

PROSPECTS FOR INDUSTRIAL FUNDS IN CHINA AS SEEN IN THE DEVELOPMENT OF SDIC

Speech at the Annual Meeting of Sentient Global Resources Fund

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Thank you, Mr. Cassidy.

Ladies and Gentlemen,

Good evening!

It is a privilege to be invited to the Annual Meeting of Sentient Global Resources Fund and I'm grateful to Sentient for giving me the opportunity to make this keynote speech. I regret that two years ago I was unable to attend Sentient's Annual Meeting held in Colorado in the United States. And it is a great pleasure today to meet old friends and make new ones here in Beijing.

Today is a special day for SDIC and the Sentient Group, for after eight long years of courtship we have at last become engaged, as it were. We have signed Heads of Agreement related to coal and coal-gangue power projects. For me, this is a dream coming true. The date for the event is also well chosen. I am sure you are all only too well aware that Chinese people always choose an auspicious date for an important event. Today is May 18 and if you say '18' in Cantonese it sounds like "will make a fortune" and May 18 sounds like "We are going to make a fortune". So please allow me to express this in a more formal way by wishing our work together prosper day by day on the basis of mutual trust with both parties coming out winners.

Two years ago, I asked Qin Ming, Vice President of SDIC, to attend Sentient's annual meeting on my behalf. In his speech at the meeting, he gave a detailed briefing on the activities of the corporation, which I am sure has helped everyone present to familiarize themselves with the general situation of SDIC. We are happy to say that over the past two years SDIC has made further progress in all of its business areas, and I am honoured to announce here that towards the end of last month the central government confirmed SDIC's ranking in top place among the "Top Ten Model State-Owned Enterprises in China". Mainstream media here in China has given extensive coverage to the successful methodology, experience and outstanding performance of SDIC in reform and innovation

as well as business operations and management. I will proceed today to give you an account of how SDIC goes about selecting and running the corporation's businesses so that you understand how SDIC, as a state-owned enterprise, has developed and expanded, and has made use of every available opportunity that the continued marketization of China's economy has presented.. As an investor in industrial funds, you just simply need to look at the development and track record of SDIC itself to see the opportunities for industrial funds here in China to become a part of China's economic development.

As you all know, China at present is still undergoing industrialization, and is still at a stage in which energy, resources and infrastructure serve as the backbone of its economic development. From a long-term perspective, the two overriding factors that will impose constraints on China's future economic development will be a shortage of resources and environmental pollution. China's lack of resources means whoever possesses resources will be well placed in terms of sustaining long-term development. In order to expand, an investment company must have a clear view of the overall situation, and in a sector where demand remains unfulfilled, size up market needs and develop the industry accordingly. So, we made a judgment about the prospects of China's future economic development, matched these with the strengths of SDIC, and made the decision to take four basic and resource-related industries, coal, power, chemical fertilizer and ports as the major lines of business that SDIC should seek to steadily develop over the long term. At the same time SDIC made a conscious decision to move into the service industry focusing on financial and assets management and advisory services to strengthen the holding company's operations with a view to supporting our core industrial developments. While promoting the development of the corporation, we have also placed emphasis on the conservation of resources, care for the environment and an earnest fulfilment of the enterprise's social responsibilities.

As a non-renewable energy source, coal will account for over 60% of the country's energy consumption for a long time to come. China has made clear the strategic position of coal in its energy supply and the leading role of coal in the energy industry. However, in 2002, when the coal industry was in a trough, people did not see its possibilities, believing that it was a sunset industry. But SDIC, in the light of its analysis of China's economy and energy needs, decisively increased its coal resources and production capacity. Coal resources held by SDIC increased to 17 billion tonnes in just a few years and coal production capacity has reached 17 million tonnes with a further capacity of 20 million tonnes presently under construction. Production is expected to reach 60 million tonnes per annum by 2012. SDIC's operating revenues from coal reached USD600 million (RMB4.92 billion) in 2005, with a profit of USD170 million (RMB1.36 billion), resulting in an increase in profit of 170%

over the past three years. To further expand its coal assets, SDIC has focused its efforts on three large regions: Anhui, Shanxi and Xinjiang, where there are rich coal resources of excellent quality. All of the coal mines SDIC has selected are located in the 13 areas which the national government has designated as coal production centres. In Shanxi Province alone, SDIC plans to inject USD400-600 million (RMB3-5 billion) into the development of coal bed methane and types of coal such as anthracite and coking coal, which are in short supply. Investment will also be directed at enterprises that integrate coal mining, power generation and chemical processing.

SDIC has also adhered to its vision of the power generation industry. The focus of its investment in power generation has been on the overall development of tiered hydropower stations in the Yalong River Valley in China's west. At the end of last century, SDIC constructed the Ertan Hydropower Plant in the lower reaches of the Yalong River in Sichuan with an installed capacity of 3.33GW, the second largest of its kind in China. Total investment in the project was USD3.4 billion (RMB28 billion), including a loan of USD1 billion from the World Bank—the largest ever granted by the World Bank for a single project anywhere in the world. SDIC has assisted Ertan Corporation in ensuring that its operations have been run according to modern corporate norms along with the adoption of legal person responsibility for individual projects, the use of project bidding, and the establishment of mechanisms for supervision during construction and contract management. Ertan has stringently enforced FDIC provisions making it a model enterprise in China—even in the world—in terms of project construction and environmental protection, and a model project for the World Bank. Today, Ertan Hydropower Development Corporation, with SDIC as its principle shareholder, has been accelerating the development of Yalong River Valley by utilizing the experience and efficiencies gained through Ertan's construction. Construction has already commenced on the Jinping Stage One Hydropower Plant which will have the highest dam in the world and an installed capacity of 3.6GW. Preparations are being made for Jinping Stage Two, Guandi and Tongzilin hydropower plants. The total installed capacity of the five tiered hydropower stations alone will reach 15GW. According to our master plan, investment in the 11 hydropower stations located at the middle and lower reaches of the river will amount to USD24.2 billion (RMB194 billion). A total of 22 hydropower stations will be built along the Yalong River Valley, with a total installed capacity of 30GW, 1.5 times that of the Three Gorges project. However only 6,000 people will be relocated which means that this river valley can be regarded as having the best development conditions in China. In the field of thermal power generation, SDIC's strategy is to focus investment on a number of key power plants and integrated coal-power generation projects in accordance with the government's national power grid layout. An example of this is the Beijiing Power Plant project in Tianjin, which the central

government has designated as a pilot project for the recycling economy. Along with sea water desalination and other projects, this power plant will be equipped with 4 highly efficient supercritical coal-fired power generating systems with a capacity of 1GW each, making it a vanguard in the promotion of the recycling economy.

SDIC presently has a total installed power capacity of 18GW, and it is estimated that the capacity will exceed 50GW by 2012. In 2005, SDIC power projects generated a total of 83.7 billion kWh, resulting in an operating revenue of USD1.5 billion (RMB 11.92 billion) and a profit of USD280 million (RMB2.22 billion) thereby maintaining a growth rate of more than 10% per annum over three consecutive years.

An enormous resources market requires an enormous transport capacity. SDIC has therefore turned its attention to ports and shipping. SDIC is the only government representative participating in the Central Government Port Operations Fund. Thirty-five ports have been designated as China's national or regional hub ports. One of the major ports that SDIC will be developing is Caofeidian Port on the Bohai Bay. This facility will be developed into the largest coal terminal to transport coal from China's north to the south and will have a freight-handling capacity of 200 million tonnes.

China's potash fertilizer resources are scarce with the country relying on imports for 80% of its needs. Xinjiang Autonomous Region has Asia's largest sylvite deposit with industrial reserves accounting for over half of the total national reserves. On April 26, SDIC started the construction of the world's largest potassium sulphate production base in Xinjiang which will have an annual production capacity of 1.2 million tonnes of potash fertilizer by 2009.

As a state-owned enterprise, simply being large isn't enough; we also need to be strong. The goal of the best managed state-owned enterprises should be to maximize return on equity. SDIC does not seek to be the biggest in what it does; rather it seeks to achieve excellence in every project it undertakes.

I understand that the arrangements for this year's AGM include a visit to Xinji Coal Mine. The mine is located in Anhui Province and is one of the best managed coal mines in China with 10.2 billion tonnes of coal resources. Xinji presently operates three mines with a total

output of 8 million tonnes per year. A new mine is soon to be commissioned which will increase annual capacity by 8 million tonnes. In addition, work has already commenced on another mine which will add another 8 million tonnes per year. The total planned annual capacity of Xinji is 35.9 million tonnes. Xinji's three operating mines have already achieved excellence in the following aspects:

- short construction period: about one-half to one-third of the time normally required in the industry;
- low capital cost: a unit cost of USD34.5 (RMB276) per tonne, half the national average;
- high productivity: raw coal output per worker is 12 tonnes, among the highest in the country;
- short lead time before reaching full capacity: all three mines reached their designed capacity in the same year of being commissioned - three to ten years less than what is normally required in the industry.

Jingyuan No.2 Power Generation Company Limited located in Gansu Province is the first joint venture thermal power generation project in northwest China. The joint venture was formed by SDIC and the US First China Electricity Cooperation Limited in 1995. The meticulous management of their operations won them the highest category of awards at the 2005 National Business Innovation Awards in Modern Management. The company has gone on to set the benchmark for management standards in China's power generation industry.

While striving for a high return on equity by creating first-class enterprises, SDIC also tries to maximize its equity value with staged equity holdings and capital market operations. In 2004, SDIC divested its 16.24% shareholding in Zhejiang Haizheng Pharmaceuticals Limited. The proceeds from the divestment were 12 times the original investment, generating an average return of 109% per annum.

SDIC also uses IPO to create a platform to access capital for its investee companies. SDIC Huajing Power is an example of a company listed by SDIC for this purpose. When it comes to capital market operations, SDIC makes full use of its excellent commercial credentials and has successfully issued short-term corporate bonds to institutional investors on two

occasions, raising nearly USD250 million (around RMB2 billion). In addition, SDIC has signed strategic cooperation agreements with the China Development Bank, Bank of China and other financial institutions, which provide SDIC with a total credit line of USD25 billion (RMB200 billion). Now, some of you might be wondering if SDIC is also highly geared, something that is quite common among state-owned enterprises. It isn't, for SDIC is very prudent when it comes to financial management. Although SDIC's business has been experiencing rapid growth, SDIC has been able to maintain its debt equity ratio at around 45%.

Earlier on when speaking about the development of SDIC, I mentioned the need to treat our environment with care. Environmental protection is a social responsibility for every enterprise. No enterprise should seek profits at the expense of the environment. Consequently, the development strategy of SDIC explicitly requires increasing investment in the environment when carrying out projects. Take coal for example. Importance has been attached to the washing of coal and recycling of waste water produced, and it is planned to increase, within the next five years, the number of coal washing plants from the current 6 to 12. The annual coal washing capacity will grow from 9.9 million tonnes to 40 million tonnes. SDIC will increase its investment in waste-water recycling and purification to help preserve water resources. The recycled waste water will be used as cooling water for nearby power plants and for public sanitary facilities and lawns. SDIC has set for itself a target of recycling over 90% of waste water at its mines. In order to make full use of the coal gangue produced in coal mining and washing, and thus reduce environmental pollution, the building of a complementary coal gangue power plant has been incorporated in SDIC's plans for investment in coal enterprises. Increasing recovery of coal is also an important part of the drive to be environmentally friendly. During a 2005 national survey concerning specifically the recovery rate of coal, all SDIC coal mines were found to comply fully with coal recovery standards.

Finally, I wish to talk about the people at SDIC. What does SDIC count on for growth? People. On employees who are responsible, committed and ready to contribute. Indeed, SDIC's most important asset is its people. SDIC has a people-oriented corporate culture aimed at creating a healthy atmosphere in which the company and its employees serve each other in a spirit of mutual respect. Let me mention just one simple example in this context. Three university students we recently recruited are from poor families and had completed university on educational loans. They were leading a difficult life, as they had to use their income not only to pay for their daily expenditures, but also to repay their loans and support their families. Well, SDIC decided to pay the balance of the unpaid loans of these three students in one go, with no strings attached. Yes, our purpose is to run our business "for our investors, for our society and for our employees". The unique corporate culture of SDIC earned itself the title of "2005 National Model Enterprise for Harmonious Labour

Relations” awarded jointly by the China Enterprise Association, International Labour Organization and other agencies.

A people-oriented culture cannot be fostered without safety in mind. And SDIC attaches great importance to production safety and regards it as a top priority in the operation of the enterprises in which it has invested. Comprehensive measures have been adopted with respect to rules and regulations, management, funding, technology, training and performance assessment, with a view to effectively guaranteeing safety in terms of human life as well as property. As a result, SDIC is one of the top performers in terms of production safety indicators. Take the coal industry for example: not a single gas explosion accident has occurred in any SDIC-invested coal enterprise. No cost has been spared in investing in safety facilities and equipment. We require low gas mines to install monitoring facilities designed for high gas mines, as has been done in Xinji. For high gas mines, we require them to pump out the gas prior to commencing the mining. Gas pumped out is used by the mines and nearby communities. The Baiyangling Mine in Xiyang is a case in point. For mines undergoing expansion, we require them to suspend production in the original mine until the expansion is completed and all safety facilities have successfully passed a series of tests, even though the suspension of production results in some short-term loss of cash flow and an increase of capital costs during the construction period. In regard to production safety, I have made it crystal clear within SDIC that everyone must always bear in mind one thing: that is, zero tolerance of production accident; company growth shall not be achieved at the expense of human lives.

When I became President of SDIC more than three years ago, I called on my staff to engage in “pioneering for a second time” based on our corporate development strategy. The 5-year development goals set by me at that time have already been achieved, and we did it 2 years ahead of schedule. The year 2005 witnessed an increase of 18% in SDIC’s total assets to US\$ 12 billion (RMB 93.9 billion) and an increase of 40% in its post-tax profit to US\$ 460 million (RMB 3.7 billion).

SDIC is still a young enterprise with a history of just over 10 years. It is my dream to build SDIC into a well established “one hundred-year-old shop”. The goals I set upon taking office were to make SDIC a first-class Chinese investment holding company within 5 years and a world-class investment holding company within 10. The first goal has already been achieved, as SDIC has become the number one Chinese investment holding company in terms of size, performance and management. We are working hard towards the second goal. A first-class investment company cannot possibly be created without cooperation with first-class overseas enterprises. For example, SDIC and UBS have set up a fund management company with 49% held by UBS, the first of its kind since China’s entry into WTO. A total of US\$ 330 million (RMB 2.7 billion) has been raised through this joint venture for investing in onshore listed companies. With a philosophy of honesty and win-win results for all, SDIC will join hands with far-sighted and strong international

investors with an excellent reputation, such as Sentient Fund, in exploring the possibilities of developing domestic and overseas resources and sharing the results of China's strong economic growth.

The case of SDIC, as just presented, demonstrates that a state-owned enterprise in a growing market economy can sustain healthy growth and strive to become a world-class enterprise, so long as it has a clear strategy and secure resources, excels in business management and team-building, and that it knows how and when to seize market opportunities.

Thank you for your attention.