1 or 4 years and the insurance premium is set by the insurance company after taking into account the log price changes and the biological growth. Therefore, although the value of our forest assets keeps changing, which is mainly due to acquisition of new forest, log price movements and biological growth of the existing forests, our Directors consider that the continual change in the value of the Group's forest assets would not materially affect the adequacy of the Group's insurance coverage.

As at the Latest Practicable Date, we were insured, under the insurance policies then in effect, in an amount of approximately RMB20,464 million. Given that the forest is our

---

## BUSINESS

---

important assets, we will, taking into account the insurance premiums and the possibility of risks to be covered under the insurance policy, regularly review the sufficiency of our insurance coverage.

For each of the three financial years ended 31 December 2006, 2007 and 2008 and the six months ended 30 June 2009, our Group paid an aggregate of approximately RMB3.0 million, RMB13.3 million, RMB15.9 million and RMB6.0 million, respectively, for insurance premiums. Given the nature of our operations and business, the value of our assets and turnover may exceed the amount of our insurance coverage. Therefore, our insurance coverage may not adequately protect us against certain risks. For details, please see the section headed "Risk Factors — Risks Relating to Our Business — Our insurance coverage may not adequately protect us against certain risks". However, considering the perceived risks and the cost of insurance premiums, our Directors believe that the current insurance coverage of our Group is reasonable for our industry and our size of operations.

We have not submitted any major claims to our insurers during the Track Record Period.

### INTERNAL CONTROLS

We are committed to strict implementation of our policies on financial budgeting, financial reporting and internal control. Our Board have established an audit committee and a remuneration committee.

We have established an internal control system to review and monitor our financial budgeting and financial position. In preparing our annual financial budgeting, each department will prepare its own departmental budget in mid-December based on the actual data in the previous 12 months. Our finance department will consolidate all the departmental budgets. In early January, our management will review and approve the financial budget (if required, as modified by our management). Our chief executive officer will then issue the approved financial budget to each department. Our finance department will monitor and review the actual expenses with budget on quarterly basis. It will investigate if there is any significant discrepancy from the budget and issue a discrepancy report to our management for their discussion and follow-up. For our capital expenditure budget and capital project, our management will review the relevant feasibility report of the capital project and prepare the capital expenditures budget. All the capital expenditures budget and capital project will have to be approved by our Board.

Currently we have procedures of financial budgeting and internal controls in place which procedures are mainly manually operated with the assistance of simple application software. The Directors believe that in view of our simple business model and existing operation scale, our current internal controls and management information system are adequate for our operation, however, they can be further improved to enhance our efficiency and productivity, in particular, when our forest reserve continues to expand. Accordingly, we are in the process of upgrading our internal reporting controls and accounting and financial systems as part of our efforts to improve and strengthen our internal controls and management information systems. For example, we are improving our record keeping systems, improving processes and formalising certain procedures to coordinate recordkeeping among our various departments and subsidiaries, strengthening and formalising certain of our internal sales procedures and inventory management systems and making further enhancements to our procedures on

---

## BUSINESS

---

information technology. These improvements will be achieved mainly by installing more advanced or specialised computer software and processing the records submitted by various departments by a central computer system.

As part of our efforts to improve its information management system, on 21 May 2008, we entered into an information management system development consulting agreement with a consulting company which is an Independent Third Party for the provision of information management system consulting service. In view of its recommendations, on 17 July 2008, we and Shanghai SVA Communication Co., Ltd. entered into ERP Implementation Project Service Agreement to implement the information management system. More details are set out in the section headed “Business — Our Future Plans — Further strengthen our overall management and information systems” of this prospectus.

### SAFETY

Our standard of occupational health and safety management was recognised by our award of the Authentication Certificate of Occupational Health and Safety Management System (GB/T28001-2001) issued by Beijing NGV Certification Centre, an approved accreditation body in China.

Since we engage Independent Third Parties to provide harvesting activities, our Directors consider that the risk of our staff experiencing industrial accident is relatively low. On the other hand, we currently make contribution to social insurance fund (which covers insurance for losses from occupational injuries) in accordance with the relevant PRC laws. Therefore our Directors are of the view that our current measures of occupational safety are adequate. As advised by our PRC legal advisers, other than the social insurance and housing fund, in PRC, we do not have any social responsibilities within the local communities as imposed by the local governments and/or stipulated by the relevant laws and regulations.

In respect of our engagement of the professional harvesting teams to undertake harvesting in Yunnan, our insurance policy taken out for our Yunnan forests covers third party liability and accident injuries. The new insurance policy we took out for our Sichuan forests also covers third party liability and accident injuries.

As at the Latest Practicable Date, we have not encountered any material operational problems such as industrial accidents, nor have we encountered any material interruptions to our business operations.

### LEGAL PROCEEDINGS AND REGULATORY COMPLIANCE

We conduct our operations and carry out our business in material compliance with relevant PRC laws and regulations. Please see the section headed “Regulatory Overview” in this prospectus for details regarding the laws and regulations that govern our operations. As advised by our PRC legal advisers, the Directors confirmed that Beijing Zhaolin had obtained all the necessary permits, certificates and licenses for its operations throughout the Track Record Period. Our PRC legal advisers have also advised us that as at the Latest Practicable Date, we have complied in all material respects with the relevant PRC laws and regulations for our two PRC subsidiaries, Kunming Ultra Big and Chengdu Yishang.

During the Track Record Period, Beijing Zhaolin was our predecessor entity. Our PRC counsel has advised that save for the failure to make certain social contributions and housing



---

## BUSINESS

---

related contributions to some of its staff, Beijing Zhaolin has complied in all material respects with the relevant PRC laws and regulations. Furthermore, the liabilities of such failure will not be transferred to the Company, Kunming Ultra Big, Chengdu Yishang or any of our PRC subsidiaries. These staff were the forest workers of Beijing Zhaolin in Sichuan. At that time, Beijing Zhaolin had agreed with these forest workers that they would use part of their salaries to make these contributions on their own and Beijing Zhaolin would include the amount of contributions in their salaries. There was such arrangement because these contributions, even if made by Beijing Zhaolin, would be made in Beijing and its forest workers in Sichuan would not be able to benefit from these contributions.

Since June 2008, our other two PRC subsidiaries, Kunming Ultra Big and Chengdu Yishang, which were established in March 2008, have commenced making contribution to the social insurance fund for their staff in compliance with the PRC laws.

As at the Latest Practicable Date, Beijing Zhaolin has been dissolved and deregistered. Our PRC legal advisers have also advised that with such dissolution and deregistration, none of the liabilities of Beijing Zhaolin will be transferred to us. Therefore, Beijing Zhaolin's failure to make certain social contributions and housing related contributions to its staff will not have any legal implication to our Group nor affect our Group's operations and financial position.

Our PRC legal advisers have advised that we have obtained all necessary licenses and permits for the operation of our business and our operation has been in compliance with the PRC laws in all material aspects during the Track Record Period. Our PRC legal advisers have also advised that the Regulations on Foreign Investors' Mergers and Acquisitions of Domestic Enterprises (《關於外國投資者併購境內企業的規定》) jointly issued by the Ministry of Commerce, the State Assets Supervision and Administration Committee, State Administration of Tax, State Administration of Industry and Commerce, CSRC and State Administration of Foreign exchange on 8 August 2006, is not applicable to our listing application on the ground that Mr. Li Kwok Cheong, our Controlling Shareholder, is a Hong Kong permanent resident, and that our listing application does not require the permission, approval or consent of the CSRC and/or any other PRC government authorities.

Our PRC legal advisers have confirmed that our Company and our Controlling Shareholders have complied with all the relevant rules and regulations imposed by the relevant PRC government authorities in respect of the Reorganisation in the PRC (namely, the incorporation of Kunming Ultra Big and Chengdu Yishang, and the transfer of Sichuan forestry rights from Beijing Zhaolin to Kunming Ultra Big) and all relevant approvals from the PRC government authorities have been obtained in respect of the aforesaid Reorganisation in the PRC.

As at the Latest Practicable Date, no member of our Group was engaged in any litigation, arbitration or administrative proceedings pending or threatening against us or any of our Directors that could have a material adverse effect on our financial condition or results of operation.

### **INFRINGEMENT OF OUR PREDECESSOR COMPANY'S NAME**

There have been reports published on websites that Beijing Zhaolin, our predecessor company, was engaged in the trading of forestry rights ("Improper Activity") in Sichuan. We have never engaged in the Improper Activity or consented to the use of Beijing Zhaolin or its

name for the Improper Activity. During the Track Record Period, Beijing Zhaolin was the owner of its forestry rights and had never held any of its forestry rights on behalf of any person. We came to be aware that an Independent Third Party (“Misuser”), who had previously proposed to establish some kind of business cooperation with Beijing Zhaolin around early 2006 (which had been subsequently refused by Beijing Zhaolin), had purported to offer such trading on behalf of Beijing Zhaolin in May 2006. The Misuser represented to others that she was engaged in trading of forestry rights on behalf of Beijing Zhaolin. This came to our attention about a week after we believe the Misuser commenced this Improper Activity and we, thereafter, immediately contacted the Misuser. She advised us that she had not yet carried out any actual trading of forestry rights since she started to make such representation to others and assured us she would discontinue the Improper Activity immediately. After receiving such assurances, we continue to monitor the matter and have neither come to be aware of continued Improper Activity nor had we been approached in this regard. We have also requested the relevant website operators to remove the inaccurate reports from their websites in July 2008 and published a clarification statement in the Chinese national newspapers on 9 July 2008.

Since the Improper Activity was terminated within about a week from the time we believe it commenced and the Misuser verbally confirmed that she had not carried out any actual trading of forestry rights during such period and had not received any benefit in respect of the Improper Activity, we considered that the risk of us being sued was low, and any further protection that we might receive by reporting the Improper Activity to the relevant government or seeking indemnity/compensation for any possible losses that could arise from such Improper Activity, was minimal, and hence, decided not to take any further action.

After investigation, it was found that the Misuser was associated with Zhengzhou Branch Office of Beijing Zhaolin as its person-in-charge, the entity alleged to be conducting the Improper Activities in the reports (“Unauthorised Branch”). Our PRC legal advisers have advised that it is the directors or shareholders of Beijing Zhaolin who have the power to approve the establishment of a branch office. In respect of the application for establishment of a branch office which must be submitted to the local administration and management bureau of industry and commerce in order to establish a branch office, under the relevant PRC laws and regulations, the legal representative is the only person who has the power to sign the application on behalf of a company.

Mr. Li Kwok Cheong, the legal representative of Beijing Zhaolin, has confirmed that (a) he has never represented Beijing Zhaolin to sign or approve the establishment of Zhengzhou branch office or any other branch offices of Beijing Zhaolin; (b) he has never authorised the Misuser or any other person to sign or approve the establishment of Zhengzhou branch office or any other branch offices of Beijing Zhaolin; (c) Beijing Zhaolin has never participated or entrusted any other person to participate in the Improper Activity; and (d) he has never indicated or consented to, or authorised, or otherwise in any form, appointed the Misuser as the agent of himself or Beijing Zhaolin. No evidence has been found that might indicate that Mr. Li Kwok Cheong’s involvement in the establishment of the Unauthorised Branch. Furthermore, based on the internet search of records at the website of the Zhengzhou administration and management bureau of industry and commerce, the business licence of the Unauthorised Branch was revoked in February 2008.

Our PRC legal advisers have advised that, based on the confirmation of Mr. Li Kwok Cheong as mentioned above, unless the other parties to the Improper Activity have valid

grounds to believe that the Misuser was acting as the agent of Beijing Zhaolin or the Group in respect of the Improper Activity, neither our Group nor Beijing Zhaolin shall be liable for any contract concluded or activities conducted by the Misuser purportedly in the name of Beijing Zhaolin in respect of the Improper Activity. Our PRC legal advisers have further advised that since the details of the Improper Activity stated in the relevant articles were not clear enough, they are not able to determine the nature of the Improper Activity and opine on the legality and legal consequence thereof.

Our PRC legal advisers have also advised that given that (i) Mr. Li Kwok Cheong has made the confirmation as mentioned above, (ii) we have confirmed that neither Beijing Zhaolin nor Mr. Li Kwok Cheong had ever authorised or at the time of the Improper Activity, was aware of the Improper Activity, none of Beijing Zhaolin and Mr. Li Kwok Cheong shall be liable for any criminal or administrative liabilities (if any) which might arise from the Improper Activity. Beijing Zhaolin's liability shall only be limited to the civil liability against any bona fide third parties who have valid reason to believe that the Unauthorised Branch was acting on behalf of Beijing Zhaolin. On 4 September 2008, Beijing Zhaolin was dissolved and deregistered. Li Kwok Cheong, being the shareholder of Beijing Zhaolin, may be required to assume such civil liability. In any event, as confirmed by our PRC legal advisers, upon dissolution of Beijing Zhaolin, any legal liabilities of Beijing Zhaolin (whether it is criminal, administrative or civil liabilities) will not be assumed by our Group or any of its subsidiaries.

As at the Latest Practicable Date, our Group or Beijing Zhaolin has not received any actual nor was it aware of any pending or threatening claims or litigation against our Group or Beijing Zhaolin in respect of the Improper Activity.