

HSBC CHINA DRAGON FUND
Annual Report 2009



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Investment advisor's report

Review

China shares moved higher in April 2008 on strong 2007 earnings results and as inflation eased. CPI inflation fell to 8.3% in March 2008 from the peak of 8.7% in February 2008. However, China shares fell again in May and June amid rising oil prices and a worsening global inflation outlook. Concerns over the economic losses from the earthquake in Sichuan on 12 May 2008 placed further uncertainties on the market. On 24 May 2008, the Chinese government announced the long-awaited telecom sector restructuring plan; 3G mobile networks are expected to be rolled out nationwide upon completion of the restructuring. China shares recovered in July 2008 as inflation eased further and on anticipation of credit relaxation in 2H08. Fears the global credit crisis may worsen triggered a sell-off from August to October 2008 despite the successful completion of the Beijing Olympics. The Chinese government announced several supportive measures to stabilize the domestic stock market, including a 50% reduction in stamp duty on stock transactions, authorizing of the sovereign fund to directly purchase stocks of China's three largest banks in the A-share market and encouraging state-owned enterprises to buy back their own shares, which uplifted the A-share market. The announcement of the RMB4 trillion stimulus package in November 2008 boosted market sentiment and triggered a rally in November and December 2008. The package will mainly invest into railway infrastructure, post-quake reconstruction, public housing, rural development, healthcare and education over two years from 2009 to 2010. China domestic A shares rose in 1Q 2009 as new bank lending exceeded RMB4.56 trillion. At the National People's Congress in March 2009, Premier Wen stated that China is prepared to roll out additional stimulus if necessary to reach the 8% GDP growth target for 2009. This statement boosted market sentiment. For 1Q 2009, GDP grew by 6.1% yoy. The main driver was the government-led investment. Fixed asset investment grew by 28.6% yoy in 1Q 2009, financed by the massive bank lending. Retail sales remained strong as it grew by 15.0% yoy, although exports fell 20% yoy in 1Q 2009.

Market outlook

Recent improvements in domestic economic activities and the rebound of the Purchasing Manager's Index for five consecutive months to 53.5 in May 2009 are encouraging signs that domestic demand and new-goods orders are gradually recovering from 4Q 2009 low levels. More infrastructure projects related to the government stimulus package are likely to commence in 2Q 2009, which would support the high rate of growth in fixed asset investment. We expect the government to introduce additional policies to stimulate domestic consumption over the coming months in order to achieve the 8% GDP targeted. However, China's stock markets may remain volatile as more non-tradable A shares will be released this year and global economic conditions remain uncertain.

**For and on behalf of
Halbis Capital Management (Hong Kong) Limited**

21 July 2009

Trustee's report to the unitholders of HSBC China Dragon Fund

We hereby confirm that, in our opinion, the Manager has in all material respects, managed HSBC China Dragon Fund ("the Fund") in accordance with the provisions of the Trust Deed dated 20 June 2007, as amended, for the year ended 31 March 2009.

CHEUNG, Keith)
LEUNG, Gary) For and on behalf of
) HSBC Institutional Trust Services (Asia) Limited, Trustee
)
)

21 July 2009

Independent auditor's report to the unitholders of HSBC China Dragon Fund

We have audited the financial statements of HSBC China Dragon Fund ("the Fund") set out on pages 4 to 20, which comprise the statement of assets and liabilities as at 31 March 2009, and the income statement, statement of changes in net assets attributable to unitholders and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Trustee's and Manager's responsibilities for the financial statements

The Trustee and the Manager are responsible for the preparation and the true and fair presentation of these financial statements in accordance with Hong Kong Financial Reporting Standards issued by the Hong Kong Institute of Certified Public Accountants, and for ensuring that the financial statements comply with the relevant disclosure provisions of the Trust Deed dated 20 June 2007, as amended, and the relevant disclosure requirements set out in Appendix E to the Hong Kong Code on United Trusts and Mutual Funds issued by the Hong Kong Securities and Futures Commission ("the Code"). This responsibility includes designing, implementing and maintaining internal control relevant to the preparation and the true and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. This report is made solely to you, as a body, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

We conducted our audit in accordance with Hong Kong Standards on Auditing issued by the Hong Kong Institute of Certified Public Accountants. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance as to whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and true and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Fund's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Trustee and the Manager, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements give a true and fair view of the financial position of the Fund as at 31 March 2009 and of its transactions and cash flows for the year ended 31 March 2009 in accordance with Hong Kong Financial Reporting Standards, and have been properly prepared in accordance with the relevant disclosure provisions of the Trust Deed dated 20 June 2007, as amended, and the relevant disclosure requirements of the Code.

KPMG

Certified Public Accountants
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
21 July 2009

Statement of assets and liabilities

As at 31 March 2009

	Note	2009 HK\$	2008 HK\$
Assets			
Investments	7	2,213,433,658	3,228,821,569
Interest and other receivables		76,265,841	2,420,309
Cash and cash equivalents	8(d)	85,811,063	169,925,839
Total assets		<u>2,375,510,562</u>	<u>3,401,167,717</u>
Liabilities			
Taxation	6	30,104,377	24,554,349
Amounts payable on purchases of investments		59,867,991	715,846
Accrued expenses and other payables		3,584,762	5,705,128
Total liabilities (excluding net assets attributable to unitholders)		<u>93,557,130</u>	<u>30,975,323</u>
Net assets attributable to unitholders		<u>2,281,953,432</u>	<u>3,370,192,394</u>
Number of units in issue	10	<u>371,910,000</u>	<u>371,910,000</u>
Net asset value per unit		<u>6.14</u>	<u>9.06</u>

Approved and authorised for issue by the Trustee and the Manager on 21 July 2009

)	
CHEUNG, Keith)	For and on behalf of
LEUNG, Gary)	HSBC Institutional Trust Services (Asia)
)	Limited, Trustee
)	
)	
LAM, Po Yee)	For and on behalf of
STOKES, Edmund Richard)	HSBC Global Asset Management
)	(Hong Kong) Limited
)	

Income statement

For the year ended 31 March 2009

		Year ended 31 March 2009 HK\$	Period from 20 June 2007 (date of inception) to 31 March 2008 HK\$
	Note		
Dividend income		41,391,830	5,813,643
Interest income on deposits	3	1,069,251	8,963,725
Gains on investments	4	735,091,699	692,352,817
Losses on investments	4	(1,800,135,158)	(802,587,490)
Net foreign exchange gain		789,962	392,564
Other income		29	–
Net investment loss		<u>(1,021,792,387)</u>	<u>(95,064,741)</u>
Expenses			
Management fee	8(a)	(37,846,166)	(44,779,670)
Transaction costs		(17,818,968)	(51,037,753)
Trustee's fee	8(b)	(2,740,308)	(3,156,109)
Custodian fee	8(c)	(1,588,183)	(1,703,654)
Auditors' remuneration		(272,850)	(260,000)
Preliminary expenses	5, 8(e)	–	(128,385,708)
Other operating expenses		(1,157,480)	(1,344,265)
Operating expenses		<u>(61,423,955)</u>	<u>(230,667,159)</u>
Loss attributable to unitholders before taxation		<u>(1,083,216,342)</u>	<u>(325,731,900)</u>
Taxation	6	(5,022,620)	(23,175,706)
Loss attributable to unitholders after taxation		<u><u>(1,088,238,962)</u></u>	<u><u>(348,907,606)</u></u>

Statement of changes in net assets attributable to unitholders

For the year ended 31 March 2009

	Year ended 31 March 2009 HK\$	Period from 20 June 2007 (date of inception) to 31 March 2008 HK\$
Subscriptions received from units issued	–	3,719,100,000
Loss attributable to unitholders after taxation	<u>(1,088,238,962)</u>	<u>(348,907,606)</u>
	(1,088,238,962)	3,370,192,394
Net assets attributable to unitholders, beginning of year/period	<u>3,370,192,394</u>	<u>–</u>
Net assets attributable to unitholders, end of year/period	<u><u>2,281,953,432</u></u>	<u><u>3,370,192,394</u></u>

Cash flow statement

For the year ended 31 March 2009

	Year ended 31 March 2009 HK\$	Period from 20 June 2007 (date of inception) to 31 March 2008 HK\$
Operating activities		
Interest received	1,144,374	8,888,602
Dividend income received	41,391,830	5,813,643
Management fees paid	(39,538,242)	(40,272,950)
Trustee's fees paid	(2,872,544)	(2,783,534)
Transaction costs paid	(17,818,968)	(51,037,753)
Preliminary expenses paid	–	(128,385,708)
Other operating expenses paid	(2,416,190)	(2,482,086)
Net cash used in operating activities	<u>(20,109,740)</u>	<u>(210,259,786)</u>
Investing activities		
Other income received	29	–
QFII custodian deposit placed	(50,766)	(2,345,186)
Proceeds from sales of investments	3,135,047,675	3,770,576,212
Purchases of investments	(3,199,420,968)	(7,108,916,608)
Net cash used in investing activities	<u>(64,424,030)</u>	<u>(3,340,685,582)</u>
Financing activities		
Proceeds from issue of units	–	3,719,100,000
Net cash generated from financing activities	<u>–</u>	<u>3,719,100,000</u>
Net (decrease)/increase in cash and cash equivalents	(84,533,770)	168,154,632
Cash and cash equivalents at the beginning of the year/period	169,925,839	–
Effect of foreign exchange rates changes	418,994	1,771,207
Cash and cash equivalents at the end of the year/period	<u>85,811,063</u>	<u>169,925,839</u>

Notes on the financial statements

For the year ended 31 March 2009

1 Background

HSBC China Dragon Fund ("the Fund") is a closed-end unit trust governed by its Trust Deed dated 20 June 2007 ("the Trust Deed"), as amended. The Fund is authorized by the Hong Kong Securities and Futures Commission ("the SFC") under Section 104 of the Hong Kong Securities and Futures Ordinance. The Fund is also listed on The Stock Exchange of Hong Kong Limited ("the Stock Exchange") (a subsidiary of the Hong Kong Exchanges and Clearing Limited). The period fixed for the duration of the Fund is eighty years after the date of inception.

The investment objective of the Fund is to achieve long-term capital growth by investing primarily in listed companies established or operating in the People's Republic of China (PRC) or listed companies that are positioned to benefit from the strong economic growth potential and promising investment opportunities in the PRC, including but not limited to A Shares, B Shares, H Shares and shares issued by Red Chip Companies and other companies which carry out a significant proportion of their business activities in the PRC.

Under the prevailing regulations in the PRC, foreign investors can invest in the PRC A-Share market through institutions that have obtained qualified foreign institutional investor (QFII) status in the PRC. The Fund itself is not a QFII, but may invest directly in A Shares via the US\$200 million QFII investment quota obtained by the Manager.

2 Significant accounting policies

(a) Statement of compliance

The financial statements of the Fund have been prepared in accordance with all applicable Hong Kong Financial Reporting Standards ("HKFRSs"), which collective term includes all applicable individual Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards ("HKASs") and Interpretations issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA"), accounting principles generally accepted in Hong Kong, the relevant disclosure provisions of the Trust Deed, as amended, and the relevant disclosure requirements of the Hong Kong Code on Unit Trusts and Mutual Funds issued by the Hong Kong Securities and Futures Commission. A summary of the significant accounting policies adopted by the Fund is set out below.

The HKICPA has issued a number of new Interpretations and amendment to HKFRSs that are first effective for the current accounting period of the Fund. However, none of these developments are relevant to the Fund's operations.

The Fund has not applied any new standard or interpretation that is not yet effective for the current accounting period (see note 13).

(b) Basis of preparation of the financial statements

The functional and presentation currency of the Fund is Hong Kong dollars reflecting the fact that the units of the Fund are issued in Hong Kong dollars.

The measurement basis used in the preparation of the financial statements is the historical cost basis except that investments are stated at their fair value as explained in the accounting policies set out below.

The preparation of financial statements in conformity with HKFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Notes on the financial statements

For the year ended 31 March 2009

(b) Basis of preparation of the financial statements (continued)

Judgements made by management in the application of HKFRSs that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are discussed in note 12.

(c) Financial instruments

(i) Classification

All of the Fund's investments are classified as financial assets at fair value through profit or loss. This category comprises financial instruments held for trading, which are instruments that the Fund has acquired principally for the purpose of short-term profit-taking. These include investments in equity and debt securities.

Financial assets that are classified as receivables include interest receivables and other receivables.

Financial liabilities that are not at fair value through profit or loss include amounts payable on purchases of investments, accrued expenses and other payables.

(ii) Recognition

The Fund recognises financial assets and financial liabilities on the date it becomes a party to the contractual provisions of the instruments.

A regular way purchase or sale of financial assets and financial liabilities is recognised using trade date accounting. From this date, any gains and losses arising from changes in fair value of the financial assets or financial liabilities are recorded.

Financial liabilities are not recognised unless one of the parties has performed their obligations under the contract or the contract is a derivative contract not exempted from the scope of HKAS 39.

(iii) Measurement

Financial instruments are measured initially at fair value (transaction price). Transaction costs on financial assets and financial liabilities at fair value through profit or loss are expensed immediately, while on other financial instruments they are amortised.

Subsequent to initial recognition, all instruments classified at fair value through profit or loss are measured at fair value with changes in their fair values recognised in the income statement.

Financial assets classified as receivables are carried at amortised cost using the effective interest method less impairment loss, if any.

Financial liabilities, other than those at fair value through profit or loss, are measured at amortised cost using the effective interest method.

Upon termination of the Fund, the unitholder is entitled to a share of all net cash proceeds derived from the sale or realisation of the assets of the Fund less any liabilities, in accordance with their proportionate interest in the Fund at the date of termination. The unitholders' funds are therefore classified as a financial liability other than equity in accordance with HKAS 32. It is shown on the statement of assets and liabilities as the "net assets attributable to unitholders".

(iv) Fair value measurement principles

The fair value of financial instruments is based on their quoted market prices at the date of the statement of assets and liabilities without any deduction for estimated future selling costs. Financial assets are priced at current bid prices, while financial liabilities are priced at current asking prices.

Notes on the financial statements

For the year ended 31 March 2009

(c) *Financial instruments (continued)*

(iv) Fair value measurement principles (continued)

If a quoted market price is not available on a recognised stock exchange or from a broker/dealer for non-exchange-traded financial instruments, the fair value of the instrument is estimated using valuation techniques, including use of recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow techniques, option pricing models or any other valuation technique that provides a reliable estimate of prices obtained in actual market transactions.

Where pricing models are used, inputs are based on market data at the date of the statement of assets and liabilities. Fair values for unquoted equity instruments are estimated, if possible, using applicable price/ratios for similar listed companies adjusted to reflect the specific circumstances of the issuer.

Gains and losses on investments are included in the income statement. Realised gains and losses include net gains or losses on contracts which have been settled or for which offsetting contracts have been entered into.

(v) Impairment

Financial assets that are stated at cost or amortised cost are reviewed at each date of the statement of assets and liabilities to determine whether there is objective evidence of impairment. If any such indication exists, an impairment loss is recognised in the income statement as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's effective interest rate.

If in a subsequent period the amount of an impairment loss recognised on a financial asset carried at amortised cost decreases and the decrease can be linked objectively to an event occurring after the write-down, the write-down is reversed through the income statement.

(vi) Derecognition

The Fund derecognises a financial asset when the contractual rights to receive the cash flows from the financial asset expire, or where the financial asset together with substantially all the risks and rewards of ownership have been transferred.

Assets held for trading that are sold are derecognised and corresponding receivables from the brokers are recognised as of the date the Fund commit to sell the assets.

A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expires.

The Fund use the weighted average method to determine realised gains and losses to be recognised in the income statement on derecognition.

(vii) Offsetting

Financial assets and liabilities are offset and the net amount is reported in the statement of assets and liabilities when the Fund has a legally enforceable right to set off the recognised amounts and the transactions are intended to be settled on a net basis, or simultaneously, e.g. through a market clearing mechanism.

(viii) Cash and cash equivalents

Cash and cash equivalents comprise deposits with banks. Cash equivalents are short-term highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.

Notes on the financial statements

For the year ended 31 March 2009

(d) Revenue recognition

Provided it is probable that the economic benefits will flow to the Fund and the revenue and costs if applicable, can be measured reliably, revenue is recognised in the income statement as follows:

Interest income

Interest income is recognised in the income statement as it accrues, using the effective interest method. Interest income on bank deposits is disclosed separately on the face of the income statement. Interest income on debt securities is included in gain on investments.

Dividend income

Dividend income from listed investments is recognised when the share price of the investment goes ex-dividend. Dividends from other investments are recognised in the income statement as dividend income when declared.

In some cases, the Fund may receive or choose to receive dividends in the form of additional shares rather than cash. In such cases, the Fund recognises the dividend income for the amount of the equivalent cash dividends with the corresponding debit treated as an additional investment.

(e) Preliminary expenses

Preliminary expenses of the Fund are charged to the income statement as incurred.

(f) Expenses

All expenses are recognised in the income statement on an accruals basis.

(g) Taxation

Taxation comprises current tax and deferred tax. Current tax and movements in deferred tax assets and liabilities are recognised in the income statement.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the date of statement of assets and liabilities.

Deferred tax assets and liabilities arise from deductible and taxable temporary differences respectively, being the differences between the carrying amounts of assets and liabilities for financial reporting purposes and their tax bases.

Apart from certain limited exceptions, all deferred tax liabilities, and all deferred tax assets to the extent that is probable that future taxable profits will be available against which the asset can be utilised, are recognised.

(h) Translation of foreign currency

Foreign currency transactions during the year are translated into Hong Kong dollars at the foreign exchange rates ruling at the transaction dates. Monetary assets and liabilities denominated in foreign currencies are translated into Hong Kong dollars at the foreign exchange rates ruling at the date of statement of assets and liabilities. Exchange gains and losses are recognised in the income statement.

(i) Related parties

For the purposes of these financial statements, a party is considered to be related to the Fund if:

- (i) the party has the ability, directly or indirectly, through one or more intermediaries, to control the Fund or exercise significant influence over the Fund in making financial and operating policy decisions, or has joint control over the Fund;

Notes on the financial statements

For the year ended 31 March 2009

(i) Related parties (continued)

- (ii) the Fund and the party are subject to common control;
- (iii) the party is an associate of the Fund;
- (iv) the party is a member of key management personnel of the Fund or the Fund's parent, or a close family member of such an individual, or is an entity under the control, joint control or significant influence of such individuals; or
- (v) the party is a close family member of a party referred to in (i) or is an entity under the control, joint control or significant influence of such individuals.

Close family members of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the Fund.

(j) Subscriptions

The Fund recognises unitholders' subscriptions and allots units upon receipt of a valid subscription application.

(k) Foreign exchange gains and losses

Foreign exchange gains and losses on financial assets and financial liabilities at fair value through profit or loss are recognised together with other changes in the fair value. Included in the profit or loss line item *Net foreign exchange gain* are net foreign exchange gains and losses on monetary financial assets and financial liabilities other than those classified at fair value through profit or loss.

3 Interest income

The Fund earned all its interest income from cash and cash equivalents.

4 Gains and losses on investments

	Year ended 31 March 2009 HK\$	Period from 20 June 2007 (date of inception) to 31 March 2008 HK\$
Realised gains	183,632,139	601,010,413
Unrealised gains	551,459,560	91,342,404
Total gains on investments	<u>735,091,699</u>	<u>692,352,817</u>
Realised losses	(1,426,040,600)	(247,120,846)
Unrealised losses	(374,094,558)	(555,466,644)
Total losses on investments	<u>(1,800,135,158)</u>	<u>(802,587,490)</u>
Net losses on investments	<u>(1,065,043,459)</u>	<u>(110,234,673)</u>

Gains and losses presented above exclude dividend income.

Notes on the financial statements

For the year ended 31 March 2009

5 Preliminary expenses

The preliminary establishment expenses of the Fund, including the Stock Exchange initial listing fees, legal and other professional fees, underwriting commission, the SFC application fee, the SFC authorisation fee and printing and other expenses relating to the Global Offering and establishment of the Fund, which amounted to \$128 million, were borne by the Fund and were written off immediately on the first Valuation Day of the Fund.

6 Taxation

No provision for Hong Kong Profits Tax has been made in the financial statements as the Fund is exempted from taxation under section 26A (1A) of the Hong Kong Inland Revenue Ordinance.

Under current tax law in the PRC, as a foreign company which does not have an establishment in the PRC, the Fund is subject to PRC withholding tax at the rate of 10% in respect of its receipt of PRC-sourced income, including capital gains, dividend income and interest income.

Pursuant to Article 13 of the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("PRC-HK DTA"), the taxing right in respect of gains derived by a Hong Kong tax resident from the alienation of shares of a PRC company, in which the assets of the PRC company comprised less than 50% of immovable property within three years prior to the transfer and the Hong Kong tax resident directly or indirectly holds less than 25% interest in the PRC company within a year prior to the transfer, are allocated to Hong Kong.

The PRC-HK DTA provides withholding tax rate for interest income derived from deposit with the custodians in the PRC to be reduced to 7%.

The Offering Circular of the Fund gives the Manager the right to provide for withholding tax on such gains or income and withhold the tax for the account of the Fund. In the absence of any precedent on the actual tax treatment of such gains to holders of QFII quota, but on the basis of the available information, the Manager has determined that it is appropriate to provide for realised gains on A-shares at the rate of 10% in the financial statements.

7 Investments

	2009 HK\$	2008 HK\$
Listed equity securities		
– in Hong Kong	1,022,131,374	1,644,646,984
– outside Hong Kong	1,188,857,157	1,584,174,585
	<u>2,210,988,531</u>	<u>3,228,821,569</u>
Listed debt securities		
– Bonds	2,445,127	–
	<u>2,213,433,658</u>	<u>3,228,821,569</u>

8 Related parties transactions

The following is a summary of transactions with related parties for the year. All such transactions were entered into in the ordinary course of business and on normal commercial terms.

Notes on the financial statements

For the year ended 31 March 2009

8 Related parties transactions (continued)

(a) Management fee

The fee payable to the Manager is calculated at the rate of 1.5% per annum of the net asset value of the Fund payable monthly in arrears. Any fees payable to the Investment Adviser should be borne by the Manager. The management fee charged by the Fund in respect of the year and payable at the end of the year amounted to \$37,846,166 (period ended 31 March 2008: \$44,779,670) and \$2,814,644 (2008: \$4,506,720) respectively.

The Fund has invested directly in A Shares via the US\$200 million QFII investment quota obtained by the Manager.

(b) Trustee's fee

The fee payable to the Trustee is calculated at the rate of 0.125% per annum for the first \$390 million of the net asset value, and 0.1% per annum thereafter. The trustee fee is accrued daily and payable in arrears on a monthly basis. The trustee fee charged by the Fund in respect of the year and payable at the end of the year amounted to \$2,740,308 (period ended 31 March 2008: \$3,156,109) and \$240,339 (2008: \$372,575) respectively.

(c) Custodian fee

The custodian fee is calculated at the rate of 0.1% per annum of the net asset value of the assets held by the QFII custodian as determined by the QFII custodian (based on the actual number of calendar days in a year). The custodian fee charged by the Fund in respect of the year and payable at the end of the year amounted to \$1,588,183 (period ended 31 March 2008: \$1,703,654) and \$31,362 (2008: \$61,884) respectively.

(d) Bank balances

Bank balances are maintained with the Trustee. The bank balances held with the Trustee as at 31 March 2009 amounted to \$85,811,063 (2008: \$169,925,839). During the year, interest earned on the above bank balances was \$1,069,251 (period ended 31 March 2008: \$8,963,725).

(e) In its purchases and sales of investments, the Fund utilises the brokerage services of The Hongkong and Shanghai Banking Corporation Limited. Details of transactions effected through this company are as follows:

	For the year ended 31 March 2009 HK\$	Period from 20 June 2007 (date of inception) to 31 March 2008 HK\$
Commission paid for the year/period	226,355	569,452
Average rate of commission	0.20%	0.13%
Total aggregate value of such transactions for the year/period	113,177,338	452,844,440
Percentage of such transactions in value to total transactions for the year/period	<u>1.78%</u>	<u>4.09%</u>

Notes on the financial statements

For the year ended 31 March 2009

9 Soft dollar practices

The Manager, the Investment Adviser or any of its connected persons may effect transactions by or through the agency of another person (or person connected with him) with whom it has an arrangement under which that party will from time to time provide it with or procure for it goods, services or other benefits (such as research and advisory services, portfolio analysis or computer hardware and software incidental to such goods or services) the nature of which is such that their provision is of demonstrable benefit to the unitholders as a whole and for which no direct payment is made but instead the Manager, the Investment Adviser or any of its connected persons undertake to place business with that party. For the avoidance of doubt, such goods and services do not include travel, accommodation, entertainment, general administrative goods or services, general office equipment or premises, membership fees, employee salaries or direct money payments.

10 Units in issue

	For the year ended 31 March 2009	Period from 20 June 2007 (date of inception) to 31 March 2008
Number of units in issue brought forward	371,910,000	–
Units issued during the year/period	–	371,910,000
	<hr/>	<hr/>
Number of units in issue carried forward	371,910,000	371,910,000
	<hr/> <hr/>	<hr/> <hr/>

The Fund is a closed-end unit trust. There was no redemption of units during the year.

11 Financial instruments and associated risks

The Fund maintains investment portfolio in a variety of listed financial instruments as dictated by its investment management strategy. The investment objective of the Fund is to achieve long-term capital growth by investing primarily in listed companies established or operating in the PRC or listed companies that are positioned to benefit from the strong economic growth potential and promising investment opportunities in the PRC, including but not limited to A Shares, B Shares, H Shares and shares issued by Red Chip Companies and other companies which carry out a significant proportion of their business activities in the PRC. The risk exposures inherent in the Fund as at 31 March 2009 are summarised below. Details of such investments held as at 31 March 2009 are shown in the investment portfolio.

The Fund's investing activities expose it to various types of risks that are associated with the financial instruments and markets in which it invests. The Manager and the Trustee have set out below the most important types of financial risks inherent in each type of financial instruments. The Manager and the Trustee would like to highlight that the following list of associated risks only sets out some of the risks but does not purport to constitute an exhaustive list of all the risks inherent in an investment in the Fund. Investors should note that additional information in respect of risks associated with investment in the Fund can be found in the Fund's offering document.

During the year, the Manager invested in financial instruments which the Manager considered are commensurate with the risk level of the Fund in accordance with its investment objective.

The nature and extent of the financial instruments outstanding at the balance sheet date and the risk management policies employed by the Fund are discussed below.

Notes on the financial statements

For the year ended 31 March 2009

11 Financial instruments and associated risks (continued)

(a) Market risk

(i) Price risk

Price risk is the risk that value of the instrument will fluctuate as a result of changes in market prices, whether caused by factors specific to an individual investment, its issuer or all factors affecting all instruments traded in the market.

The Fund is exposed to price risk arising from changes in market price of equity instruments. Price risk is managed by investments across different industries in accordance with the investment objective of the Fund.

Price sensitivity

The impact on a 5% increase in value of the investments at 31 March 2009, with all other variables held constant, is shown below. An equal change in the opposite direction would have reduced the net assets value by an equal but opposite amount. The analysis is performed on the same basis for 2008.

	2009			2008		
	% of total assets	Change in equity price %	Effect on net assets attributable to the unitholders HK\$	% of total assets	Change in equity price %	Effect on net assets attributable to the unitholders HK\$
Investment assets						
Listed equity investments:						
- in Hong Kong	43.03	5	51,106,569	48.36	5	82,232,349
- outside Hong Kong	50.04	5	59,442,858	46.57	5	79,208,729
	<u>93.07</u>		<u>110,549,427</u>	<u>94.93</u>		<u>161,441,078</u>

(ii) Interest rate risk

Interest rate risk arises from change in interest rates which may inversely affect the value of debt securities and therefore result in a potential gain or loss to the Fund. The Fund's interest rate risk is managed on an ongoing basis by the manager in accordance with policies and procedures in place.

The following table indicates the expected next repricing dates (or maturity dates whichever are earlier) for interest bearing assets and liabilities at the date of statement of assets and liabilities.

Notes on the financial statements

For the year ended 31 March 2009

11 Financial instruments and associated risks (continued)

(a) Market risk (continued)

(ii) Interest rate risk (continued)

	2009			Total HK\$
	1 year or less HK\$	Over 5 years HK\$	Non-interest bearing HK\$	
Assets				
Investments	–	2,445,127	2,210,988,531	2,213,433,658
Interest and other receivables	–	–	2,395,952	2,395,952
Amount receivable on sale of investments	–	–	73,869,889	73,869,889
Cash and cash equivalents	85,811,063	–	–	85,811,063
Total assets	<u>85,811,063</u>	<u>2,445,127</u>	<u>2,287,254,372</u>	<u>2,375,510,562</u>
Liabilities				
Taxation	–	–	(30,104,377)	(30,104,377)
Amounts payable on purchases of investments	–	–	(59,867,991)	(59,867,991)
Accrued expenses and other payables	–	–	(3,584,762)	(3,584,762)
Total liabilities	<u>–</u>	<u>–</u>	<u>(93,557,130)</u>	<u>(93,557,130)</u>
Total interest sensitivity gap	<u>85,811,063</u>	<u>2,445,127</u>		
	2008			
	1 year or less HK\$	Non-interest bearing HK\$	Total HK\$	
Assets				
Investments	–	3,228,821,569	3,228,821,569	
Interest and other receivables	75,123	2,345,186	2,420,309	
Cash and cash equivalents	91,602,582	78,323,257	169,925,839	
Total assets	<u>3,309,490,012</u>	<u>3,309,490,012</u>	<u>3,401,167,717</u>	
Liabilities				
Taxation	–	(24,554,349)	(24,554,349)	
Amounts payable on purchases of investments	–	(715,846)	(715,846)	
Accrued expenses and other payables	–	(5,705,128)	(5,705,128)	
Total liabilities	<u>–</u>	<u>(30,975,323)</u>	<u>(30,975,323)</u>	
Total interest sensitivity gap	<u>91,677,705</u>			

Notes on the financial statements

For the year ended 31 March 2009

11 Financial instruments and associated risks (continued)

(a) Market risk (continued)

- (ii) Interest rate risk (continued)

Interest rate sensitivity

Assuming all other factors unchanged, an increase of 50 basis point in interest rates as at the date of statement of assets and liabilities, the net assets attributable to the unitholders and changes in net assets attributable to unitholders from operation of the Fund would have increased by \$410,391 (2008: \$458,013); an equal change in the opposite direction would have reduced the net asset attributable to unitholders by an equal amount. The analysis is performed on the same basis for 2008.

- (iii) Currency risk

The Fund may invest in financial investments and enter into transactions denominated in currencies other than its functional currency. Consequently, the Fund is exposed to risks that the exchange rate of its functional currency relative to other foreign currencies may change in a manner that has an adverse effect on the value of that portion of the Fund's assets or liabilities denominated in currencies other than the Hong Kong dollars.

The fluctuations in the rate of exchange between the currency in which the asset or liability is denominated and the functional currency could result in an appreciation or depreciation in the fair value of that asset or liability. The manager may attempt to mitigate this risk by using financial derivative instruments.

In accordance with the Fund's policy, the Manager monitors the Fund's currency exposure on an ongoing basis.

At the date of statement of assets and liabilities the Fund had the following exposure:

	Assets HK\$	Liabilities HK\$	Net exposure HK\$
31 March 2009			
Renminbi	1,159,341,335	(30,331,143)	1,129,010,192
United States dollar	14,509,224	(31,362)	14,477,862
	<u>1,173,850,559</u>	<u>(30,362,505)</u>	<u>1,143,488,054</u>
31 March 2008			
Renminbi	1,550,836,171	(24,776,308)	1,526,059,863

Amounts in the above table are based on the carrying value of the assets and liabilities.

Currency sensitivity

At 31 March 2009, had the HKD strengthened by 5% in relation to the above currencies, with all other variables held constant, net assets attributable to unitholders would have decreased by the amounts shown below.

Notes on the financial statements

For the year ended 31 March 2009

11 Financial instruments and associated risks (continued)

(a) Market risk (continued)

(ii) Interest rate risk (continued)

	HK\$
31 March 2009	
Renminbi	56,450,510
Total	<u>56,450,510</u>
31 March 2008	
Renminbi	76,302,993
Total	<u>76,302,993</u>

A 5% weakening of the HKD against the above currencies would have resulted in an equal but opposite effect on the above financial statement on the basis that all other variables remain constant.

(b) Credit risk

Credit risk is the risk that a counterparty to a financial instrument will fail to discharge an obligation or commitment that it has entered into with the Fund. The Fund's exposure to credit risk is monitored by the Manager on an ongoing basis. At 31 March 2009, all the Fund's financial assets were exposed to credit risk.

Credit risk arising on transactions with brokers relates to transactions awaiting settlement. Risk relating to unsettled transactions is considered small due to the short settlement period involved and the high credit quality of the brokers used.

Substantially all of the assets of the Fund are held by the Trustee or Bank of Communications Co., Ltd (the "QFII Custodian"). Bankruptcy or insolvency of the Trustee or the QFII Custodian may cause the Fund's rights with respect to securities held by the Trustee or the QFII Custodian to be delayed or limited.

The majority of the cash held by the Fund is deposited with Bank of Communications Co., Ltd and The Hongkong and Shanghai Banking Corporation Limited (the "banks"). Bankruptcy or insolvency of the banks may cause the Fund's rights with respect to the cash held by the banks to be delayed or limited. The Fund monitors the credit rating of the banks on an ongoing basis.

The carrying amounts of financial assets best represent the maximum credit risk exposure at the date of statement of assets and liabilities.

At both 31 March 2009 and 2008, there were no significant concentrations of credit risk to counterparties except to the Trustee and the QFII Custodian.

(c) Liquidity risk

Liquidity risk arises from the risk that the Manager may not be able to convert investments into cash to meet liquidity needs in a timely manner.

The Fund's policy is to regularly monitor current and expected liquidity requirements to ensure that it maintains sufficient reserves of cash and readily realisable marketable securities to meet its liquidity requirements in the short and longer term.

The Fund's equity investments are considered to be readily realisable under normal condition as they are all listed on stock exchanges in Hong Kong or the PRC.

As at 31 March 2009 and 2008, the Fund's financial liabilities are due within three months.

Notes on the financial statements

For the year ended 31 March 2009

12 Fair value information

The Fund's financial instruments are measured at fair value on the date of statement of assets and liabilities. Fair value estimates are made at a specified point in time, based on market conditions and information about the financial instruments. Usually, fair values can be reliably determined within a reasonable range of estimates. For certain other financial instruments, including interest receivable, amounts receivable from sale of investments, provision for tax, deferred tax liabilities, amounts payable on purchase of investments, accrued expenses and other payables, the carrying amounts approximate fair value due to the immediate or short-term nature of these financial instruments.

The carrying amounts of all the Fund's financial assets and financial liabilities at the date of statement of assets and liabilities approximated their fair values as at 31 March 2009 and 2008.

(a) Estimation of fair values

The major methods and assumptions used in estimating the fair values of financial instruments were disclosed in note 2(c)(iv) of the significant accounting policies section.

At 31 March 2009, the carrying amounts of equity investments which fair values were determined directly by reference to published price quotations amounted to \$2,210,988,531 (2008: \$3,228,821,569). There is no equity investments for which fair values were determined using valuation techniques.

Quoted market prices are readily available for all the Fund's financial instruments.

Fair value estimates are made at a specific point in time, based on market conditions and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement (e.g. interest rates, volatility, estimated cash flows, etc.) and therefore, cannot be determined with precision.

(b) Fair value

All financial instruments are stated at fair value or carried at amounts not materially different from their fair values as at 31 March 2009 and 2008.

13 Possible impact of amendments, new standards and interpretations issued but not yet effective for the annual accounting year ended 31 March 2009

Up to the date of issue of these financial statements, the HKICPA has issued a number of amendments, new standards and interpretations which are not yet effective for the year ended 31 March 2009 and which have not been adopted in these financial statements.

The Fund is in the process of making an assessment of what the impact of these amendments, new standards and new interpretations is expected to be in the period of initial application.

So far it has concluded that the adoption of them is unlikely to result in a restatement of the Fund's results of operations and financial position.

In addition, the following developments are expected to result in amended disclosures in the financial statements, including restatement of comparative amounts in the first period of adoption:

	Effective for accounting periods beginning on or after
HKAS 1 (revised 2007) <i>Presentation of Financial Statements</i>	1 January 2009
Amendments to HKAS 32 <i>Financial instruments: Presentation</i>	1 January 2009

Investment portfolio

As at 31 March 2009

HSBC China Dragon Fund

			<i>% of total net assets attributable to unitholders</i>
	<i>Holdings</i>	<i>Market value HK\$</i>	
Equities			
Listed investments			
<i>The People's Republic of China</i>			
Beijing Tiantan Biological Prod Corp	1,692,440	33,926,577	1.49
Beijing Wangfujing Department Store Co Ltd	1,199,351	28,325,662	1.24
Chengdu B-Ray Media Co Ltd	2,726,581	45,073,411	1.97
China Merchants Bank Co Ltd	3,504,500	63,337,203	2.78
China Railway Construction Corp	4,134,100	44,014,023	1.93
China Shenhua Energy Co Ltd	1,816,110	42,624,274	1.87
China Shipping Development Co Ltd	601,500	8,006,602	0.35
China Vanke Co Ltd	5,672,200	53,186,516	2.33
Faw Car Co Ltd	2,129,701	29,604,219	1.30
Gree Electric Appliances Inc	1,213,441	35,785,205	1.57
Hangzhou Steam Turbine Co	2,729,991	21,839,928	0.96
Harbin Pharm Group Co Ltd	4,156,700	57,922,202	2.54
Huangshan Tourism Development	1,949,015	35,423,641	1.55
Offshore Oil Engineering Co Ltd	1,751,108	32,660,538	1.43
Ping An Insurance Group Co	1,353,600	59,900,906	2.61
Qingdao Mesnac Co Ltd	1,608,300	31,036,384	1.36
Shandong Gold Mining Co Ltd	523,716	47,646,528	2.09
Shanghai International Airport Co Ltd	1,959,500	31,592,890	1.38
Shanghai Pudong Development Bank Co	5,628,984	139,835,322	6.13
TBEA Co Ltd	865,071	27,836,116	1.22
Tian Di Science & Technology Co Ltd	2,076,351	40,304,081	1.77
Tsingtao Brewery Co Ltd	1,323,265	30,892,117	1.35
Xinjiang Ba Yi Iron & Steel Co Ltd	5,079,008	48,660,896	2.13
Yantai Changyu Pioneer Wine Co Ltd	631,280	17,802,096	0.78
Yantai Wanhua Polythurene Co Ltd	2,858,800	51,699,811	2.27
Zhejiang Tianma Bearing Co Ltd	1,109,337	82,045,615	3.60
ZTE Corp	832,688	33,365,170	1.46
		<hr/> 1,174,347,933 <hr/>	<hr/> 51.46 <hr/>

Investment portfolio

As at 31 March 2009

HSBC China Dragon Fund

	<i>Holdings</i>	<i>Market value HK\$</i>	<i>% of total net assets attributable to unitholders</i>
Equities			
Listed investments			
<i>Hong Kong</i>			
Bank of China Ltd	30,000,000	77,100,000	3.38
Beijing Enterprises Holdings Ltd	1,000,000	32,250,000	1.41
Catic International Holdings Ltd	50,992,000	6,679,952	0.29
China Agri-Industries Holdings Ltd	3,632,000	13,402,080	0.59
China Bluechemical Ltd	8,100,000	34,182,000	1.50
China Coal Energy Co	4,200,000	23,898,000	1.05
China Communications Construction Co Ltd	4,900,000	41,650,000	1.82
China Communication Services Corp Ltd	2,854,000	13,214,020	0.58
China Construction Bank	14,137,000	62,061,430	2.72
China Everbright Ltd	2,000,000	24,080,000	1.06
China Insurance International Holdings Co Ltd	1,066,000	13,282,360	0.58
China Life Insurance Co Ltd	3,312,000	84,952,800	3.72
China Mobile Ltd	1,124,500	76,016,200	3.33
China Overseas Land & Investment Limited	2,178,801	26,581,372	1.16
China Petroleum & Chemical Corp	13,500,000	66,825,000	2.93
China Shenhua Energy Co Ltd	800,000	13,952,000	0.61
China South Locomotive & Rolling	3,000,000	10,530,000	0.46
China Unicom Hong Kong Ltd	3,422,000	28,334,160	1.24
China Yurun Food Group Limited	2,000,000	19,760,000	0.87
CNOOC Ltd	6,000,000	46,200,000	2.02
Comba Telecom Systems Holdings Ltd	274,000	745,280	0.03
Dongfeng Motor Group Limited	8,000,000	31,920,000	1.40
Industrial and Commercial Bank of China	13,700,000	54,937,000	2.41
Jiangsu Expressway Co Ltd	2,300,000	11,960,000	0.52
Lonking Holdings Ltd	8,000,000	37,680,000	1.65
Ping An Insurance (Group) Co Of China	300,000	13,905,000	0.61
Sino-Ocean Land Holdings Ltd	6,300,000	31,941,000	1.40
Tencent Holdings Ltd	500,000	28,725,000	1.26
Want Want China Holdings Ltd	4,804,000	17,006,160	0.75
Xinyi Glass Holdings Co Ltd	5,000,000	17,150,000	0.75
Zhejiang Expressway Co Ltd	3,000,000	17,010,000	0.75
Zijin Mining Group Co Ltd	4,578,000	25,270,560	1.11
ZTE Corp	600,000	18,930,000	0.83
		<u>1,022,131,374</u>	<u>44.79</u>

Investment portfolio

As at 31 March 2009

HSBC China Dragon Fund

	<i>Holdings</i>	<i>Market value HK\$</i>	<i>% of total net assets attributable to unitholders</i>
Equities			
Listed investments			
<i>USA</i>			
Netease Communication Inc Sponsored ADR	69,727	14,509,224	0.64
Total equities		<u>2,210,988,531</u>	<u>96.89</u>
Bond			
Listed investment			
Guangxi Liugong Step Cpn CB 18 April 2014	1,574,000	2,445,127	0.11
Total investments (Total cost of investments: \$2,528,753,293)		2,213,433,658	97.00
Other net assets		<u>68,519,774</u>	<u>3.00</u>
Total net assets attributable to unitholders		<u>2,281,953,432</u>	<u>100.00</u>

Statement of movements in portfolio holdings

For the year ended 31 March 2009

	<i>% of total net assets attributable to unitholders</i>	
	<i>31 March 2009</i>	<i>31 March 2008</i>
Equities	96.89	95.81
Bonds	0.11	–
Total investments	97.00	95.81
Other net assets	3.00	4.19
Total net assets attributable to unitholders	100.00	100.00

Performance table

For the year ended 31 March 2009

(a) **Total net asset value**

Year/period end

31 March 2009	HK\$2,281,953,432
31 March 2008	HK\$3,370,192,394

(b) **Total net asset value per unit**

Year/period end

31 March 2009	HK\$6.14
31 March 2008	HK\$9.06

(c) **Price record**

The Fund is a closed-end fund listed on The Stock Exchange of Hong Kong Limited and no unitholders may demand redemption of their units. In general, closed-end funds may trade on the exchange at a discount or at a premium to their net asset value. There is no assurance that the units will be traded at a price that is equal to the Net Asset Value. As the market price of the units may be determined by factors such as the Net Asset Value and market supply and demand for the units, there is a risk that the units will be traded at a discount to its Net Asset Value. In times of market disruption or when there is an insufficient number of buyers and/or sellers of the units, the bid/ask spread of the market price of the units may widen significantly.

Year	Net asset value per unit	
	Lowest HK\$	Highest HK\$
2009	4.12	10.22
20 June 2007 (date of inception) to 31 March 2008	8.62	13.94

Administration and management

Directors of the Manager

Executive Directors:

APENBRINK, Rudolf Eduard Walter

LAM, Po Yee

STOKES, Edmund Richard

CONXICOEUR, Patrice Pierre Henri (appointed on 1 August 2008)

AU, King Lun (resigned on 1 August 2008)

LOUIE, Ngar Yee (resigned on 5 May 2008)

Non-Executive Directors:

CHENG, Hoi Chuen Vincent

CHEANG, Wai Wan Louisa

FRIED, David Lawrence

LEECH, Paul Ernest

LEUNG, Wing Cheung William

McCOMBE, Mark Seumas

COVERDALE, John Edward (appointed on 4 May 2009)

YUEN, Jeanie (appointed on 4 May 2009)

AMANDINI, Peter James (appointed on 5 May 2008 and resigned on 4 May 2009)

ENGEL, Conrado (resigned on 18 May 2009)

LEUNG, Ko May Yee Margaret (resigned on 4 May 2009)

Trustee

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Hong Kong

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Computershare Hong Kong Investor Services Limited

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Manager

HSBC Global Asset Management (Hong Kong) Limited

HSBC Main Building

1 Queen's Road Central

Hong Kong

Investment Adviser

Halbis Capital Management (Hong Kong) Limited

HSBC Main Building

1 Queen's Road Central

Hong Kong

QFII Custodian

Bank of Communications Co., Ltd

188, Yin Cheng Zhong Road

Shanghai 200120

The People's Republic of China

Auditors

KPMG

Certified Public Accountants

8th Floor, Prince's Building

10 Chater Road

Central

Hong Kong

