

HSBC CHINA DRAGON FUND
Interim Report 2009



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Investment Advisor's Report

Interim period ended 30 September 2009

Review

In the second quarter of 2009, the H-share and MSCI China index rallied 35.8% and 33.3% respectively, as investors gained confidence following the release of stronger-than-expected macro data. The pick up in economic activities in China and additional measures to stimulate consumption and boost investment helped raise investors' hopes that the market had finally bottomed. China's Purchasing Managers' Index registered 53.2 in June, staying above 50 for the fourth consecutive month, indicating that economic activities will continue to expand. Following the RMB 4-trillion stimulus package and sharp interest rate reductions last year, China announced more measures to boost domestic consumption, such as subsidies to replace old cars and household appliances. Premier Wen Jiabao further encouraged the market after he announced that more stimulus policies were likely to be implemented this year.

In the third quarter of 2009, the H-share and MSCI China index rallied 8.2% and 7.3% respectively on better-than-expected interim results and economic data. The surprisingly strong 7.9% GDP growth in the second-quarter of 2009 further boosted investor confidence in China's recovery. The revival of investment growth in the private sector, such as property, was also encouraging.

Outlook

The fund manager remains positive on the China market; he expects the rise in consumption and private investment, as well as the stabilisation in the export sector, to drive GDP growth.

With stronger economic growth going into the second half of 2009, the fund manager expects more upward earnings revisions, which should further support market upside. As at late September, consensus earnings growth forecast for MSCI China was revised to 13.8% year-on-year for all of 2009, and 20.3% year-on-year for all of 2010 respectively.

The fund manager believes recent concerns of credit tightening in China are premature as economic recovery, especially in the private sector, is still at an early stage and the country continues to experience deflation.

However, the large supply of IPOs could hurt market liquidity in the short term, and increasing trade protectionism is also a

concern. The risk of trade protectionism is rising as governments in developed economies attempt to protect their economies already affected by high unemployment and weak demand. Fears of a trade war between China and the US have also intensified. The US Commerce Department recently launched an inquiry into Chinese-made steel pipes, in an investigation that could lead to a near 100% tariff on imported steel pipes from China. That development came less than a month after the US imposed punitive duties on Chinese-made tyres, a move that China denounced.

Overall, the fund manager remains positive on China's outlook as government policies have been effective in driving investment and consumption to support economic growth.

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

31 October 2009

Independent review report to the Manager

Interim period ended 30 September 2009

Introduction

We have reviewed the interim financial statements of the Fund set out on pages 3 to 24 which comprise the interim statement of assets and liabilities of the Fund as of 30 September 2009 and the related interim statement of comprehensive income, interim statement of changes in net assets attributable to unitholders and interim cash flow statement for the six months period then ended, and a summary of significant accounting policies and other explanatory notes. The Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited require the preparation of an interim financial report to be in compliance with the relevant provisions thereof and Hong Kong Accounting Standard 34 "Interim financial reporting" issued by the Hong Kong Institute of Certified Public Accountants. The Manager is responsible for the preparation and presentation of the interim financial statements in accordance with Hong Kong Accounting Standard 34.

Our responsibility is to form a conclusion, based on our review, on the interim financial statements and to report our conclusion solely to you, as a body, in accordance with our agreed terms of engagement, and for no other purpose. We do not assume responsibility towards or accept liability to any other person for the contents of this report.

Scope of review

We conducted our review in accordance with Hong Kong Standard on Review Engagements 2410, "Review of interim financial information performed by the independent auditor of the entity" issued by the Hong Kong Institute of Certified Public Accountants. A review of the interim financial statements consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Hong Kong Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim financial statements as at 30 September 2009 is not prepared, in all material respects, in accordance with Hong Kong Accounting Standard 34 "Interim financial reporting".

Certified Public Accountants

8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong

Interim statement of assets and liabilities (unaudited)

As at 30 September 2009

	Note	30 September 2009 (Unaudited) HK\$	31 March 2009 (Audited) HK\$
Assets			
Investments	6	2,968,224,660	2,213,433,658
Dividend receivables		1,904,653	–
Interest and other receivables		2,398,558	2,395,952
Amounts due from brokers		3,066,508	73,869,889
Cash and cash equivalents		91,792,940	85,811,063
		<u>3,067,387,319</u>	<u>2,375,510,562</u>
Total assets			
Liabilities			
Taxation	5	39,762,194	30,104,377
Amounts due to brokers		8,657,109	59,867,991
Accrued expenses and other payables		4,339,148	3,584,762
		<u>52,758,451</u>	<u>93,557,130</u>
Total liabilities (excluding net assets attributable to unitholders)			
		<u>3,014,628,868</u>	<u>2,281,953,432</u>
Net assets attributable to unitholders			
Number of units in issue	9	<u>371,910,000</u>	<u>371,910,000</u>
Net asset value per unit		<u>8.11</u>	<u>6.14</u>

Interim statement of comprehensive income (unaudited)

For the period ended 30 September 2009

	Note	Period from 1 April 2009 to 30 September 2009 (Unaudited) HK\$	Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$
Dividend income		40,990,506	40,151,844
Interest income	7(d)	261,224	327,147
Gains on investments	4	996,301,500	294,406,869
Losses on investments	4	(257,620,387)	(1,457,909,111)
Net foreign exchange (loss)/gain		(22,298)	853,884
Net investment income/(loss)		<u>779,910,545</u>	<u>(1,122,169,367)</u>
Expenses			
Management fee	7(a)	(21,696,038)	(22,986,866)
Transaction costs	7(e)	(8,540,060)	(9,963,974)
Trustee's fee	7(b)	(1,556,055)	(1,641,409)
Custodian fee	7(c)	(836,363)	(963,886)
Auditors' remuneration		(134,347)	(179,832)
Other operating expenses		(913,508)	(500,797)
Operating expenses		<u>(33,676,371)</u>	<u>(36,236,764)</u>
Changes in net assets attributable to unitholders before taxation		746,234,174	(1,158,406,131)
Taxation	5	(13,558,738)	(2,479,425)
Profits/(losses) and total comprehensive income/(loss) for the period		<u><u>732,675,436</u></u>	<u><u>(1,160,885,556)</u></u>

Interim statement of changes in net assets attributable to unitholders (unaudited)

For the period ended 30 September 2009

	Period from 1 April 2009 to 30 September 2009 (Unaudited) HK\$	Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$
Net assets attributable to unitholders, beginning of period	2,281,953,432	3,370,192,394
Profits/(losses) and total comprehensive income/(loss) for the period	<u>732,675,436</u>	<u>(1,160,885,556)</u>
Net assets attributable to unitholders, end of period	<u><u>3,014,628,868</u></u>	<u><u>2,209,306,838</u></u>

Interim cash flow statement (unaudited)

For the period ended 30 September 2009

	Period from 1 April 2009 to 30 September 2009 (Unaudited) HK\$	Period from 1 April 2008 to 30 September 2008 (Unaudited) HK\$
Operating activities		
Interest received	261,224	392,319
Dividends received	39,085,853	38,316,315
Management fee paid	(20,730,123)	(24,447,466)
Trustee's fees paid	(1,499,909)	(1,766,162)
Other operating expenses paid	(14,617,778)	(10,399,880)
Net cash generated from operating activities	<u>2,499,267</u>	<u>2,095,126</u>
Investing activities		
Proceeds from sales of investments	1,721,650,227	1,569,437,834
Payments on purchases of investments	(1,718,167,617)	(1,635,131,990)
Net cash generated from/(used in) investing activities	<u>3,482,610</u>	<u>(65,694,156)</u>
Net increase/(decrease) in cash and cash equivalents	5,981,877	(63,599,030)
Cash and cash equivalents at the beginning of the period	<u>85,811,063</u>	<u>169,925,839</u>
Cash and cash equivalents at the end of the period	<u><u>91,792,940</u></u>	<u><u>106,326,809</u></u>

The notes on pages 7 to 24 form part of these financial statements.

Notes on the unaudited interim financial statements

For the period ended 30 September 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

These interim financial statements have been prepared in accordance with Hong Kong Accounting Standard ("HKAS") 34 "Interim Financial Reporting", issued by the Hong Kong Institute of Certified Public Accountants ("HKICPA").

The interim financial statements have been prepared in accordance with the same accounting policies adopted in the annual financial statements for the year ended 31 March 2009, except for the accounting policy changes that are expected to be reflected in the 2009 interim financial statements.

The preparation of interim financial statements in conformity with HKAS 34 requires management to make judgements, estimates and assumptions that affect the application of accounting policies to and reported amounts of assets and liabilities, income and expenses on a year to date basis. Actual results may differ from these estimates.

The interim financial statements are unaudited, but has been reviewed in accordance with Hong Kong Standard on Review Engagements 2410, "Review of interim financial information performed by the independent auditor of the entity", issued by the HKICPA. The review report to the Manager of the Fund is included on page 2.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

The financial information relating to the financial year ended 31 March 2009 that is included in the interim financial statements as being previously reported information does not constitute the Fund's statutory financial statements for that financial year but is derived from those financial statements. The auditors have expressed an unqualified opinion on the financial statements for the year ended 31 March 2009 in their report dated 21 July 2009.

(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.

(c) Financial instruments

(i) Classification

The Fund designated all its equity investments into the financial assets at fair value through profit or loss category upon initial recognition.

Financial instruments are designated at fair value through profit or loss upon initial recognition when:

- the assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- the designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- the asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract; or
- the separation of the embedded derivative(s) from the financial instrument is not prohibited.

Financial assets that are classified as receivables include amounts due from brokers, interest receivables and other receivables, and dividend receivables.

Financial liabilities that are not at fair value through profit or loss include amounts due to brokers, accrued expenses and other payables.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

(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 obligation 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 statement of comprehensive income.

Financial assets classified as receivables are carried at amortised cost using the effective interest rate 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 rate method.

Upon termination of the Fund, all net cash proceeds derived from the sale or realisation of the Fund less any liabilities will be shared among the unitholders at the value proportionate to the unitholders' 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.

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.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

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 statement of comprehensive income. 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 statement of comprehensive income as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial asset's original 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 statement of comprehensive income.

(vi) Derecognition

A financial asset is derecognised 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 commits to sell the assets.

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

The Fund uses the weighted average method to determine realised gains and losses to be recognised in profit or loss 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 there is an intention to settle on a net basis, or simultaneously, e.g. through a market mechanism.

(viii) Cash and cash equivalents

Cash and cash equivalents comprise current 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 unaudited interim financial statements

For the period ended 30 September 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 statement of comprehensive income as follows:

Interest income

Interest income is recognised in the statement of comprehensive income as it accrues, by using the effective interest rate method. Interest income on bank deposits is disclosed separately on the face of the statement of comprehensive income. Interest income on debt securities is included in gains 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 statement of comprehensive income 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 dividend with the corresponding debit treated as an additional investment.

(e) Expenses

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

(f) Taxation

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

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

Deferred tax is provided using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes.

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.

(g) Translation of foreign currency

Foreign currency transactions during the period 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 statement of comprehensive income.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

(h) 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;
- (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.

(i) Subscriptions

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

(j) 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 (loss)/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.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

3. Changes in accounting policies

The HKICPA has issued one new HKFRS, a number of amendments to HKFRSs and new Interpretations that are first effective for the current accounting period of the Fund. Of these, HKAS 1 (revised 2007), *Presentation of financial statements* and Amendment and HKFRS 7, *Financial instruments: Disclosures: improving disclosures about financial instruments* are relevant to the Fund's financial statements.

The impact of these developments is as follows:

- As a result of the adoption of HKAS 1 (revised 2007), details of net assets attributable to unitholders during the period arising from transactions with unitholders in their capacity as such have been presented separately from all other income and expenses in a statement of net assets attributable to unitholders. All other items of income and expense are presented in the income statement, if they are recognised as part of profit or loss for the period, or otherwise in a new primary statement, the statement of comprehensive income. The new format for the statement of comprehensive income and the statement of changes in net assets attributable to unitholders has been adopted in this interim financial report. This change in presentation has no effect on reported profit or loss, total income and expense or net assets for any period presented.
- As a result of the adoption of the amendments to HKFRS 7, the financial statements include expanded disclosures in note 11 about the fair value measurement of the Fund's financial instruments, categorising these fair value measurements into a three-level fair value hierarchy according to the extent to which they are based on observable market data. The Fund has taken advantage of the transitional provisions set out in the amendments to HKFRS 7, under which comparative information for the newly required disclosures about the fair value measurements of financial instruments has not been provided.

The Fund has not applied any new standard or Interpretation that is not yet effective for the current accounting period (see note 12).

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

4. Gains and losses on investments

	Period from 1 April 2009 to 30 September 2009 HK\$	Period from 1 April 2008 to 30 September 2008 HK\$
Realised gains	238,775,242	95,484,605
Unrealised gains	757,526,258	198,922,264
Total gains on investments	<u>996,301,500</u>	<u>294,406,869</u>
Realised losses	(123,671,339)	(560,911,852)
Unrealised losses	(133,949,048)	(896,997,259)
Total losses on investments	<u>(257,620,387)</u>	<u>(1,457,909,111)</u>
Net gains/(losses) on investments	<u>738,681,113</u>	<u>(1,163,502,242)</u>

Gains and losses presented above exclude dividend income.

5. 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 the current general provisions of the PRC Corporate Income Tax Law and published tax circulars, the Fund would be subject to PRC withholding tax at the rate of 10% in respect of its PRC sourced income earned, including capital gains realised on the sale of PRC listed companies, dividend income derived from PRC listed companies and interest income earned in respect of PRC bank deposits and corporate bonds. This withholding taxation basis should apply as it is intended that the Fund would be managed and operated in such a manner that it would not be considered a tax resident enterprise in China or otherwise as having a taxable permanent establishment in the PRC. The 10% withholding tax rate may be further reduced under an applicable tax treaty which the PRC has entered into with the jurisdiction in which the beneficial owner of the relevant income is a resident. However, in the Fund's case, as the beneficial owners of the Fund may be difficult to identify precisely to the satisfaction of the PRC tax authorities, any preferential tax treatment under an applicable tax treaty/tax arrangement would unlikely to be applied. On this basis, the 10% withholding tax rate would likely be applicable in respect of the Fund's PRC sourced income derived.

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. On the basis of the available information, the Manager has determined that it is appropriate to provide for PRC taxation at the withholding tax rate of 10% on realised gains on A-shares, dividend income from A, B and H shares and interest income from PRC bank deposits in the financial statements.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

Taxation in the statement of comprehensive income represents:

	Period from 1 April 2009 to 30 September 2009 HK\$	Period from 1 April 2008 to 30 September 2008 HK\$
PRC dividend and interest income withholding tax	4,368,148	–
PRC capital gains tax	9,190,590	2,479,425
	<u>13,558,738</u>	<u>2,479,425</u>

6. Investments

	As at 30 September 2009 HK\$	As at 31 March 2009 HK\$
Listed equity securities		
– in Hong Kong	1,530,632,334	1,022,131,374
– outside Hong Kong	1,437,592,326	1,188,857,157
	<u>2,968,224,660</u>	<u>2,210,988,531</u>
Listed bonds		
– outside Hong Kong	–	2,445,127
	<u>2,968,224,660</u>	<u>2,213,433,658</u>
Investments, at cost	2,659,967,085	2,528,753,293
Net unrealised appreciation/(depreciation) in value of investments	<u>308,257,575</u>	<u>(315,319,635)</u>
Investments, at market value	<u>2,968,224,660</u>	<u>2,213,433,658</u>

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

7. Related parties transactions

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

(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 period and payable at the end of the period amounted to \$21,696,038 (for the period from 1 April 2008 to 30 September 2008: \$22,986,866) and \$3,780,559 (as at 31 March 2009: \$2,814,644) 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 period and payable at the end of the period amounted to \$1,556,055 (for the period from 1 April 2008 to 30 September 2008: \$1,641,409) and \$296,485 (as at 31 March 2009: \$240,339) 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 period and payable at the end of the period amounted to \$836,363 (for the period from 1 April 2008 to 30 September 2008: \$963,886) and \$12,090 (as at 31 March 2009: \$31,362) respectively.

(d) Bank balances

Bank balances are maintained with the Trustee. The bank balances held with the Trustee as at 30 September 2009 amounted to \$33,423,679 (as at 31 March 2009: \$58,732,645). During the period, interest earned on the above bank balances was nil (for the period from 1 April 2008 to 30 September 2008: \$71,453).

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

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

	The Hongkong and Shanghai Banking Corporation Limited	
	Period from 1 April 2009 to 30 September 2009 HK\$	Period from 1 April 2008 to 30 September 2008 HK\$
Commission paid for the period	156,303	1,683
Average rate of commission	0.19%	0.20%
Total aggregate value of such transactions for the period	81,812,167	841,457
Percentage of such transactions in value to total transactions for the period	<u>2.47%</u>	<u>0.03%</u>

8. 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.

9. Units in issue

	As at 30 September 2009	As at 30 September 2008
Number of units in issue carried forward	<u>371,910,000</u>	<u>371,910,000</u>

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

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

10. 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 30 September 2009 are summarised below.

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 period, 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.

(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 a diversified portfolio of 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 30 September 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 same basis for 31 March 2009.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

As at 30 September 2009

	Market exposures HK\$	Change in net assets if investment value increased by 5% HK\$
Investment assets		
Listed equity investments:		
– in Hong Kong	1,530,632,334	76,531,617
– outside Hong Kong	1,437,592,326	71,879,616
	<u>2,968,224,660</u>	<u>148,411,233</u>

As at 31 March 2009

	Market exposures HK\$	Change in net assets if investment value increased by 5% HK\$
Investment assets		
Listed equity investments:		
– in Hong Kong	1,022,131,374	51,106,569
– outside Hong Kong	1,188,857,157	59,442,858
	<u>2,210,988,531</u>	<u>110,549,427</u>

(ii) Interest rate risk

Interest rate risk arises from change in interest rates which may inversely affect the value of debt instruments and therefore result in 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 period in which the interest bearing assets and liabilities mature at the date of statement of assets and liabilities.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

	30 September 2009		
	1 year or less HK\$	Non-interest bearing HK\$	Total HK\$
Assets			
Investments	–	2,968,224,660	2,968,224,660
Dividend receivables	–	1,904,653	1,904,653
Interest and other receivables	–	2,398,558	2,398,558
Amounts due from brokers	–	3,066,508	3,066,508
Cash and cash equivalents	58,369,261	33,423,679	91,792,940
Total assets	<u>58,369,261</u>	<u>3,009,018,058</u>	<u>3,067,387,319</u>
Liabilities			
Taxation	–	(39,762,194)	(39,762,194)
Amounts due to brokers	–	(8,657,109)	(8,657,109)
Accrued expenses and other payables	–	(4,339,148)	(4,339,148)
Total liabilities	<u>–</u>	<u>(52,758,451)</u>	<u>(52,758,451)</u>
Total interest sensitivity gap	<u>58,369,261</u>		

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

	31 March 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 due from brokers	–	–	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 due to brokers	–	–	(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>		

Interest rate sensitivity

At the date of statement of assets and liabilities, assuming all other factors unchanged, it is estimated that an increase in interest rates of 50 basis points would result in an increase in the net assets attributable to unitholders and changes in net assets attributable to unitholders from operation of the Fund by \$303,839 (31 March 2009: \$410,391); an equal change in the opposite direction would result in a decrease in the net assets attributable to unitholders by an equal amount. The analysis is performed on the same basis for 31 March 2009.

(iii) Currency risk

The Fund may invest in financial instruments 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. The Manager monitors the Fund's currency exposures on an ongoing basis.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

Currency sensitivity

As at 30 September 2009

At 30 September 2009, had the following exposures in Hong Kong dollars ("HKD") weakened by 5% in relation to all currencies, with all other variables held constant, net assets attributable to unitholders and the change in net assets attributable to unitholders from operations would have increased by the amounts shown below. The analysis is performed on the same basis for period ended 30 September 2008.

Currencies	Net exposures	Changes in net assets if HKD weakened by 5%
Renminbi	<u>1,350,634,126</u>	<u>67,531,706</u>

As at 31 March 2009

Currencies	Net exposures	Changes in net assets if HKD weakened by 5%
Renminbi	<u>1,129,010,192</u>	<u>56,450,510</u>

As the HKD is pegged to the United States dollars ("USD"), the Fund does not expect any significant movements in USD/HKD exchange rate. A 5% appreciation of the HKD against the above currencies would have resulted in an equal but opposite effect on the financial statements 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 30 September 2009, all of the Fund's financial assets were exposed to credit risk. These include investments and cash and cash equivalents placed with banks and Bank of Communications Co., Ltd (the "QFII Custodian").

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 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.

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

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 30 September 2009 and 31 March 2009, 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 market condition as they are all listed on stock exchanges in Hong Kong or the PRC.

As at 30 September 2009 and 31 March 2009, the Fund's financial liabilities are due within three months except for redemptions payable which is repayable on demand.

11. Fair value information

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

The carrying amounts of all the financial assets and financial liabilities at the date of statement of assets and liabilities approximated their fair values. For listed investments, the fair values were determined directly, in full or in part, by reference to published price quotations. Unlisted investments are stated at fair values estimated by the Manager. For other financial instruments, including amounts due from/to brokers, other account receivables and accounts payables, the carrying amounts approximate fair value due to the immediate or short-term nature of these financial instruments.

(i) Financial instruments carried at fair value

The following table presents the carrying value of financial instruments measured at fair value at the date of statement of assets and liabilities across the three levels of the fair value hierarchy defined in HKFRS 7, *Financial instruments: Disclosures*, with the fair value of each financial instrument categorised in its entirety based on the lowest level of input this is the significant to that fair value measurement. The levels are defined as follows:

- Level 1 (highest level): fair values measured using quoted prices (unadjusted) in active markets for identical financial instruments

Notes on the unaudited interim financial statements

For the period ended 30 September 2009

- Level 2: fair values measured using quoted prices in active markets for similar financial instruments, or using valuation techniques in which all significant inputs are directly or indirectly based on observable market data
- Level 3 (lowest level): fair values measured using valuation techniques in which any significant input is not based on observable market data

As at 30 September 2009

	Level 1 HK\$'000	Level 2 HK\$'000	Level 3 HK\$'000	Total HK\$'000
Assets				
Equity securities:				
– Listed	2,968,225	–	–	2,968,225

12. Possible impact of amendments, new standards and interpretations issued but not yet effective for the period ended 30 September 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 period ended 30 September 2009 and which have not been adopted in these financial statements.

Of these developments, the following relates to matters that may be relevant to the Fund's operations and financial statements:

**Effective for
accounting periods
beginning on or after**

Improvements to HKFRSs 2009

1 July 2009
or 1 January 2010

The Fund is in the process of making an assessment of what the impact of these amendments is expected to be in the period of initial application. So far it has concluded that the adoption of them is unlikely to have a significant impact on the Fund's results of operations and financial position.

Investment portfolio (unaudited)

As at 30 September 2009

HSBC China Dragon Fund

Holdings	Market value HK\$	% of total net assets
Equities		
Listed investments		
The People's Republic of China		
Anhui Conch Cement Co Ltd - A Share	285,700	13,944,254
Beijing Wangfujing Department Store Co Ltd - A Share	1,132,243	41,086,475
Chengdu B-Ray Media Co Ltd - A Share	2,417,381	54,849,731
China Animal Husbandry Ind Co Ltd - A Share	1,295,600	27,896,831
China Merchants Bank Co Ltd - A Share	5,443,620	91,260,931
China Merchants Property Development Co Ltd	1,332,900	37,822,844
China Minsheng Banking Corp Ltd - A Share	3,187,000	24,381,395
Citic Securities Co Ltd - A Share	978,200	27,768,854
Faw Car Co Ltd - A Share	1,650,714	31,908,257
Fujian Dongbai (Group) Co Ltd - A Share	1,465,720	13,359,283
Gree Electric Appliances Inc - A Share	2,449,080	60,600,480
Hangzhou Steam Turbine Co - B Share	2,729,991	35,298,784
Harbin Pharm Group Co Ltd - A Share	3,285,500	60,003,159
Henan Hanwei Electronics Co Ltd - A Share	500	15,323
Jiangsu Hengbao Co Ltd - A Share	2,256,832	24,719,697
Kweichow Moutai Co Ltd - A Share	73,715	13,783,882
Nanfeng Ventilator Co Ltd - A Share	500	12,991
Offshore Oil Engineering Co Ltd - A Share	2,076,462	25,265,935
Ping An Insurance Group Co - A Share	1,616,300	92,940,233
Shandong Gold Mining Co Ltd - A Share	217,932	14,599,461
Shanghai International Airport Co Ltd - A Share	1,959,500	29,847,941
Shanghai Pudong Development Bank Co - A Share	7,880,578	175,766,954
Shanghai Zhangjiang High-Tech Park - A Share	2,793,400	41,218,585
Shanxi Lanhua Sci-Tech Venture Co Ltd - A Share	839,942	32,872,532
Shanxi Xishan Coal & Electricity Power - A Share	677,300	24,062,570
TBEA Co Ltd CI - A Share	1,015,457	24,481,197
Tellhow Sci-Tech Co Ltd - A Share	2,966,990	40,446,010
Tian Di Science & Technology Co Ltd	1,546,651	44,063,871
Tsingtao Brewery Co Ltd - A Share	899,765	30,107,395
Wuhan Iron & Steel Co Ltd	4,095,700	32,216,471
Yantai Wanhua Polyurethane Co Ltd - A Share	2,858,800	55,812,159
Yibin Wuliangye Co Ltd - A Share	568,600	13,495,143
Zhejiang Tianma Bearing Co Ltd - A Share	1,915,474	55,180,354
ZTE Corp - A Share	1,704,524	73,829,187
	1,364,919,169	45.28

Investment portfolio (unaudited)

As at 30 September 2009

HSBC China Dragon Fund

	<i>Holdings</i>	<i>Market value HK\$</i>	<i>% of total net assets</i>
Equities			
Listed investments			
Hong Kong			
Aluminium Corp of China Ltd - H Share	2,700,000	22,842,000	0.76
Bank of China Ltd - H Share	27,300,000	111,111,000	3.69
China Coal Energy Co - H Share	4,200,000	42,588,000	1.41
China Construction Bank - H Share	27,137,000	167,978,030	5.57
China Cosco Holdings Co Ltd - H Share	2,500,000	23,175,000	0.77
China Dongxiang Group Co	4,958,000	25,484,120	0.85
China Life Insurance Co Ltd - H Share	2,812,000	94,905,000	3.15
China National Building Material Co Ltd - H Share	3,774,000	68,686,800	2.28
China Overseas Land & Investment Limited	2,178,801	36,473,129	1.21
China Pharmaceutical Group Ltd	3,032,000	13,158,880	0.44
China Railway Group Ltd - H Share	3,000,000	19,980,000	0.66
China Resources Cement Holdings Ltd	286,000	1,126,654	0.04
China Resources Land Ltd	1,660,000	28,153,600	0.93
China Shenhua Energy Co Ltd - H Share	2,300,000	77,740,000	2.58
China Shipping Container Lines Co Ltd - H Share	5,300,000	14,893,000	0.49
China Unicom Hong Kong Ltd - H Share	3,422,000	37,436,680	1.24
China Windpower Group Ltd - H Share	31,690,000	21,232,300	0.69
CNOOC Ltd	6,000,000	62,640,000	2.08
Comba Telecom Systems Holdings Ltd	9,045,600	71,188,872	2.36
Dongfeng Motor Group Co Ltd - H Share	8,000,000	65,600,000	2.18
Glorious Property Holdings Ltd	1,688,000	7,502,147	0.25
Jiangxi Copper Co Ltd - H Share	1,900,000	32,946,000	1.09
Ju Teng International Holdings Ltd	1,300,000	8,528,000	0.28
Loudong General Nice Resources China	9,489,000	10,817,460	0.36
Maanshan Iron & Steel Co Ltd - H Share	2,200,000	10,274,000	0.34
Petrochina Co Ltd - H Share	7,000,000	61,320,000	2.03
Ping An Insurance (Group) Co of China - H Share	300,000	18,465,000	0.61
Poly (Hong Kong) Investment Ltd	2,667,000	24,029,670	0.80
Sino-Ocean Land Holdings Ltd	6,370,234	44,655,340	1.48
Sinofert Holdings Ltd	5,000,000	17,100,000	0.57
Sinopec Shanghai Petrochem Co Ltd - H Shares	6,000,000	19,320,000	0.64
Sinopharm Group Co - H Shares	2,051,600	40,252,392	1.34
TCL Multimedia Technology Holdings Ltd	4,000,000	17,600,000	0.58
Tencent Holdings Ltd	500,000	62,600,000	2.08
Want Want China Holdings Ltd	4,804,000	21,906,240	0.73
Xinyi Glass Holdings Co Ltd	5,000,000	27,150,000	0.90
Zhejiang Expressway Co Ltd - H Share	4,900,000	33,124,000	1.10
Zijin Mining Group Co Ltd - H Share	4,578,000	34,747,020	1.15
ZTE Corp - H Share	780,000	31,902,000	1.06
		<u>1,530,632,334</u>	<u>50.77</u>

Investment portfolio (unaudited)

As at 30 September 2009

HSBC China Dragon Fund

	<i>Holdings</i>	<i>Market value HK\$</i>	<i>% of total net assets</i>
Equities			
Listed investments			
United States of America			
Netease Com Inc Sponsored ADR	100,000	35,394,935	1.17
Perfect World Co Ltd ADR	100,000	37,278,222	1.24
		<u>72,673,157</u>	<u>2.41</u>
Total investments		2,968,224,660	98.46
Other net assets		<u>46,404,208</u>	<u>1.54</u>
Total net assets		<u><u>3,014,628,868</u></u>	<u><u>100.00</u></u>
Total cost of investments		<u><u>2,659,967,085</u></u>	

Statement of movements in portfolio holdings (unaudited)

For the period ended 30 September 2009

	% of total net assets	
	30 September 2009	31 March 2009
Equities	98.46	96.89
Bonds	–	0.11
Total investments	<u>98.46</u>	<u>97.00</u>
Other net assets	<u>1.54</u>	<u>3.00</u>
Total net assets attributable to unitholders	<u><u>100.00</u></u>	<u><u>100.00</u></u>

Performance table (unaudited)

For the period ended 30 September 2009

(a) Total net asset value (at bid prices)

Year/period end

31 March 2008	HK\$3,370,192,394
30 September 2008	HK\$2,209,306,838
31 March 2009	HK\$2,281,953,432
30 September 2009	HK\$3,014,628,868

(b) Total net asset value per unit (at bid prices)

Year/period end

31 March 2008	HK\$9.06
30 September 2008	HK\$5.94
31 March 2009	HK\$6.14
30 September 2009	HK\$8.11

(c) Price record (Dealing NAV)

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/period	Lowest HK\$	Highest HK\$
20 June 2007 (date of inception) to 31 March 2008	8.62	13.94
1 April 2008 to 30 September 2008	5.55	10.22
1 April 2008 to 31 March 2009	4.12	10.22
1 April 2009 to 30 September 2009	6.22	9.05

Administration and management

Directors of the Manager

Executive Directors:

APENBRINK, Rudolf Eduard Walter
CONXICOEUR, Patrice Pierre Heuri
LAM, Po Yee
STOKES, Edmund Richard

Non-Executive Directors:

CHEANG, Wai Wan Louisa
CHENG, Hoi Chuen Vincent
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 and
resigned on 18 August 2009)
LEUNG, Ko May Yee Margaret (resigned on 4 May 2009)
ENGEL, Conrado (resigned on 18 May 2009)
AMANDINI, Peter James (resigned on 4 May 2009)

Trustee

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Hong Kong

Registrar and Processing Agent

Computershare Hong Kong Investor Services Limited
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Hopewell Centre
183 Queen's Road East
Wanchai
Hong Kong

Manager

HSBC Global Asset Management (Hong Kong) Limited
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Hong Kong

Investment Adviser

Halbis Capital Management (Hong Kong) Limited
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QFII Custodian

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Auditor

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