CIC
China Investment Corporation

# Newsletter October 2004

- Surprise rate hike in China
- Strong GDP figures in China
- Traffic growth for Hopewell Highway remains healthy
- Double digit turnover and profit growth at Tong Ren Tang
- Placement of China Fire Safety shares not to change strategy

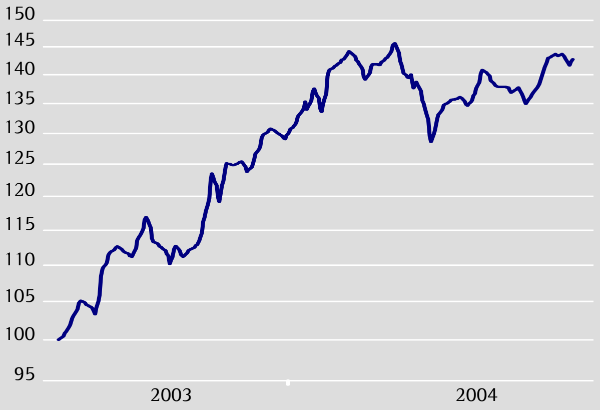
Figures as of October 31, 2004

## Net Asset Value

Per Share: USD 143.51

Market Capitalization: USD 1.7 million

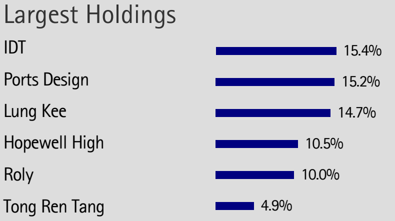
## Share Price in USD Since May 27, 03



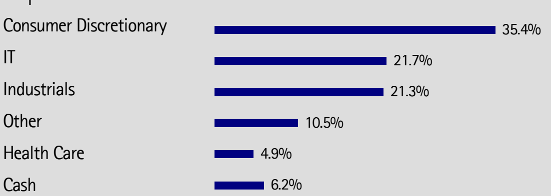

## Performance

| Oct | YTD | 1 Y | May 27, 03 |
|---|---|---|---|
| 0.5% | 10.6% | 17.9% | 43.5% |

## Largest Holdings




## Exposure




The first rate hike since 1995 put pressure on China shares towards the end of the month. Although with 27 basis points small in size, the rate hike sends two messages. Officials remain concerned about the scope for overinvestment and the outlook for inflation. Most importantly, the move represents an important shift in strategy, from administrative controls towards managing the business cycle through market-based measures. As rates remain well below inflation levels, further rate hikes are likely. During the month, we participated in the IPO of China Power and the secondary market placement of China Aviation which were both sold with gains.

China's economy grew 9.1 percent year-on-year in the third quarter. That's below the second quarter number of 9.6 percent, but slightly above market expectations of an 8.9 percent increase. By sector, output of agriculture and services picked up pace, while industrial activity slowed. In light of the questionable quality of China's GDP statistics, the overall message, that the economy and the investment cycle continue to slow, is more important than the specific numeric details.

Hopewell Highway Infrastructure continued to report healthy traffic and revenue data in September. The daily traffic of the Guangzhou-Shenzhen Superhighway increased by 16 percent year-on-year to 229'000 vehicles, compared to the 9-month average of 200'000. Daily revenue was CNY 8.1 million, 14 percent higher compared to the 9-month average of CNY 7.3 million. The Guangzhou East-South-West Ring Road reported 35 percent and 33 percent growth to 62'000 vehicles and CNY 971'000 for daily traffic and daily revenue respectively.

Tong Ren Tang's turnover increased by 16 percent year on year to CNY 208 million for the quarter ended September 30. Due to a change in product mix and higher material costs, the gross margin declined 10.8 percentage points to 52.4 percent. Due to better cost controls, the operating margin declined by only 0.1 percentage points to 24.2 percent. Net profit increased by 12 percent to CNY 46 million. Cash collection improved with receivables down by almost half from CNY 159 million in June, implying 30 days of daily sales.

Jiang Qing, the brother of the Chairman, and CLSA Private Equity sold 8.6 percent of China Fire Safety shares at an 8.3 percent discount to the previous day's closing price. Upon completion, Jiang Qing's holdings in the company will be reduced from 5 percent to 0.4 percent; CLSA Private Equity's interest from 13.1 percent to 9.1 percent. Chairman Jiang Xiong's stake remains at 49.1 percent. The sale by CLSA Private Equity has been well expected as a normal investment realization. The sale by Jiang Qing is believed to be related to personal reasons. We expect no change in the strategy of the company.

# General Information

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|---|---|
| Legal Nature | Trust account, CSPB Singapore |
| Security | Phantom shares |

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|---|---|
| Trading | Daily, based on NAV |
| Dilution Levy | 0.7% |
| Trading Fee | 0.5% |
| Management Fee | 1% |
| Performance Fee | 20% above 8% hurdle rate, high water mark |

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|---|---|
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| | Pang Shun Pen, Singapore |
| | Dr. Andreas Eppenberger, Zurich |
| | Christoph Himmelstein, Hong Kong |
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## Investment Rationale

Since Deng Xiao-ping succeeded Mao towards the end of the 1970s, economic development has taken center stage in China. Market-oriented reforms and decentralized decision making were introduced at the Party Congress in 1978. Over the last decade the shift from communist dogmatism to economic pragmatism has become deeply entrenched. As a consequence, China has become 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. China Investment Corporation ("CIC") is managed with a view to careful selection and trading of its portfolio companies. In order to mitigate the risks invariably associated with young and fast growing economies, CIC emphasizes quality in all its aspects. CIC is designed to provide investors with a conservative and liquid equity exposure to a part of the world that is gradually gaining in importance.

## The Fund

CIC is a trust account in the name of HSZ Limited with the Singapore Branch of Credit Suisse Private Banking and was set up on May 27, 2003. Phantom shares are issued and redeemed daily based on CIC's net asset value. It is planned to incorporate CIC upon reaching net assets of approximately USD 10 million.

## Investment Strategy

The objective is to create sustained shareholder value by acquiring and managing equity and equity-linked investments in a select number of high-quality companies that have a significant exposure to China, regardless of the listing location. Companies with significant China exposure generate at least 50 percent of their revenues and/or have at least 50 percent of their manufacturing capacity in China. 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. Investments by CIC in any single company may not exceed 20 percent of CIC's gross assets upon the date of purchase and 10 percent of a company's capital. No debt financing is employed. Derivatives are used, however with moderation.

## The Manager

HSZ Group is a global investment management company with a special interest in Asia. The company is majority owned by its four partners and employs a total staff of thirteen in Hong Kong, Singapore and Zurich. The team has managed Asian equity portfolios since 1994.