HSZ China Fund

# Newsletter March 2011

| | |
|---|---|
| Figures as of | March 31, 2011 |
| Net Asset Value | USD 135.04, CHF 98.95, EUR 122.90 |
| Fund Size | USD 141.2 million |
| Inception Date* | May 27, 2003 |
| Cumulative Return | 284.0% in USD |
| Annual Return | 18.7% in USD |

* The track record is the combination of two consecutive track records of China Investment Corporation (CIC) and HSZ China Fund (HCF). From May 27, 2003 to November 17, 2006 it is the performance of CIC, a trust account managed by HSZ Group for listed Chinese equities. Since the launch of HCF on November 17, 2006 it is the performance of HCF.

Net Asset Value (Monthly)


Performance

| | March | YTD | 1 Year | Nov 17, 06 |
|---|---|---|---|---|
| USD Class | +6.5% | +0.2% | +12.0% | +35.0% |
| CHF Class | +5.4% | -1.4% | -4.2% | -1.1% |
| EUR Class | +3.5% | -5.0% | +6.1% | +22.9% |

Largest Holdings

| | |
|---|---|
| Lonking Holdings Ltd | 5.8% |
| China Merchants Bank | 5.8% |
| GCL Poly Energy Holdings | 5.2% |
| Zhuzhou CSR | 4.9% |
| Ajisen China Holdings Ltd | 4.6% |
| Anta Sports Products Ltd | 4.6% |

Exposure

| | |
|---|---|
| Consumer Discretionary | 31.6% |
| Industrials | 29.4% |
| Financials | 22.7% |
| Energy | 8.5% |
| Consumer Staples | 4.7% |
| Cash | 3.1% |

- China's NPC calls for quality growth
- Ajisen delivers strong results on store efficiency and expansion
- Zhuzhou CSR sees good visibilities with ample order backlog
- KWG diversifies land bank and increases exposure in more cities

China's annual National People's Congress (NPC) meeting concluded on March 14. In his annual works report at the meeting, Premier Wen set a GDP growth target of 8 percent for 2011 and 7 percent for the five years to 2015, compared with the average of 11.2 percent achieved in the past 5 years. Greater focus would be placed on quality of growth rather than speed of growth. Inflation remained the top priority in the agenda where the government is committed to keeping prices stable. Great emphasis is put on social welfare spending. The government targets a construction start of 10 million units of social housing in 2011 and to cover 20 percent of the population in 2015. Urbanization will be continued from the current level of 47.5 percent to 51.5 percent over the next five years. Overall, the tone is in line with the direction of transformation of the economic development pattern towards the domestic demand driven model.

Turnover for the full year of 2010 rose 35 percent year on year to HKD 2.7 billion, driven by rapid store expansion and solid same store sales growth. Gross margin remained stable at 69 percent despite strong food inflation, thanks to adjustments of menu prices twice in 2010. EBIT margin improved by 1.5 percentage points resulted from effective cost control and strategic focus on small stores with better productivity. Net income increased by 42 percent to HKD 447 million, with a payout ratio of 55 percent. Ajisen has 580 stores at the end of 2010 and will add 150 and 160 stores in 2011 and 2012 respectively, targets to reach 1000 stores by the end of 2013.

Revenue for the full year of 2010 was CNY 5'831 million, a 75 percent increase year on year. Sales from locomotive products jumped 130 percent to CNY 2'351 million, EMU products increased by 107 percent to CNY 1'472 million, urban rail products sales increased by 101 percent to CNY 312 million. Gross margin was at 36.9 percent, 60 basis points higher year on year. Adjusted net profit came in at CNY 1 billion, compared to CNY 534 million last year. The company expects a strong revenue growth in the first quarter of 2011 on mass delivery of 250km/hr EMU train-borne electric system. As of the end of 2010, order backlog was around CNY 7 to 8 billion, able to support sales to at least first half of 2012.

The company's full year 2010 revenue came in at CNY 7'466 million, up by 75 percent year on year. During the year, there was 54 percent expansion in the gross floor area delivery and a 14 percent increase in average selling prices to CNY 9'209 per square metre (sqm). Gross margin expanded from 37.9 percent to 41.5 percent. In 2010, 34 percent of the contracted sales were derived from Guangzhou, 27 percent from Suzhou, 23 percent from Chengdu and 16 percent from Beijing. Rental income was up by 26 percent due to the full year contribution by certain tenants in International Finance Place and higher occupancy rate. The company set a contracted sales target of CNY 15 billion in 2011, representing a 36 percent increase from 2010 actual sales.

# General Information

| | |
|---|---|
| Name | HSZ China Fund |
| Theme | Entrepreneurial China |
| Nature | Long-only equity fund, actively managed for absolute return |
| Focus | Listed Chinese equities focusing on privately controlled companies |

| | |
|---|---|
| Structure | Swiss investment fund, regulated by FINMA, open-ended |
| Distributions | Income annually |
| Fiscal Year End | December 31 |
| Reporting | Semi-annually in USD |
| Currency Classes | USD, CHF, EUR (all unhedged) |
| Trading | Daily issuance and redemption, based on net asset value |

| | |
|---|---|
| Fund Manager | Falcon Fund Management (Switzerland) Ltd., Zurich |
| Custodian Bank | Falcon Private Bank Ltd., Zurich |
| Investment Manager | HSZ Group, Hong Kong |
| Auditors | PricewaterhouseCoopers Ltd. |
| Management Fee | 1.5% annually |
| Performance Fee | 10% above hurdle rate of 5%, high water mark |
| Issuance Fee | Maximum 5% |
| Redemption Fee | None |

| | |
|---|---|
| USD Class | ISIN CH0026828035, Valor 2682803<br>WKN A0LC13<br>Bloomberg HSZCHID SW Equity |
| CHF Class | ISIN CH0026828068, Valor 2682806<br>WKN A0LC15<br>Bloomberg HSZCFCH SW Equity |
| EUR Class | ISIN CH0026828092, Valor 2682809<br>WKN A0LC14<br>Bloomberg HSZCHEU SW Equity |
| Orders via Banks | Falcon Private Bank Ltd.<br>Fund Order Desk<br>Pelikanstrasse 37, PO Box 1376<br>8021 Zurich, Switzerland<br>Tel: +4144 227 5566<br>Fax: +4144 824 6932 |

| | |
|---|---|
| Contact & Website | HSZ Group<br>Unit 605A, 6/F, Tower 2<br>Lippo Centre, 89 Queensway<br>Hong Kong<br>Tel: +852 2287 2300<br>Fax: +852 2287 2380<br>www.hszgroup.com<br>mail@hszgroup.com |

### Investment Opportunity

Once the world's largest trading power, China's gradual decline during the second millennium culminated in the Maoist purgatory. However, since the 1980s economic development has taken center stage. China has become the engine of the fastest growing region in the world attracting substantial foreign investments and developing into the world's manufacturing hub. Furthermore, an increasing middle class is fuelling demand for consumer products. The growth momentum is set to continue as China strives to catch up with mature economies, producing attractive investment opportunities.

### Investment Strategy

The objective of HSZ China Fund is to create sustained shareholder value by acquiring and managing equity and equity-linked investments in a select number of high-quality companies that are rooted in China. At least two-thirds of the total assets are to be invested in companies which are domiciled in China or participate as holding companies in enterprises domiciled there. At most one-third of the total fund volume can be invested in equity oriented stocks and money market instruments of issuers worldwide. Based on fundamental analysis and a bottom up approach, investment opportunities are identified that are assessed to provide above-average return on invested capital, have strong earnings per share growth and are priced attractively.

### Risk Management

The Chinese stock market has many of the particular risks and characteristics of emerging markets. HSZ Group exerts itself for reducing specific risks by accurately screening and monitoring high quality assets. That is why the long-lived experience of its specialists based locally is invaluable for investors. The fund is well diversified by investing in at least 15 companies. Each position represents a weight of between 5 to 10% of total assets with a maximum limit of 15%. No portfolio leverage is employed. The fact that HSZ China Fund invests in listed equity provides the investor with a reasonable degree of liquidity.

### Investment Manager

HSZ Group is a Hong Kong based independent investment management company. Its investment team has been managing Asian equity portfolios since 1994.