

CORPORATE HIGH YIELD FUND III INC  
Form N-CSR  
August 03, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT  
INVESTMENT COMPANIES

Investment Company Act file number 811-8497

Name of Fund: Corporate High Yield Fund III, Inc.

Fund Address: P.O. Box 9011  
Princeton, NJ 08543-9011

Name and address of agent for service: Terry K. Glenn, President, Corporate High  
Yield Fund III, Inc., 800 Scudders Mill Road, Plainsboro, NJ 08536.  
Mailing address: P.O. Box 9011, Princeton, NJ 08543-9011

Registrant's telephone number, including area code: (609) 282-2800

Date of fiscal year end: 05/31/04

Date of reporting period: 06/01/03 - 05/31/04

Item 1 - Report to Stockholders

[LOGO] Merrill Lynch Investment Managers

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Corporate High Yield  
Fund III, Inc.

Annual Report  
May 31, 2004

[LOGO] Merrill Lynch Investment Managers

Corporate High Yield Fund III, Inc.

The Benefits and Risks of Leveraging

Corporate High Yield Fund III, Inc. utilizes leveraging through borrowings or issuance of short-term debt securities or shares of Preferred Stock. The concept of leveraging is based on the premise that the cost of assets to be obtained from leverage will be based on short-term interest rates, which normally will be lower than the income earned by the Fund on its longer-term portfolio investments. Since the total assets of the Fund (including the assets obtained from leverage) are invested in higher-yielding portfolio investments, the Fund's Common Stock shareholders are the beneficiaries of the incremental yield.

Leverage creates risks for holders of Common Stock including the likelihood of greater net asset value and market price volatility. In addition, there is the risk that fluctuations in interest rates on borrowings (or in the dividend rates

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on any Preferred Stock, if the Fund were to issue Preferred Stock) may reduce the Common Stock's yield and negatively impact its net asset value and market price. If the income derived from securities purchased with assets received from leverage exceeds the cost of leverage, the Fund's net income will be greater than if leverage had not been used. Conversely, if the income from the securities purchased is not sufficient to cover the cost of leverage, the Fund's net income will be less than if leverage had not been used, and therefore the amount available for distribution to Common Stock shareholders will be reduced.

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A Letter From the President

Dear Shareholder

Fixed income markets were mixed over the most recent six-month and 12-month reporting periods. The high yield market, as measured by the Credit Suisse First Boston High Yield Index, had a six-month return of +3.24% and a 12-month return of +13.25% as of May 31, 2004. Corporate bonds, represented by the Merrill Lynch U.S. Corporate Master Index, posted returns of +.67% and -.16% for the six-month and 12-month periods ended May 31, 2004, respectively. Treasury issues, as measured by the Citigroup Treasury 1 - 3 Year Index, returned +.48% and +.63% for the same six-month and 12-month periods.

By May month-end, the Federal Reserve Board appeared poised to raise the Federal Funds target rate from its 45-year low of 1%. This anticipated shift in monetary policy was largely prompted by better-than-expected employment reports for the months of March, April and May, as well as by rising producer prices. The good news on the employment front -- previously a dim spot in an otherwise bright economic picture -- helped cause the yield on the 10-year Treasury bond to spike 75 basis points (.75%), from 3.91% on April 1 to 4.66% on May 28.

Equity markets, in the meantime, gleaned support from the improving economic environment and provided attractive returns. Although we did experience a market correction toward the end of the period, for the six months and 12 months ended May 31, 2004, the Standard & Poor's 500 Index returned +6.79% and +18.33%, respectively. Significant fiscal and monetary stimulus in 2003, including low interest rates and tax cuts, opened the door to consumer spending, capital spending, increases in exports and long-awaited job growth. As expected, these developments led the way to improvements in corporate earnings -- a positive for stock markets.

The events and efforts of the past year leave us with a much stronger economy today. Of course, markets will always fluctuate, and there are many uncertainties -- including the possibility of geopolitical events -- that can translate into negative market movements. Keeping this in mind, however, we encourage you to revisit your portfolio and your asset allocation strategy to ensure you are well positioned to take advantage of the opportunities that lie ahead. Importantly, your financial advisor can help you develop a strategy most suitable for your circumstances through all types of market and economic cycles.

We thank you for trusting Merrill Lynch Investment Managers with your investment assets, and we look forward to serving you in the months and years ahead.

Sincerely,

/s/ Terry K. Glenn

Terry K. Glenn

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President and Director

CORPORATE HIGH YIELD FUND III, INC.

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## A Discussion With Your Fund's Portfolio Managers

Fund performance benefited during the fiscal year from favorable security selection and our use of leverage, a strategy that enhances returns in a rising market.

### How did the Fund perform?

For the 12-month period ended May 31, 2004, the Common Stock of Corporate High Yield Fund III, Inc. had net annualized yields of 10.60% and 11.21%, based on a year-end per share net asset value of \$8.43 and a per share market price of \$7.97, respectively, and \$.893 per share income dividends. Over the same period, the total investment return on the Fund's Common Stock was +19.33%, based on a change in per share net asset value from \$7.86 to \$8.43, and assuming reinvestment of \$.895 per share ordinary income dividends.

The Fund's return for the year significantly exceeded that of the high yield market as measured by the Credit Suisse First Boston (CSFB) High Yield Index, which returned +13.25% for the 12 months ended May 31, 2004. The Fund also outperformed its comparable Lipper category of High Current Yield Funds (Leveraged), which had an average return of +19.00% for the same period. (Funds in this Lipper category aim for relatively high current yield from investment in fixed income securities, have no quality or maturity restrictions and tend to invest in lower-grade debt issues.)

For the six-month period ended May 31, 2004, the total investment return on the Fund's Common Stock was +5.35%, based on a change in per share net asset value from \$8.44 to \$8.43, and assuming reinvestment of \$.457 per share income dividends. The Fund outperformed the +3.24% return of the CSFB High Yield Index and the +4.91% average return of the Lipper High Current Yield (Leveraged) category for the same six-month period.

For a description of the Fund's total investment return based on a change in the per share market value of the Fund's Common Stock (as measured by the trading price of the Fund's shares on the New York Stock Exchange), and assuming reinvestment of dividends, please refer to the Financial Highlights section included in this report. As a closed-end fund, the Fund's shares may trade in the secondary market at a premium or a discount to the Fund's net asset value. As a result, total investment returns based on changes in the market value of the Fund's Common Stock can vary significantly from total investment returns based on changes in the Fund's net asset value.

### What factors contributed to the Fund's performance?

The first part of the fiscal year was characterized by the continuation of a high yield market rally that began in mid-October 2002. The main drivers of the upturn were investors' improved outlook on the economy, generally favorable corporate earnings reports, a shrinking number of defaults by high yield corporate borrowers and falling interest rates. The market also benefited from increasing demand on the part of investors searching for yield in the low interest rate environment. The momentum changed sharply toward the end of January 2004, as market sentiment reversed in reaction to uncertainty regarding interest rates. The resultant high yield market softness persisted through May 2004.

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Fund performance benefited from the use of leverage and positive results from several holdings that rebounded during the period. During the first part of the fiscal year -- which, as mentioned earlier, was characterized by high yield market strength -- the riskier, previously downtrodden sectors and bonds were the market's best performers.

Toward the end of the period, amid concerns about rising interest rates and the momentum of economic growth, high yield investors became more cautious about assuming additional risk. Bonds in the portfolio that provided strong performance were those with solid credit quality and good earnings prospects, such as the convertible bonds of Tyco International Group SA, and bonds of companies in previously downtrodden sectors that have shown sustainable recovery, including bonds of independent power producer Mission Energy Holding Company. On the other hand, our holdings in telecommunications bonds of Qwest Communications and Time Warner Telecom, Inc. were hurt by earnings that did not meet investor expectations.

What changes were made to the portfolio during the period?

We allocated approximately 5% of the Fund's net assets to convertible securities in an effort to capture the potential upside in the equity markets. The goal also was to diversify the portfolio amid what we believe is an increasingly skittish and fully valued high yield market. Convertibles can be volatile, reflecting movements in the underlying stocks;

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therefore, we anticipate that our holdings will be subject to the same risks. However, we have attempted to mitigate that risk by choosing higher-quality issues and by purchasing bonds that are somewhat insulated from downside volatility while benefiting from rising stock prices. Among the Fund's most significant convertible positions are Tyco International (rated BBB-), General Motors Corp. (BBB), Liberty Media Corporation (BBB-) and the securities of Citizens Utilities (BB+), a telephone service provider. With the potential for higher interest rates, we also invested modestly in floating rate securities and bank loans.

In addition, we temporarily increased our holdings in the riskier CCC-rated credits. The strong performance of a number of our downtrodden credits -- most notably Mission Energy -- increased the Fund's weighting in the CCC sector, as we did not reduce our holdings when the prices of these securities rose. Our overweight position in this rating category also reflects our view that the underlying credit quality of several companies with CCC-rated securities is better than the credit quality implied by the rating. We believe the low rating may reflect recently resolved financial difficulties (as is the case with Qwest Communications, a telecommunications provider), or high financial leverage on what we consider to be sound and improving fundamentals (for example, American Tower Corporation).

The Fund's leverage position averaged 26.1% during the past six months. That is, the Fund borrowed the equivalent of 26.1% of total assets invested, earning incremental yield on the investments we made with the borrowed funds. As of May 31, 2004, the Fund was 25.9% leveraged after borrowing \$109.6 million at a cost of 1.04%. Over the past six months, the average amount borrowed was approximately \$112.3 million and the daily weighted average borrowing rate was 1.37%. While leveraging will hinder the Fund's total return in a weak market, the converse also is true. We intend to maintain our leverage position in the mid-20% range, although that level may vary somewhat as we adjust the portfolio's holdings. (For a more complete discussion of the benefits and risks

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of leveraging, see page 2 of this report to shareholders.)

In May, we received approval from the Fund's Board of Directors to execute various credit hedging strategies, such as selling uncovered call options or buying protection under a credit default swap. However, we did not make use of these capabilities during the period.

How would you characterize the Fund's position at the close of the period?

The low valuations found in the market during early 2003 have largely evaporated, leaving limited potential for strong upward momentum in the high yield market. We expect increasing market volatility in the near term, but believe high yield securities will continue to find support from a gradually improving economy and the resultant positive corporate earnings. We have positioned the Fund to benefit in this environment. We believe that increasing pressure for higher interest rates will begin to have a greater effect on the high yield market, and we have taken steps -- for example, adding floating rate securities for interest rate protection -- to moderate the impact on the portfolio.

Within this broad picture, we believe certain industries, such as the utility and independent power producer sector and the chemicals sector, represent good relative value. As of May 31, 2004, the Fund's largest industry allocations were in utilities, at 11.3% of total market value, and chemicals, at 7.8%. In our opinion, the utility sector has exhibited favorable fundamentals, and the independent power producer subsector offers attractive valuations. Within the chemical sector, we have found what we believe to be good relative value in the specialty chemical business, which has been hurt by high energy prices but avoids dramatically volatile end markets.

The Fund is underweight in the leisure sector, based on our belief that these securities already have priced in the upside potential. We maintain an underweight position in information technology, given our perception of high valuations, unstable earnings and potentially limited recovery value if earnings decline in the sector. We have limited exposure to the retail, food and drug, and finance sectors based on what we believe is inadequate and uncertain asset protection in these areas of the market. Similar to the CSFB High Yield Index, the Fund had an average credit rating of B at the close of the period.

B. Daniel Evans  
Vice President and Portfolio Manager

Elizabeth M. Phillips  
Vice President and Portfolio Manager

June 8, 2004

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[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (in U.S. dollars)

| Industry+   | S&P Ratings@ | Moody's Ratings@ | Face Amount | Corporate Bonds                        |
|-------------|--------------|------------------|-------------|--|
| Aerospace & | B            | B2               | \$2,275,000 | Alliant Techsystems Inc., 2.75% due 2/ |

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|                     |      |      |           |  |
|---------------------|------|------|-----------|--|
| Defense--1.9%       | B+   | B1   | 975,000   | (Convertible) (e)<br>Esterline Technologies Corporation, 7.8% due 10/15/2007 |
|                     | B    | B3   | 350,000   | K & F Industries, Inc.:<br>9.25% due 10/15/2007                              |
|                     | B    | B3   | 350,000   | 9.625% due 12/15/2010  |
|                     | B-   | B3   | 750,000   | TD Funding Corp., 8.375% due 7/15/2011                                       |
|                     | B    | B2   | 1,000,000 | Titan Corporation, 8% due 5/15/2011 (e)                                      |
| =====               |      |      |           |  |
| Airlines--1.5%      | BB   | B1   | 1,300,000 | American Airlines, Inc., 7.80% due 10/15/2007                                |
|                     | CCC+ | Caa2 | 950,000   | Continental Airlines, Inc.:<br>8% due 12/15/2005                             |
|                     | B+   | B2   | 552,557   | 6.541% due 9/15/2008   |
|                     | BB-  | B2   | 1,401,614 | 7.033% due 6/15/2011   |
|                     | BB+  | Ba2  | 1,328,933 | 6.90% due 1/02/2017  |
| =====               |      |      |           |  |
| Automotive--2.4%    | B    | B3   | 1,225,000 | Asbury Automotive Group, Inc., 8% due 10/15/2007                             |
|                     | B-   | B3   | 1,900,000 | Autocam Corporation, 10.875% due 6/15/2007                                   |
|                     | B-   | B2   | 950,000   | Collins & Aikman Products Co., 10.75% due 10/15/2007                         |
|                     | B    | Caal | 2,625,000 | Metaldyne Corporation:<br>11% due 6/15/2012                                  |
|                     | B    | B3   | 1,190,000 | 10% due 11/01/2013 (e)   |
|                     | B    | B3   | 250,000   | United Auto Group, Inc., 9.625% due 3/15/2007                                |
| =====               |      |      |           |  |
| Broadcasting--4.2%  | CCC  | B3   | 2,300,000 | Granite Broadcasting Corporation, 9.75% due 10/15/2007                       |
|                     | B    | B1   | 1,750,000 | LIN Television Corporation, 6.50% due 10/15/2007                             |
|                     | B-   | B3   | 1,375,000 | NextMedia Operating, Inc., 10.75% due 10/15/2007                             |
|                     | CCC+ | Caal | 2,125,000 | Paxson Communications Corporation, 10.75% due 10/15/2007                     |
|                     | B-   | B3   | 1,175,000 | Salem Communications Holding Corporation, 7.75% due 12/15/2010               |
|                     | B-   | B3   | 2,100,000 | 9% due 7/01/2011   |
|                     | CCC+ | Caal | 2,300,000 | Young Broadcasting Inc., 8.75% due 1/15/2007                                 |
| =====               |      |      |           |  |
| Cable--             |      |      |           | NTL Cable PLC (e):   |
| International--1.7% | B-   | B3   | 2,125,000 | 6.14% due 10/15/2012 (d)   |
|                     | B-   | B3   | 325,000   | 8.75% due 4/15/2014  |
|                     | D    | Ca   | 5,250,000 | Telewest Communications PLC, 11% due 10/15/2007                              |
| =====               |      |      |           |  |
| Cable--U.S.--7.8%   | NR*  | NR*  | 750,000   | Adelphia Communications Corporation, 6.75% due 10/15/2007                    |
|                     | CCC- | Caal | 236,329   | (Convertible) (c)<br>Avalon Cable LLC, 11.875% due 12/01/2009                |
|                     | BB-  | B1   | 2,600,000 | CSC Holdings, Inc., 7.625% due 4/01/2009                                     |
|                     | D    | Caal | 4,850,000 | Century Cable Holdings LLC, Term, due 10/15/2007                             |
|                     | CCC- | Ca   | 3,500,000 | Charter Communications Holdings, LLC:<br>8.625% due 4/01/2009                |
|                     | CCC- | Ca   | 2,000,000 | 9.625% due 11/15/2009  |
|                     | B-   | Caa2 | 3,025,000 | Insight Communications Company, Inc.,<br>due 2/15/2011                       |
|                     | B+   | B2   | 1,025,000 | Insight Midwest, LP:<br>9.75% due 10/01/2009                                 |
|                     | B+   | B2   | 1,400,000 | 10.50% due 11/01/2010  |
|                     | NR*  | Caal | 3,069,000 | Loral Cyberstar, Inc., 10% due 7/15/2007                                     |
|                     | NR*  | Ca   | 1,875,000 | Loral Space & Communications Ltd., 9.5% due 10/15/2007                       |

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B+ B2 3,975,000 Mediacom Broadband LLC, 11% due 7/15/2009

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Schedule of Investments (continued) (in U.S. dollars)

| Industry+                   | S&P Ratings@ | Moody's Ratings@ | Face Amount | Corporate Bonds  |
|-----------------------------|--------------|------------------|-------------|--|
| Chemicals--10.4%            | BB-          | B3               | \$1,575,000 | Geon Company, 6.875% due 12/15/2005                        |
|                             | CCC+         | NR*              | 2,200,000   | HMP Equity Holdings Corporation, 14.90% due 5/15/2008 (e)  |
|                             | CCC+         | Caa2             | 2,025,000   | Huntsman International Holdings LLC, 11.00% due 12/31/2009 |
|                             | B-           | B3               | 525,000     | Huntsman International LLC: 9.875% due 3/01/2009           |
|                             | CCC+         | Caa1             | 2,500,000   | 10.125% due 7/01/2009                                      |
|                             | BB-          | B1               | 2,025,000   | ISP Chemco Inc., 10.25% due 7/01/2011                      |
|                             | B+           | B2               | 2,000,000   | ISP Holdings, Inc., 10.625% due 12/15/2009                 |
|                             | BB-          | B1               | 3,025,000   | Millennium America Inc., 7% due 11/15/2009                 |
|                             | B-           | B2               | 450,000     | Nalco Company (e): 7.75% due 11/15/2011                    |
|                             | B-           | Caa1             | 1,125,000   | 8.875% due 11/15/2013                                      |
|                             | B-           | Caa2             | 3,500,000   | Nalco Finance Holdings Inc., 9.037%**                      |
|                             | BB-          | B2               | 3,125,000   | Omnova Solutions Inc., 11.25% due 6/01/2011                |
|                             | BB-          | B3               | 3,125,000   | PolyOne Corporation, 10.625% due 5/15/2011                 |
|                             | CCC+         | Caa1             | 2,075,000   | Rhodia SA, 8.875% due 6/01/2011 (e)                        |
|                             | B-           | B3               | 1,825,000   | Rockwood Specialties Group, Inc., 10.625% due 6/01/2011    |
|                             | B-           | Caa1             | 3,025,000   | Terra Capital, Inc., 11.50% due 6/01/2011                  |
|                             | B-           | B1               | 950,000     | Wellman, Inc., First Lien Term, due 2/15/2011              |
| Consumer Durables--0.9%     | B-           | Caa1             | 2,050,000   | Sealy Mattress Company, 8.25% due 6/15/2011                |
|                             | B            | B2               | 785,000     | Tempur-Pedic, Inc., 10.25% due 8/15/2011                   |
| Consumer Non-Durables--3.5% | B-           | B3               | 400,000     | Amscan Holdings, Inc., 8.75% due 5/01/2011                 |
|                             | B+           | Ba3              | 650,000     | Chattem, Inc.: 4.31% due 3/01/2010 (d)                     |
|                             | B-           | B2               | 600,000     | 7% due 3/01/2014   |
|                             | B            | B3               | 2,550,000   | Hines Nurseries, Inc., 10.25% due 10/01/2011               |
|                             | CCC+         | B3               | 425,000     | Leiner Health Products Inc., 11% due 6/01/2011             |
|                             | B-           | Caa1             | 3,875,000   | Samsonite Corporation: 10.75% due 6/15/2008                |
|                             | B-           | B3               | 2,200,000   | 8.875% due 6/01/2011 (e)                                   |
| Diversified Media--6.4%     | B-           | B3               | 2,150,000   | CBD Media LLC, 8.625% due 6/01/2011                        |
|                             | B            | Caa1             | 1,400,000   | Dex Media West LLC, 9.875% due 8/15/2011                   |
|                             | B            | B2               | 1,900,000   | Houghton Mifflin Company, 8.25% due 2/15/2011              |

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|  |      |      |           |   |
|--|------|------|-----------|---|
|  | BBB- | Baa3 | 3,800,000 | Liberty Media Corporation, 0.75% due 3/15/2011 (Convertible)  |
|  |      |      |           | PRIMEDIA Inc.:  |
|  | B    | B3   | 2,475,000 | 7.625% due 4/01/2008  |
|  | B    | B3   | 875,000   | 8.875% due 5/15/2011  |
|  |      |      |           | R.H. Donnelley Financial Corporation 10.00% due 12/15/2010    |
|  | B+   | B1   | 200,000   | 8.875% due 12/15/2010   |
|  | B+   | B2   | 725,000   | 10.875% due 12/15/2012 (e)                                    |
|  | B-   | B3   | 2,450,000 | Six Flags, Inc., 9.50% due 2/01/2009                          |
|  | BB-  | B1   | 3,302,000 | Yell Finance BV, 12.52%** due 8/01/2011                       |
| =====                                  |      |      |           |   |
| Energy--Exploration & Production--1.3% | CCC+ | Caal | 825,000   | Continental Resources, Inc., 10.25% due 12/15/2011            |
|  | B    | B2   | 425,000   | Encore Acquisition Company, 6.25% due 12/15/2011              |
|  | B+   | B2   | 2,525,000 | Plains Exploration & Production Company, 10.00% due 7/01/2012 |
| =====                                  |      |      |           |   |

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[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (continued)

(in U.S. dollars)

| Industry+           | S&P Ratings@ | Moody's Ratings@ | Face Amount | Corporate Bonds  |
|---------------------|--------------|------------------|-------------|--|
| =====               |              |                  |             |  |
| Energy--Other--6.3% | BB           | Ba3              | \$1,925,000 | CITGO Petroleum Corporation, 11.375% due 12/15/2011    |
|                     | B            | B2               | 1,875,000   | Dresser, Inc., 9.375% due 4/15/2011                    |
|                     | B            | B2               | 2,075,000   | Ferrellgas Partners LP, 8.75% due 6/15/2011            |
|                     | BBB          | Baa2             | 2,300,000   | Halliburton Company, 3.125% due 7/15/2011              |
|                     | CCC          | B3               | 3,325,000   | Ocean Rig Norway AS, 10.25% due 6/01/2011              |
|                     | BB           | Ba3              | 3,536,000   | Port Arthur Finance Corporation, 12.50% due 12/15/2011 |
|                     | B            | B3               | 2,250,000   | Star Gas Partners, LP, 10.25% due 2/15/2011            |
|                     | D            | Ca               | 2,025,000   | Trico Marine Services, Inc., 8.875% due 12/15/2011     |
| =====               |              |                  |             |  |
| Food/Tobacco--5.5%  | B            | B3               | 750,000     | American Seafoods Group LLC, 10.125% due 12/15/2011    |
|                     |              |                  |             | Commonwealth Brands, Inc. (e):                         |
|                     | B-           | B2               | 1,925,000   | 9.75% due 4/15/2008                                    |
|                     | B-           | B3               | 1,475,000   | 10.625% due 9/01/2008                                  |
|                     | B+           | B2               | 3,250,000   | Cott Beverages, Inc., 8% due 12/15/2011                |
|                     | B            | B2               | 1,250,000   | Del Monte Corporation, 8.625% due 12/15/2011           |
|                     | CCC          | B2               | 2,200,000   | Doane Pet Care Company, 10.75% due 3/01/2011           |
|                     | B-           | B3               | 2,500,000   | Merisant Company, 9.50% due 7/15/2013                  |
|                     | NR*          | Caa3             | 1,950,000   | New World Pasta Company, 9.25% due 2/15/2011           |
|                     | BB           | Ba2              | 2,100,000   | Smithfield Foods, Inc., 8% due 10/15/2011              |
|                     | B-           | Caal             | 1,250,000   | Tabletop Holdings, Inc., 12.25%** due 12/15/2011       |
| =====               |              |                  |             |  |
| Gaming--9.2%        | B+           | B3               | 1,225,000   | Argosy Gaming Company, 7% due 1/15/2011                |



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|                   |      |      |           |  |
|-------------------|------|------|-----------|--|
|                   | B+   | B1   | 3,250,000 | Boyd Gaming Corporation, 8.75% due 4/1                         |
|                   | B-   | Caa1 | 925,000   | Global Cash Access LLC, 8.75% due 3/15                         |
|                   | B    | Caa1 | 1,925,000 | Inn of the Mountain Gods Resort and Ca<br>due 11/15/2010 (e)   |
|                   | B+   | B2   | 2,250,000 | Kerzner International Limited, 8.875%                          |
|                   | BB+  | Ba1  | 1,550,000 | MGM Mirage Inc., 8.50% due 9/15/2010                           |
|                   | B    | B2   | 3,425,000 | The Majestic Star Casino, LLC, 9.50% d                         |
|                   | BB-  | Ba2  | 2,325,000 | Park Place Entertainment Corporation,                          |
|                   | NR*  | Caa1 | 1,425,000 | Pinnacle Entertainment, Inc., 8.25% du                         |
|                   | B    | B2   | 2,175,000 | Poster Financial Group Inc., 8.75% due                         |
|                   | B    | B2   | 2,700,000 | Resorts International Hotel & Casino,<br>due 3/15/2009         |
|                   | CCC+ | Caa1 | 2,875,000 | Trump Casino Holdings, LLC, 12.625% du                         |
|                   | CCC+ | B3   | 1,475,000 | Wynn Las Vegas, LLC, 12% due 11/01/201                         |
| =====             |      |      |           |  |
| Health Care--6.1% | B    | B3   | 2,100,000 | Alpharma Inc., 8.625% due 5/01/2011 (e)                        |
|                   | BBB- | Ba1  | 1,400,000 | Apogent Technologies Inc., 1.183% due<br>(Convertible) (d) (e) |
|                   | BB-  | B2   | 1,325,000 | Biovail Corporation, 7.875% due 4/01/2                         |
|                   | B-   | B3   | 425,000   | Concentra Operating Corporation, 9.125                         |
|                   | B+   | B2   | 2,902,000 | Fisher Scientific International Inc.,                          |
|                   | BB-  | Ba2  | 3,750,000 | Fresenius Medical Care Capital Trust I<br>due 2/01/2008        |
|                   | B-   | B3   | 475,000   | InSight Health Services Corp.:<br>9.875% due 11/01/2011        |
|                   | B-   | B3   | 1,500,000 | 9.875% due 11/01/2011 (e)                                      |
|                   | NR*  | B2   | 1,100,000 | InterMune Inc., 5.75% due 7/15/2006 (C                         |
|                   | B-   | B3   | 1,000,000 | Tenet Healthcare Corporation, 5.375% d                         |
|                   | B    | B3   | 1,525,000 | Triad Hospitals, Inc., 7% due 11/15/20                         |
|                   | B    | B2   | 475,000   | VWR International, Inc. (e):<br>6.875% due 4/15/2012           |
|                   | B    | B3   | 525,000   | 8% due 4/15/2014   |
| =====             |      |      |           |  |

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CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004

Schedule of Investments (continued)

(in U.S. dollars)

| Industry+     | S&P<br>Ratings@ | Moody's<br>Ratings@ | Face<br>Amount | Corporate Bonds  |
|---------------|-----------------|---------------------|----------------|--|
| =====         |                 |                     |                |  |
| Housing--4.3% |                 |                     |                | Building Materials Corporation of Amer                 |
|               | B+              | B2                  | \$ 400,000     | 7.75% due 7/15/2005                                    |
|               | B+              | B2                  | 850,000        | 8% due 10/15/2007                                      |
|               | B+              | B2                  | 5,325,000      | 8% due 12/01/2008                                      |
|               | BB-             | Ba3                 | 650,000        | Forest City Enterprises, Inc., 7.625%                  |
|               | B-              | B3                  | 425,000        | MAAX Corporation, 9.75% due 6/15/2012                  |
|               | B+              | B1                  | 2,250,000      | Nortek Holdings, Inc.:<br>4.17% due 12/31/2010 (d) (e) |
|               | B-              | Caa1                | 1,775,000      | 10%** due 5/15/2011 (e)                                |
|               | B-              | B3                  | 550,000        | 9.875% due 6/15/2011                                   |
|               | BB-             | B1                  | 1,475,000      | Texas Industries, Inc., 10.25% due 6/1                 |

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|                                 |      |      |           |  |
|---------------------------------|------|------|-----------|--|
| Hybrid--0.6%                    | NR*  | B3   | 1,900,000 | Dow Jones TRAC-X North America High Yield<br>March 2009, Trust 3, 8% due 3/25/2009 |
| Information<br>Technology--0.9% | NR*  | NR*  | 2,200,000 | ADC Telecommunications, Inc. (Convertible)<br>1% due 6/15/2008                     |
|                                 | NR*  | NR*  | 750,000   | 1.605% due 6/15/2013 (d)   |
| Leisure--1.7%                   |      |      |           | FelCor Lodging LP:   |
|                                 | B-   | B1   | 2,850,000 | 5.84% due 6/01/2011 (d) (e)  |
|                                 | B-   | B1   | 1,550,000 | 9% due 6/01/2011   |
|                                 | B+   | B1   | 1,050,000 | Intrawest Corporation, 7.50% due 10/15/2011  |
| Manufacturing--7.7%             | CCC+ | Caa1 | 800,000   | Columbus McKinnon Corporation, 8.50% due 6/15/2009 (e)                             |
|                                 | B-   | B2   | 925,000   | Da-Lite Screen Company, Inc., 9.50% due 6/15/2009 (e)                              |
|                                 | B-   | B3   | 2,500,000 | Eagle-Picher Incorporated, 9.75% due 6/15/2009 (e)                                 |
|                                 | B-   | B3   | 2,700,000 | Invensys PLC, 9.875% due 3/15/2011 (e)   |
|                                 | B    | B2   | 2,475,000 | JohnsonDiversey, Inc., 9.625% due 5/15/2011 (e)                                    |
|                                 | B-   | Caa1 | 1,175,000 | Mueller Group, Inc., 10% due 5/01/2012   |
|                                 | B-   | B3   | 775,000   | Rexnord Corporation, 10.125% due 12/15/2011 (e)                                    |
|                                 | B-   | Caa1 | 975,000   | Sensus Metering Systems Inc., 8.625% due 6/15/2011 (e)                             |
|                                 | B    | B3   | 2,800,000 | Superior Essex Communications LLC, 9% due 6/15/2011 (e)                            |
|                                 | B    | B3   | 3,125,000 | TriMas Corporation, 9.875% due 6/15/2011 (e)                                       |
|                                 | BBB  | Baa3 | 3,330,000 | Tyco International Group SA (Convertible)<br>2.75% due 1/15/2018                   |
|                                 | BBB  | Baa3 | 500,000   | 2.75% due 1/15/2018 (e)  |
| Metal--Other--1.6%              | BB   | Ba3  | 2,925,000 | Luscar Coal Ltd., 9.75% due 10/15/2011 (e)   |
|                                 | NR*  | Ba2  | 1,925,000 | Vale Overseas Ltd., 8.25% due 1/17/2012 (e)  |
| Packaging--6.1%                 | CCC  | B3   | 1,400,000 | Consolidated Container Company LLC, 10% due 6/15/2009 (e)                          |
|                                 |      |      |           | Crown Euro Holdings SA:  |
|                                 | B+   | B1   | 950,000   | 9.50% due 3/01/2011  |
|                                 | B    | B2   | 500,000   | 10.875% due 3/01/2013  |
|                                 | CCC+ | Caa1 | 950,000   | Graham Packaging Company, 8.75% due 1/15/2012 (e)                                  |
|                                 | CCC+ | Caa2 | 2,625,000 | Graham Packaging Holdings Company, 10.125% due 6/15/2011 (e)                       |
|                                 | BB-  | B2   | 3,325,000 | Owens-Brockway Glass Container, Inc., 10.125% due 6/15/2011 (e)                    |
|                                 |      |      |           | Pliant Corporation:  |
|                                 | B    | B3   | 2,200,000 | 11.125%** due 6/15/2009 (e)  |
|                                 | B-   | Caa2 | 3,550,000 | 13% due 6/01/2010  |
|                                 | B-   | B3   | 825,000   | Tekni-Plex, Inc., 12.75% due 6/15/2010 (e)   |
|                                 |      |      |           | U.S. Can Corporation:  |
|                                 | CCC+ | Caa1 | 375,000   | 10.875% due 7/15/2010  |
|                                 | CCC+ | Caa2 | 2,825,000 | 12.375% due 10/01/2010   |
|                                 | B    | B2   | 650,000   | Wise Metals Group LLC, 10.25% due 5/15/2011 (e)                                    |

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CORPORATE HIGH YIELD FUND III, INC.

MAY 31, 2004

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[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (continued)

(in U.S. dollars)

| Industry+                | S&P Ratings@ | Moody's Ratings@ | Face Amount | Corporate Bonds  |
|--------------------------|--------------|------------------|-------------|--|
| Paper--6.6%              | D            | Ca               | \$1,000,000 | APP International Finance Company B.V. due 10/01/2005 (c)        |
|                          | BB           | Ba2              | 3,025,000   | Bowater Incorporated, 4.11% due 3/15/2008                        |
|                          | B            | Caa1             | 2,125,000   | Caraustar Industries, Inc., 9.875% due 10/01/2005 (c)            |
|                          | D            | Ca               | 4,475,000   | Doman Industries Limited (c): 8.75% due 3/15/2004 (g)            |
|                          | D            | Ca               | 550,000     | 9.25% due 11/15/2007   |
|                          | BB+          | Ba2              | 1,425,000   | Georgia-Pacific Corporation: 7.375% due 7/15/2008                |
|                          | BB+          | Ba2              | 1,925,000   | 9.375% due 2/01/2013   |
|                          | B-           | B2               | 825,000     | Graphic Packaging International Inc.: 8.50% due 8/15/2011        |
|                          | B-           | B3               | 950,000     | 9.50% due 8/15/2013  |
|                          | B            | B3               | 1,900,000   | JSG Funding PLC, 9.625% due 10/01/2012                           |
|                          | B            | B2               | 2,975,000   | Jefferson Smurfit Corporation, 8.25% due 10/01/2005 (c)          |
|                          | BB           | Ba3              | 2,450,000   | Norske Skog Canada Ltd.: 8.625% due 6/15/2011                    |
|                          | BB           | Ba3              | 150,000     | 7.375% due 3/01/2014 (e)   |
| Retail--0.1%             | B+           | B1               | 425,000     | Finlay Fine Jewelry Corporation, 8.375% due 10/01/2005 (c)       |
| Services--5.3%           | BB-          | Ba3              | 2,625,000   | Allied Waste North America, Inc.: 8.875% due 4/01/2008           |
|                          | BB-          | Ba3              | 950,000     | 7.875% due 4/15/2013   |
|                          | B            | B2               | 2,900,000   | The Coinmach Corporation, 9% due 2/01/2008                       |
|                          | B            | B1               | 2,725,000   | Corrections Corporation of America, 7.375% due 10/01/2005 (c)    |
|                          | BB-          | Ba2              | 875,000     | MSW Energy Finance Co. II, Inc., 7.375% due 10/01/2005 (c)       |
|                          | BB           | Ba1              | 1,500,000   | MSW Energy Holdings LLC, 8.50% due 9/01/2007                     |
|                          | B-           | Caa1             | 400,000     | Williams Scotsman, Inc.: 9.50% due 4/15/2008                     |
|                          | B-           | B3               | 3,750,000   | 9.875% due 6/01/2007   |
|                          | B            | B2               | 375,000     | 10% due 8/15/2008  |
| Steel--1.6%              | B+           | B1               | 1,425,000   | CSN Islands VIII Corp., 9.75% due 12/15/2007                     |
|                          | B-           | Caa1             | 1,550,000   | Ispat Inland ULC, 9.75% due 4/01/2014                            |
|                          | B            | B2               | 1,950,000   | UCAR Finance Inc., 10.25% due 2/15/2008                          |
| Telecommunications--5.7% | B-           | B2               | 2,475,000   | Alaska Communications System Holdings, Inc., 8.50% due 8/15/2011 |
|                          | B-           | B3               | 1,800,000   | Cincinnati Bell Inc., 8.375% due 1/15/2008                       |
|                          | B-           | Caa1             | 3,250,000   | FairPoint Communications, Inc., 12.50% due 10/01/2005 (c)        |
|                          | NR*          | Caa1             | 2,000,000   | LCI International, Inc., 7.25% due 6/15/2007                     |
|                          | CCC+         | Caa2             | 2,475,000   | Qwest Capital Funding, Inc., 7.25% due 10/01/2005 (c)            |

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|      |      |           |   |
|------|------|-----------|---|
| CCC+ | Caal | 1,350,000 | Qwest Services Corp., 13.50% due 12/15                          |
| B    | B1   | 850,000   | Time Warner Telecom Holdings, Inc., 5.00% due 2/15/2011 (d) (e) |
| CCC+ | B3   | 500,000   | Time Warner Telecom, Inc.: 9.75% due 7/15/2008                  |
| CCC+ | B3   | 3,875,000 | 10.125% due 2/01/2011   |

|                      |     |     |           |  |
|----------------------|-----|-----|-----------|--|
| Transportation--1.5% | B+  | B2  | 1,900,000 | Laidlaw International, Inc., 10.75% due 12/15/2011 |
|                      | BB- | Ba2 | 2,325,000 | Teekay Shipping Corporation, 8.875% due 12/15/2011 |

10 CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004

Schedule of Investments (continued) (in U.S. dollars)

| Industry+      | S&P Ratings@ | Moody's Ratings@ | Face Amount | Corporate Bonds  |
|----------------|--------------|------------------|-------------|--|
| Utility--13.7% | B-           | NR*              | \$4,458,000 | The AES Corporation: 9.375% due 9/15/2010                |
|                | B+           | NR*              | 2,100,000   | 8.75% due 5/15/2013 (e)                                  |
|                | NR*          | Ba2              | 850,000     | AES Drax Energy Limited, 11.50% due 8/15/2011            |
|                | CCC+         | Caal             | 8,275,000   | Calpine Canada Energy Finance ULC, 8.50% due 12/15/2011  |
|                | CCC+         | Caal             | 1,500,000   | Calpine Corporation, 8.25% due 8/15/2011                 |
|                | BBB-         | Ba2              | 3,600,000   | CenterPoint Energy, Inc., 3.75% due 5/15/2011            |
|                | BB           | Ba1              | 2,117,000   | ESI Tractebel Acquisition Corp., 7.99% due 12/15/2011    |
|                | B            | B2               | 1,900,000   | Edison Mission Energy, 9.875% due 4/15/2011              |
|                | CCC+         | Caal             | 4,625,000   | El Paso CGP Company, 7.75% due 6/15/2011                 |
|                | B-           | B3               | 475,000     | El Paso Production Holding Company, 7.00% due 12/15/2011 |
|                | CCC          | Caa2             | 3,325,000   | Mission Energy Holding Company, 13.50% due 12/15/2011    |
|                | BB           | Ba2              | 3,300,000   | Nevada Power Company: 10.875% due 10/15/2009             |
|                | BB           | Ba2              | 600,000     | 9% due 8/15/2013 (e)                                     |
|                | BB           | Ba2              | 1,650,000   | Sierra Pacific Power Company, 8% due 6/15/2011           |
|                | B-           | B2               | 1,200,000   | Sierra Pacific Resources, 8.625% due 3/15/2011           |
|                | B-           | B1               | 925,000     | Southern Natural Gas Company, 8.875% due 12/15/2011      |
|                | B+           | B3               | 1,975,000   | The Williams Companies, Inc.: 6.50% due 8/01/2006        |
|                | B+           | B3               | 3,350,000   | 8.125% due 3/15/2012                                     |
| Wireless--4.4% | CCC          | Caal             | 2,725,000   | American Tower Corporation, 9.375% due 12/15/2011        |
|                | CCC          | B3               | 825,000     | American Tower Escrow Corporation, 14.00% due 12/15/2011 |
|                | CCC          | Caal             | 2,000,000   | Centennial Communications Corp., 10.12% due 12/15/2011   |
|                | CCC          | B3               | 2,800,000   | Crown Castle International Corp., 9.37% due 12/15/2011   |
|                | B-           | B2               | 625,000     | Rural Cellular Corporation, 5.61% due 12/15/2011         |
|                | CCC-         | Caa2             | 2,750,000   | SBA Communications Corporation, 10.25% due 12/15/2011    |
|                | C            | Caa3             | 1,900,000   | US Unwired Inc., 13.009%** due 11/01/2011                |

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Total Investments in Corporate Bonds  
(Cost--\$401,111,967)--130.9%

|                             | Shares<br>Held | Common Stocks                          |
|-----------------------------|----------------|--|
| Airlines--0.1%              | 81,243         | ABX Air, Inc. (c)                      |
|                             | 2,591          | US Airways Group, Inc. (Class A) (c)   |
| Consumer Non-Durables--0.0% | 34,177         | WKI Holding Company, Inc. (c)          |
| Telecommunications--0.1%    | 16,244         | MCI, Inc. (c)                          |
|                             |                | Total Investments in Common Stocks (Co |

CORPORATE HIGH YIELD FUND III, INC.      MAY 31, 2004      11

[LOGO] Merrill Lynch Investment Managers

Schedule of Investments (continued)      (in U.S. dollars)

| Industry+         | Shares<br>Held | Warrants (b)                            |
|-------------------|----------------|---|
| Airlines--0.0%    | 1,589          | US Airways Group, Inc.                  |
| Cable--U.S.--0.0% | 32,981         | Loral Space & Communications Ltd.       |
| Chemicals--0.0%   | 725            | Huntsman Company LLC (e)                |
| Health Care--0.0% | 32,042         | HealthSouth Corporation                 |
| Packaging--0.0%   | 4,000          | Pliant Corporation                      |
| Paper--0.0%       | 700            | JSG Funding PLC                         |
| Wireless--0.1%    | 825            | American Tower Corporation              |
|                   |                | Total Investments in Warrants (Cost--\$ |

Preferred Securities

Preferred Stocks

|                |       |                            |
|----------------|-------|----------------------------|
| Airlines--0.0% | 1,589 | US Airways Group, Inc. (c) |
|----------------|-------|----------------------------|

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|                  |         |  |
|------------------|---------|--|
| Automotive--1.2% | 128,000 | General Motors Corporation (Convertible)                           |
|                  |         | Total Investments in Preferred Stocks<br>(Cost--\$3,199,472)--1.2% |

|               |                |  |
|---------------|----------------|--|
|               | Face<br>Amount | Trust Preferred  |
| Utility--1.4% | \$4,240,000    | Citizens Utilities Trust, 5% due 1/15/                                 |
|               |                | Total Investments in Trust Preferred<br>(Cost--\$4,252,130)--1.4%      |
|               |                | Total Investments in Preferred Securities<br>(Cost--\$7,451,602)--2.6% |

12 CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004

Schedule of Investments (concluded) (in U.S. dollars)

|  |                        |  |
|--|------------------------|--|
|  | Beneficial<br>Interest | Other Interests (f)  |
|  | \$3,780,240<br>1,500   | US Airways Group, Inc.--Certificate of<br>WorldCom, Inc.--Escrow Notes (c) |
|  |                        | Total Investments in Other Interests<br>(Cost--\$1,020,665)--0.4%          |

|  |        |  |
|--|--------|--|
|  |        | Short-Term Securities  |
|  | 82,499 | Merrill Lynch Liquidity Series, LLC Ca                               |
|  |        | Total Investments in Short-Term Securities<br>(Cost--\$82,499)--0.0% |

Total Investments (Cost--\$419,009,348)--134.2%

Liabilities in Excess of Other Assets--(34.2%)

Net Assets--100.0%

+ For Fund compliance purposes, "Industry" means any one or more of the industry sub-classifications used by one or more widely recognized market indexes or ratings group indexes, and/or as defined by Fund management. This definition may not apply for purposes of this report, which may

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combine such industry sub-classifications for reporting ease. These industry classifications are unaudited.

@ Ratings of issues shown are unaudited.

\* Not Rated.

\*\* Represents a zero coupon or step bond; the interest rate shown reflects the effective yield at the time of purchase by the Fund.

- (a) Floating rate corporate debt in which the Fund invests generally pays interest at rates that are periodically redetermined by reference to a base lending rate plus a premium. These base lending rates are generally (i) the lending rate offered by one or more major European banks, such as LIBOR (London InterBank Offered Rate), (ii) the prime rate offered by one or more major U.S. banks or (iii) the certificate of deposit rate. Floating rate corporate debt is generally considered to be restricted in that the Fund ordinarily is contractually obligated to receive approval from the agent bank and/or borrower prior to its disposition. Corporate loans represent 1.8% of the Fund's net assets.
- (b) Warrants entitle the Fund to purchase a predetermined number of shares of common stock and are non-income producing. The purchase price and number of shares are subject to adjustment under certain conditions until the expiration date.
- (c) Non-income producing security.
- (d) Floating rate note.
- (e) The security may be offered and sold to "qualified institutional buyers" under Rule 144A of the Securities Act of 1933.
- (f) Other interests represent beneficial interest in liquidation trusts and other reorganization entities.
- (g) As a result of bankruptcy proceedings, the company did not repay the principal amount of the security upon maturity.
- (h) Investments in companies considered to be an affiliate of the Fund (such companies are defined as "Affiliated Companies" in Section 2(a)(3) of the Investment Company Act of 1940) are as follows:

| Affiliate  | Net<br>Activity | Interest<br>Income |
|--|-----------------|--------------------|
| Merrill Lynch Liquidity Series, LLC<br>Cash Sweep Series I | \$82,499        | \$6,697            |

Swaps entered into as of May 31, 2004 were as follows:

|   | Notional<br>Amount | Unrealized<br>Appreciation |
|---|--------------------|----------------------------|
| Receive a variable rate return based on 1-month USD LIBOR and pay a fixed rate equal to 1.56% |                    |                            |
| Broker, UBS Warburg<br>Expires June 2005  | \$30,000,000       | \$260,140                  |

See Notes to Financial Statements.

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Statement of Assets, Liabilities and Capital

As of May 31, 2004

Assets

|   |    |
|---|----|
| Investments in unaffiliated securities, at value (identified cost--\$418,926,849) ..... |    |
| Investments in affiliated securities, at value (identified cost--\$82,499) .....        |    |
| Cash .....  |    |
| Unrealized appreciation on swaps .....  |    |
| Receivables:  |    |
| Interest .....  | \$ |
| Securities sold .....   |    |
| Prepaid expenses and other assets .....   |    |
| Total assets .....  |    |

Liabilities

|                                 |  |
|---------------------------------|--|
| Loans .....                     |  |
| Payables:                       |  |
| Securities purchased .....      |  |
| Dividends to shareholders ..... |  |
| Investment adviser .....        |  |
| Interest on swaps .....         |  |
| Interest on loans .....         |  |
| Other affiliates .....          |  |
| Total liabilities .....         |  |

Net Assets

|                  |  |
|------------------|--|
| Net Assets ..... |  |
|------------------|--|

Capital

|  |     |
|--|-----|
| Common Stock, \$.10 par value, 200,000,000 shares authorized .....   |     |
| Paid-in capital in excess of par .....   |     |
| Undistributed investment income--net .....   | \$  |
| Accumulated realized capital losses on investments--net .....  | (23 |
| Unrealized appreciation on investments--net .....  |     |
| Total accumulated losses--net .....  |     |
| Total--Equivalent to \$8.43 per share based on 37,219,239 shares of capital stock outstanding (market price--\$7.97) ..... |     |

See Notes to Financial Statements.



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Statement of Operations

For the Year Ended May 31, 2004

Investment Income

Interest (including \$6,697 from affiliates) .....  
 Dividends .....  
 Other .....  
 Total income .....

Expenses

Investment advisory fees ..... \$  
 Loan interest expense .....  
 Borrowing costs .....  
 Accounting services .....  
 Professional fees .....  
 Transfer agent fees .....  
 Printing and shareholder reports .....  
 Custodian fees .....  
 Pricing services .....  
 Listing fees .....  
 Directors' fees and expenses .....  
 Other .....  
 Total expenses .....  
 Investment income--net .....

Realized & Unrealized Gain on Investments--Net

Realized gain on investments--net .....  
 Change in unrealized appreciation/depreciation on investments--net .....  
 Total realized and unrealized gain on investments--net .....  
 Net Increase in Net Assets Resulting from Operations .....

See Notes to Financial Statements.

CORPORATE HIGH YIELD FUND III, INC.      MAY 31, 2004      15

[LOGO] Merrill Lynch Investment Managers

Statements of Changes in Net Assets

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Increase (Decrease) in Net Assets:

Operations

|  |      |
|--|------|
| Investment income--net .....   | \$ 3 |
| Realized gain (loss) on investments--net .....                           | 1    |
| Change in unrealized appreciation/depreciation on investments--net ..... | 1    |
| Net increase in net assets resulting from operations .....               | 5    |

Dividends to Shareholders

|   |     |
|---|-----|
| Dividends to shareholders from investment income--net ..... | (3) |
|---|-----|

Capital Stock Transactions

|  |  |
|--|--|
| Value of shares issued to Common Stock shareholders in reinvestment of dividends ..... |  |
| Recovery of previously expensed Common Stock offering costs .....                      |  |
| Net increase in net assets resulting from capital stock transactions .....             |  |

Net Assets

|  |       |
|--|-------|
| Total increase in net assets .....           | 2     |
| Beginning of year .....                      | 28    |
| End of year* .....                           | \$ 31 |
| * Undistributed investment income--net ..... | \$    |

See Notes to Financial Statements.

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Statement of Cash Flows

For the Year Ended May 31, 2004

Cash Provided by Operating Activities

|   |  |
|---|--|
| Net increase in net assets resulting from operations .....  |  |
| Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities: |  |
| Decrease in receivables .....   |  |
| Increase in prepaid expenses and other assets .....   |  |
| Increase in other liabilities .....   |  |
| Realized and unrealized gain on investments--net .....  |  |
| Amortization of discount .....  |  |
| Proceeds from sales and paydowns of long-term investments .....   |  |
| Purchases of long-term investments .....  |  |

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Purchases of short-term investments--net .....  
 Termination of swap contracts .....  
 Net cash provided by operating activities .....

=====  
 Cash Used for Financing Activities  
 -----

Cash receipts from borrowings .....  
 Cash payments on borrowings .....  
 Recovery of previously expensed Common Stock offering costs .....  
 Dividends paid to shareholders .....  
 Net cash used for financing activities .....

=====  
 Cash  
 -----

Net decrease in cash .....  
 Cash at beginning of year .....  
 Cash at end of year .....

=====  
 Cash Flow Information  
 -----

Cash paid for interest .....

=====  
 Non-Cash Financing Activities  
 -----

Reinvestment of dividends paid to shareholders .....

See Notes to Financial Statements.

CORPORATE HIGH YIELD FUND III, INC.      MAY 31, 2004      17

[LOGO] Merrill Lynch Investment Managers

Financial Highlights

The following per share data and ratios have been derived from information provided in the financial statements.

|   | For the Year |         |         |
|---|--------------|---------|---------|
| Increase (Decrease) in Net Asset Value:                       | 2004         | 2003    | 2002    |
| <b>Per Share Operating Performance</b>                        |              |         |         |
| Net asset value, beginning of year                            | \$ 7.86      | \$ 7.68 | \$ 9.10 |
| Investment income--net* .....                                 | .88          | .92     | 1.00    |
| Realized and unrealized gain (loss) on investments--net ..... | .58          | .17     | (1.00)  |
| Total from investment operations ..                           | 1.46         | 1.09    | (0.00)  |

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|   |           |           |        |
|---|-----------|-----------|--------|
| Less dividends from investment income--net .....  | (.89)     | (.91)     | (1)    |
| Capital charge resulting from issuance of Common Stock .....  | --        | --        |        |
| Recovery of previously expensed offering costs (capital charge) resulting from issuance of Common Stock ..... | ---+      | --        |        |
| Net asset value, end of year .....  | \$ 8.43   | \$ 7.86   | \$ 7   |
| Market price per share, end of year .....   | \$ 7.97   | \$ 8.36   | \$ 8   |
| =====   |           |           |        |
| Total Investment Return**   |           |           |        |
| Based on net asset value per share  | 19.33%    | 16.46%    | (3)    |
| Based on market price per share ...   | 6.07%     | 15.73%    |        |
| =====   |           |           |        |
| Ratios to Average Net Assets  |           |           |        |
| Expenses, excluding interest expense .....  | 1.01%     | 1.04%     | 1      |
| Expenses .....  | 1.51%     | 1.59%     | 2      |
| Investment income--net .....  | 10.48%    | 13.35%    | 14     |
| =====   |           |           |        |
| Leverage  |           |           |        |
| Amount of borrowings outstanding, end of year (in thousands) .....  | \$109,600 | \$ 98,800 | \$ 84, |
| Average amount of borrowings outstanding during the year (in thousands) .....                                 | \$112,297 | \$ 75,558 | \$ 98, |
| Average amount of borrowings outstanding per share during the year* .....                                     | \$ 3.03   | \$ 2.07   | \$ 2   |
| =====   |           |           |        |
| Supplemental Data   |           |           |        |
| Net assets, end of year (in thousands) .....  | \$313,583 | \$289,820 | \$279, |
| Portfolio turnover .....  | 82.54%    | 76.61%    | 65     |

+ Amount is less than \$(.01) per share.

++ Amount is less than \$.01 per share.

\* Based on average shares outstanding.

\*\* Total investment returns based on market value, which can be significantly greater or lesser than the net asset value, may result in substantially

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different returns. Total investment returns exclude the effect of sales charges.

See Notes to Financial Statements.

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### Notes to Financial Statements

#### 1. Significant Accounting Policies:

Corporate High Yield Fund III, Inc. (the "Fund") is registered under the Investment Company Act of 1940, as amended, as a diversified, closed-end management investment company. The Fund's financial statements are prepared in conformity with U.S. generally accepted accounting principles, which may require the use of management accruals and estimates. Actual results may differ from these estimates. The Fund determines and makes available for publication the net asset value of its Common Stock on a daily basis. The Fund's Common Stock is listed on the New York Stock Exchange ("NYSE") under the symbol CYE. The following is a summary of significant accounting policies followed by the Fund.

(a) Valuation of investments -- Equity securities that are held by the Fund that are traded on stock exchanges or the Nasdaq National Market are valued at the last sale price or official close price on the exchange, as of the close of business on the day the securities are being valued or, lacking any sales, at the last available bid price for long positions, and at the last available ask price for short positions. In cases where equity securities are traded on more than one exchange, the securities are valued on the exchange designated as the primary market by or under the authority of the Board of Directors of the Fund. Long positions traded in the over-the-counter ("OTC") market, Nasdaq Small Cap or Bulletin Board are valued at the last available bid price or yield equivalent obtained from one or more dealers or pricing services approved by the Board of Directors of the Fund. Short positions traded in the OTC market are valued at the last available ask price. Portfolio securities that are traded both in the OTC market and on a stock exchange are valued according to the broadest and most representative market.

Options written are valued at the last sale price in the case of exchange-traded options or, in the case of options traded in the OTC market, the last ask price. Options purchased are valued at their last sale price in the case of exchange-traded options or, in the case of options traded in the OTC market, the last bid price. Swap agreements are valued daily based upon quotations from market makers. Financial futures contracts and options thereon, which are traded on exchanges, are valued at their last sale price as of the close of such exchanges. Obligations with remaining maturities of 60 days or less are valued at amortized cost unless the Investment Adviser believes that this method no longer produces fair valuations.

Repurchase agreements are valued at cost plus accrued interest. The Fund employs pricing services to provide certain securities prices for the Fund. Securities and assets for which market quotations are not readily available are valued at fair value as determined in good faith by or under the direction of the Board of Directors of the Fund, including valuations furnished by the pricing services retained by the Fund, which may use a matrix system for valuations. The procedures of a pricing service and its valuations are reviewed by the officers of the Fund under the general supervision of the Fund's Board of Directors. Such valuations and procedures will be reviewed periodically by the Board of Directors of the Fund.

Generally, trading in foreign securities, as well as U.S. government securities

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and money market instruments, is substantially completed each day at various times prior to the close of business on the NYSE. The values of such securities used in computing the net asset value of the Fund's shares are determined as of such times. Foreign currency exchange rates also are generally determined prior to the close of business on the NYSE. Occasionally, events affecting the values of such securities and such exchange rates may occur between the times at which they are determined and the close of business on the NYSE that may not be reflected in the computation of the Fund's net asset value. If events (for example, a company announcement, market volatility or a natural disaster) occur during such periods that are expected to materially affect the value of such securities, those securities may be valued at their fair value as determined in good faith by the Fund's Board of Directors or by the Investment Adviser using a pricing service and/or procedures approved by the Fund's Board of Directors.

(b) Derivative financial instruments -- The Fund may engage in various portfolio investment strategies both to increase the return of the Fund and to hedge, or protect, its exposure to interest rate movements and movements in the securities markets. Losses may arise due to changes in the value of the contract or if the counterparty does not perform under the contract.

- o Options -- The Fund may write and purchase call and put options. When the Fund writes an option, an amount equal to the premium received by the Fund is reflected as an asset and an equivalent liability. The amount of the liability is subsequently marked to market to reflect the current market value of the option written. When a security is purchased or sold through an exercise of an

CORPORATE HIGH YIELD FUND III, INC.

MAY 31, 2004

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[LOGO] Merrill Lynch Investment Managers

Notes to Financial Statements (continued)

option, the related premium paid (or received) is added to (or deducted from) the basis of the security acquired or deducted from (or added to) the proceeds of the security sold. When an option expires (or the Fund enters into a closing transaction), the Fund realizes a gain or loss on the option to the extent of the premiums received or paid (or gain or loss to the extent the cost of the closing transaction exceeds the premium paid or received).

Written and purchased options are non-income producing investments.

- o Financial futures contracts -- The Fund may purchase or sell financial futures contracts and options on such futures contracts. Futures contracts are contracts for delayed delivery of securities at a specific future date and at a specific price or yield. Upon entering into a contract, the Fund deposits and maintains as collateral such initial margin as required by the exchange on which the transaction is effected. Pursuant to the contract, the Fund agrees to receive from or pay to the broker an amount of cash equal to the daily fluctuation in value of the contract. Such receipts or payments are known as variation margin and are recorded by the Fund as unrealized gains or losses. When the contract is closed, the Fund records a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed.
- o Swaps -- The Fund may enter into swap agreements, which are over-the-counter contracts in which the Fund and a counterparty agree to make periodic net payments on a specified notional amount. The net

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payments can be made for a set period of time or may be triggered by a predetermined credit event. The net periodic payments may be based on a fixed or variable interest rate; the change in market value of a specified security, basket of securities, or index; or the return generated by a security.

(c) Income taxes -- It is the Fund's policy to comply with the requirements of the Internal Revenue Code applicable to regulated investment companies and to distribute substantially all of its taxable income to its shareholders. Therefore, no federal income tax provision is required.

(d) Security transactions and investment income -- Security transactions are recorded on the dates the transactions are entered into (the trade dates). Realized gains and losses on security transactions are determined on the identified cost basis. Dividend income is recorded on the ex-dividend dates. Interest income is recognized on the accrual basis. The Fund amortizes all premiums and discounts on debt securities.

(e) Dividends and distributions -- Dividends from net investment income are declared and paid monthly. Distributions of capital gains are recorded on the ex-dividend dates.

(f) Securities lending -- The Fund may lend securities to financial institutions that provide cash or securities issued or guaranteed by the U.S. government as collateral, which will be maintained at all times in an amount equal to at least 100% of the current market value of the loaned securities. The market value of the loaned securities is determined at the close of business of the Fund and any additional required collateral is delivered to the Fund on the next business day. Where the Fund receives securities as collateral for the loaned securities, it collects a fee from the borrower. The Fund typically receives the income on the loaned securities but does not receive the income on the collateral. Where the Fund receives cash collateral, it may invest such collateral and retain the amount earned on such investment, net of any amount rebated to the borrower. Loans of securities are terminable at any time and the borrower, after notice, is required to return borrowed securities within five business days. The Fund may pay reasonable finder's, lending agent, administrative and custodial fees in connection with its loans. In the event that the borrower defaults on its obligation to return borrowed securities because of insolvency or for any other reason, the Fund could experience delays and costs in gaining access to the collateral. The Fund also could suffer a loss where the value of the collateral falls below the market value of the borrowed securities, in the event of borrower default or in the event of losses on investments made with cash collateral.

(g) Reclassification -- U.S. generally accepted accounting principles require that certain components of net assets be adjusted to reflect permanent differences between financial and tax reporting. Accordingly, during the current year, \$311,884 has been reclassified between undistributed net investment income and accumulated net realized capital losses as a result of permanent differences attributable to

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Notes to Financial Statements (continued)

amortization methods on fixed income securities and accounting treatment for swap contracts. This reclassification has no effect on net assets or net asset values per share.

2. Investment Advisory Agreement and Transactions with Affiliates:

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The Fund has entered into an Investment Advisory Agreement with Fund Asset Management, L.P. ("FAM"). The general partner of FAM is Princeton Services, Inc. ("PSI"), an indirect, wholly-owned subsidiary of Merrill Lynch & Co., Inc. ("ML & Co."), which is the limited partner.

FAM is responsible for the management of the Fund's portfolio and provides the necessary personnel, facilities, equipment and certain other services necessary to the operation of the Fund. For such services, the Fund pays a monthly fee at an annual rate of .60% of the Fund's average weekly net assets plus the proceeds of any outstanding principal borrowed. FAM has entered into a Sub-Advisory Agreement with Merrill Lynch Asset Management U.K. Limited ("MLAM U.K."), an affiliate of FAM, pursuant to which MLAM U.K. provides investment advisory services to FAM with respect to the Fund. There is no increase in the aggregate fees paid by the Fund for these services.

The Fund has received an exemptive order from the Securities and Exchange Commission permitting it to lend portfolio securities to Merrill Lynch, Pierce, Fenner & Smith Incorporated ("MLPF&S"), a subsidiary of ML & Co., or its affiliates. Pursuant to that order, the Fund also has retained Merrill Lynch Investment Managers, LLC ("MLIM, LLC"), an affiliate of FAM, as the securities lending agent for a fee based on a share of the returns on investment of cash collateral. MLIM, LLC may, on behalf of the Fund, invest cash collateral received by the Fund for such loans, among other things, in a private investment company managed by MLIM, LLC or in registered money market funds advised by FAM or its affiliates.

In addition, MLPF&S received \$5,438 in commissions on the execution of portfolio security transactions for the Fund for the year ended May 31, 2004.

For the year ended May 31, 2004, the Fund reimbursed FAM \$6,153 for certain accounting services.

Certain officers and/or directors of the Fund are officers and/or directors of FAM, PSI, MLAM U.K. and/or ML & Co.

### 3. Investments:

Purchases and sales of investments, excluding short-term securities, for the year ended May 31, 2004 were \$361,660,436 and \$342,175,095, respectively.

Net realized gains (losses) for the year ended May 31, 2004 and net unrealized appreciation as of May 31, 2004 were as follows:

|                             | Realized<br>Gains (Losses) | Unrealized<br>Appreciation |
|-----------------------------|----------------------------|----------------------------|
| Long-term investments ..... | \$ 11,043,978              | \$ 1,886,119               |
| Swaps .....                 | (118,054)                  | 260,140                    |
| Total .....                 | \$ 10,925,924              | \$ 2,146,259               |

As of May 31, 2004, net unrealized appreciation for federal income tax purposes aggregated \$2,901,976, of which \$25,219,738 related to appreciated securities and \$22,317,762 related to depreciated securities. The aggregate cost of investments at May 31, 2004 for federal income tax purposes was \$417,993,491.

### 4. Capital Share Transactions:

The Fund is authorized to issue 200,000,000 shares of capital stock, par value



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\$ .10, all of which were initially classified as Common Stock. The Board of Directors is authorized, however, to classify and reclassify any unissued shares of capital stock without approval of the holders of Common Stock.

Shares issued and outstanding during the years ended May 31, 2004 and May 31, 2003 increased by 325,778 and 496,500, respectively, as a result of dividend reinvestment.

### 5. Short-Term Borrowings:

On May 26, 2004, the Fund entered into a \$160,000,000 revolving credit and security agreement with Citibank, N.A. and other lenders (the "Lenders"). Under the revolving credit and security agreement, the Fund may borrow money through (i) a line of credit from certain Lenders at the eurodollar rate plus .75% or the highest of the Federal Funds rate plus .50%, a base rate as determined by

CORPORATE HIGH YIELD FUND III, INC.                      MAY 31, 2004                      21

[LOGO] Merrill Lynch Investment Managers

### Notes to Financial Statements (concluded)

Citibank, N.A. and/or the latest three-week moving average of secondary market morning offering rates in the United States for three-month certificates of deposit of major U.S. money market banks plus .50%, or (ii) the issuance of commercial paper notes by certain Lenders at rates of interest based upon the weighted average of the per annum rates paid or payable by such Lenders in respect of those commercial paper notes. As security for its obligations to the Lenders under the revolving credit and security agreement, the Fund has granted a security interest in substantially all of its assets to and in favor of the Lenders. The Fund also pays additional borrowing costs which include a commitment fee for this facility at the annual rate of .10% and a program fee of .24% on the borrowings outstanding.

For the year ended May 31, 2004, the average amount borrowed was approximately \$112,297,000 and the daily weighted average interest rate was 1.37%.

### 6. Distributions to Shareholders:

The Fund paid an ordinary income dividend in the amount of \$.072000 per share on June 30, 2004 to shareholders of record on June 14, 2004.

The tax character of distributions paid during the fiscal years ended May 31, 2004 and May 31, 2003 was as follows:

|                                   | 5/31/2004    | 5/31/2003    |
|-----------------------------------|--------------|--------------|
| Distributions paid from:          |              |              |
| Ordinary income .....             | \$33,172,274 | \$33,386,856 |
| Total taxable distributions ..... | \$33,172,274 | \$33,386,856 |
|                                   |              |              |

As of May 31, 2004, the components of accumulated losses on a tax basis were as follows:

|  |              |
|--|--------------|
| Undistributed ordinary income--net .....         | \$ 3,753,970 |
| Undistributed long-term capital gains--net ..... | --           |

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|   |                 |
|---|-----------------|
| Total undistributed earnings--net ..... | 3,753,970       |
| Capital loss carryforward .....         | (236,944,109)*  |
| Unrealized gains--net .....             | 3,108,935**     |
| <hr/>                                   |                 |
| Total accumulated losses--net .....     | \$(230,081,204) |
| <hr/>                                   |                 |

- \* On May 31, 2004, the Fund had a net capital loss carryforward of \$236,944,109, of which \$6,419,421 expires in 2007, \$21,954,305 expires in 2008, \$34,200,029 expires in 2009, \$52,918,036 expires in 2010, \$119,513,437 expires in 2011 and \$1,938,881 expires in 2012. This amount will be available to offset like amounts of any future taxable gains.
- \*\* The difference between book-basis and tax-basis net unrealized gains is attributable primarily to the tax deferral of losses on wash sales, the difference between book and tax amortization methods for premiums and discounts on fixed income securities and book/tax differences in the accrual of income on securities in default.

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Report of Independent Registered Public Accounting Firm

To the Shareholders and Board of Directors of  
Corporate High Yield Fund III, Inc.:

We have audited the accompanying statement of assets, liabilities and capital, including the schedule of investments, of Corporate High Yield Fund III, Inc. as of May 31, 2004, and the related statements of operations and cash flows for the year then ended, the statements of changes in net assets for each of the two years in the period then ended, and the financial highlights for each of the five years in the period then ended. These financial statements and financial highlights are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of May 31, 2004, by correspondence with the custodian and brokers; where replies were not received from brokers, we performed other auditing procedures. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of Corporate High Yield Fund III, Inc. as of May 31, 2004, the results of its operations and its cash flows for the year then ended, the changes in its net assets for each of the two years in the period then ended, and its financial highlights for each of the five years in the period then ended, in conformity with U.S. generally accepted accounting principles.

Deloitte & Touche LLP  
Princeton, New Jersey  
July 16, 2004

[LOGO] Merrill Lynch Investment Managers

Automatic Dividend Reinvestment Plan (unaudited)

The following description of the Fund's Automatic Dividend Reinvestment Plan (the "Plan") is sent to you annually as required by Federal securities laws.

Pursuant to the Fund's Plan, unless a holder of Common Stock otherwise elects, all dividend and capital gains distributions will be automatically reinvested by EquiServe (the "Plan Agent"), as agent for shareholders in administering the Plan, in additional shares of Common Stock of the Fund. Holders of Common Stock who elect not to participate in the Plan will receive all distributions in cash paid by check mailed directly to the shareholder of record (or, if the shares are held in street or other nominee name then to such nominee) by EquiServe, as dividend paying agent. Such participants may elect not to participate in the Plan and to receive all distributions of dividends and capital gains in cash by sending written instructions to EquiServe, as dividend paying agent, at the address set forth below. Participation in the Plan is completely voluntary and may be terminated or resumed at any time without penalty by written notice if received by the Plan Agent not less than ten days prior to any dividend record date; otherwise such termination will be effective with respect to any subsequently declared dividend or distribution.

Whenever the Fund declares an income dividend or capital gains distribution (collectively referred to as "dividends") payable either in shares or in cash, non-participants in the Plan will receive cash and participants in the Plan will receive the equivalent in shares of Common Stock. The shares will be acquired by the Plan Agent for the participant's account, depending upon the circumstances described below, either (i) through receipt of additional unissued but authorized shares of Common Stock from the Fund ("newly issued shares") or (ii) by purchase of outstanding shares of Common Stock on the open market ("open-market purchases") on the New York Stock Exchange or elsewhere. If on the payment date for the dividend, the net asset value per share of the Common Stock is equal to or less than the market price per share of the Common Stock plus estimated brokerage commissions (such conditions being referred to herein as "market premium"), the Plan Agent will invest the dividend amount in newly issued shares on behalf of the participant. The number of newly issued shares of Common Stock to be credited to the participant's account will be determined by dividing the dollar amount of the dividend by the net asset value per share on the date the shares are issued, provided that the maximum discount from the then current market price per share on the date of issuance may not exceed 5%. If on the dividend payment date the net asset value per share is greater than the market value (such condition being referred to herein as "market discount"), the Plan Agent will invest the dividend amount in shares acquired on behalf of the participant in open-market purchases.

In the event of a market discount on the dividend payment date, the Plan Agent will have until the last business day before the next date on which the shares trade on an "ex-dividend" basis or in no event more than 30 days after the dividend payment date (the "last purchase date") to invest the dividend amount in shares acquired in open-market purchases. It is contemplated that the Fund will pay monthly income dividends. Therefore, the period during which open-market purchases can be made will exist only from the payment date on the dividend through the date before the next "ex-dividend" date, which typically will be approximately ten days. If, before the Plan Agent has completed its open-market purchases, the market price of a share of Common Stock exceeds the net asset value per share, the average per share purchase price paid by the Plan

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Agent may exceed the net asset value of the Fund's shares, resulting in the acquisitions of fewer shares than if the dividend had been paid in newly issued shares on the dividend payment date. Because of the foregoing difficulty with respect to open-market purchases, the Plan provides that if the Plan Agent is unable to invest the full dividend amount in open-market purchases during the purchase period or if the market discount shifts to a market premium during the purchase period, the Plan Agent will cease making open-market purchases and will invest the uninvested portion of the dividend amount in newly issued shares at the close of business on the last purchase date determined by dividing the uninvested portion of the dividend by the net asset value per share.

The Plan Agent maintains all shareholders' accounts in the Plan and furnishes written confirmation of all transactions in the account, including information needed by shareholders for tax records. Shares in the account of each Plan participant will be held by the Plan Agent in non-certificated form in the name of the participant, and each shareholder's proxy will include those shares purchased or received pursuant to the Plan. The Plan Agent will forward all proxy solicitation materials to participants and vote proxies for shares held pursuant to the Plan in accordance with the instructions of the participants.

In the case of shareholders such as banks, brokers or nominees which hold shares of others who are the beneficial owners, the Plan Agent will administer the Plan on the basis of the number of shares certified from time to time by the record

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shareholders as representing the total amount registered in the record shareholder's name and held for the account of beneficial owners who are to participate in the Plan.

There will be no brokerage charges with respect to shares issued directly by the Fund as a result of dividends or capital gains distributions payable either in shares or in cash. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to the Plan Agent's open-market purchases in connection with the reinvestment of dividends.

The automatic reinvestment of dividends and distributions will not relieve participants of any federal, state or local income tax that may be payable (or required to be withheld) on such dividends.

Shareholders participating in the Plan may receive benefits not available to shareholders not participating in the Plan. If the market price plus commissions of the Fund's shares is above the net asset value, participants in the Plan will receive shares of the Fund at less than they could otherwise purchase them and will have shares with a cash value greater than the value of any cash distribution they would have received on their shares. If the market price plus commissions is below the net asset value, participants will receive distributions in shares with a net asset value greater than the value of any cash distribution they would have received on their shares. However, there may be insufficient shares available in the market to make distributions in shares at prices below the net asset value. Also, since the Fund does not redeem shares, the price on resale may be more or less than the net asset value.

The value of shares acquired pursuant to the Plan will generally be excluded from gross income to the extent that the cash amount reinvested would be excluded from gross income. If, when the Fund's shares are trading at a premium over net asset value, the Fund issues shares pursuant to the Plan that have a greater fair market value than the amount of cash reinvested, it is possible that all or a portion of such discount (which may not exceed 5% of the fair market value of the Fund's shares) could be viewed as a taxable distribution. If

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the discount is viewed as a taxable distribution, it is also possible that the taxable character of this discount would be allocable to all the shareholders, including shareholders who do not participate in the Plan. Thus, shareholders who do not participate in the Plan might be required to report as ordinary income a portion of their distributions equal to their allocable share of the discount.

Experience under the Plan may indicate that changes are desirable. Accordingly, the Fund reserves the right to amend or terminate the Plan. There is no direct service charge to participants in the Plan; however, the Fund reserves the right to amend the Plan to include a service charge payable by the participants.

All correspondence concerning the Plan should be directed to the Plan Agent at EquiServe, P.O. Box 43010, Providence, RI 02940-3010, Telephone: 800-426-5523.

CORPORATE HIGH YIELD FUND III, INC.

MAY 31, 2004

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[LOGO] Merrill Lynch Investment Managers

Portfolio Information (unaudited)

As of May 31, 2004

Ten Largest Holdings

Sierra Pacific Resources\*

Sierra Pacific Resources is the holding company for Sierra Pacific Power Company and Sierra Pacific Power Company. Both companies serve the state of Nevada.

The AES Corporation\*

AES is a worldwide power producer with operations in Europe, Latin America and Asia. Electricity generated is sold primarily to wholesale customers, although the company also has a distribution business to end users.

Building Materials Corporation of America\*

Building Materials is a manufacturer of residential building products. Timberline is its major brand.

Samsonite Corporation\*

Samsonite designs, manufactures and distributes luggage, garment bags, casual bags, business cases and accessories in the United States and internationally. Its primary brands are American Tourister and Lark. The company also licenses its name on such products as travel accessories, leather goods and furniture.

Calpine Corporation\*

Calpine owns, develops and operates power generating facilities and is engaged in selling electricity in the United States. The company also provides thermal energy for industrial customers.

Edison International Inc.\*

This utility holding company operates, through its subsidiaries, power generation facilities worldwide. The company is also involved in infrastructure projects. Our bonds are at the company and Edison Mission subsidiaries.

The Williams Companies, Inc.\*

Williams is involved in a number of energy-related activities that include transport and storage of natural gas and oil, as well as oil and gas exploration and production. The company also provides pipeline services.

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of petroleum products and trades energy and relat

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El Paso\*

El Paso is a diversified energy company with oper  
gas gathering, transportation and processing, as  
production. The company also has operations in po  
energy services. Our bonds are at the company's C  
Production Holdings and Southern Natural Gas subs

-----  
HMP Equity Holdings Corporation\*

HMP is a diversified specialty and performance ch  
company's polyurethane products have applications  
footwear and insulation, among others. Titanium d  
architectural coatings. Other specialty chemicals  
industrial and consumer markets, including person  
products.

-----  
Qwest Communications International\*

Qwest provides a broad range of telecommunication  
broadband Internet-based data, voice and image co  
services, and data and long-distance services to  
customers. The company also provides Web hosting,  
and private networks.

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\* Includes combined holdings and/or affiliates, where applicable.

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Portfolio Profile (unaudited)

As of May 31, 2004

| Quality Ratings by<br>Standard & Poor's | Percent of<br>Total Market Value |
|---|----------------------------------|
| BBB .....                               | 5%                               |
| BB .....                                | 19                               |
| B .....                                 | 54                               |
| CCC .....                               | 20                               |
| NR (Not Rated) .....                    | 2                                |

| Five Largest Industries* | Percent of<br>Total Market Value |
|--------------------------|----------------------------------|
| Utility .....            | 11.3%                            |
| Chemicals .....          | 7.8                              |
| Gaming .....             | 6.9                              |
| Cable--U.S. ....         | 5.8                              |
| Manufacturing .....      | 5.7                              |

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\* For Fund compliance purposes, "Industries" means any one or more of the industry sub-classifications used by one or more widely recognized market indexes or ratings group indexes, and/or as defined by Fund management. This definition may not apply for purposes of this report, which may combine such industry sub-classifications for reporting ease. These industry classifications are unaudited.

| Five Largest Foreign Countries* | Percent of<br>Total Market Value |
|---------------------------------|----------------------------------|
|---------------------------------|----------------------------------|

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|                      |      |
|----------------------|------|
| Canada .....         | 3.8% |
| United Kingdom ..... | 2.0  |
| Luxembourg .....     | 1.3  |
| Netherlands .....    | 0.8  |
| Norway .....         | 0.8  |

\* All holdings are denominated in U.S. dollars.

Average Portfolio Maturity ..... 7.2 years

CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004 27

[LOGO] Merrill Lynch Investment Managers

Officers and Directors (unaudited)

| Name                       | Address & Age   | Position(s)<br>Held with<br>Fund | Length of<br>Time<br>Served                     | Principal Occupation(s) During Past 5 Years  |
|----------------------------|---|----------------------------------|---|--|
| <b>Interested Director</b> |   |                                  |   |  |
| Terry K.<br>Glenn*         | P.O. Box 9011<br>Princeton, NJ<br>08543-9011<br>Age: 63 | President<br>and<br>Director     | 1999 to<br>present<br>and<br>1998 to<br>present | President of the Merrill Lynch Investment Management L.P. ("MLIM")/Fund Asset Management, L.P. ("FAM")--Advised Funds since 1999; Chairman (Americas Region) of MLIM from 2000 to 2002; Executive Vice President of MLIM and FAM (which terms as used herein include their corporate predecessors) from 1983 to 2002; President of Financial Data Distributors, Inc. ("FAMD") from 1986 to 2002 and Director thereof from 1991 to 2002; Executive Vice President and Director of Princeton Services, Inc. ("Princeton Services") from 1993 to 2002; President of Princeton Administrators, L.P. from 1989 to 2002; Director of Financial Data Services, Inc. since 1993. |

\* Mr. Glenn is a director, trustee or member of an advisory board of certain other funds or FAM acts as investment adviser. Mr. Glenn is an "interested person," as described in the Fund based on his former positions with MLIM, FAM, FAMD, Princeton Services and Princeton Administrators, L.P. Director's term is unlimited. Directors serve until their resignation, removal, or death, or the year in which they turn 72. As Fund President, Mr. Glenn serves at the pleasure of the Board.

**Independent Directors\***

|                      |   |          |                    |  |
|----------------------|---|----------|--------------------|--|
| James H.<br>Bodurtha | P.O. Box 9095<br>Princeton, NJ<br>08543-9095<br>Age: 60 | Director | 2002 to<br>present | Director, The China Business Group, Inc. since 1996 and Executive Vice President thereof from 1996 to 2003; Chairman of the Board, Berkshire Holding Corporation since 1980; Partner, Squire, Sanders & Dempsey from 1980 to 1993. |
| Joe Grills           | P.O. Box 9095<br>Princeton, NJ                          | Director | 1998 to<br>present | Member of the Committee of Investment of Employee Benefit Assets of the Association of   |

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08543-9095  
Age: 69

Financial Professionals ("CIEBA") since 1986; Member of CIEBA's Executive Committee since 1988 and its Chairman from 1991 to 1992; Assistant Treasurer of International Business Machines Corporation ("IBM") and Chief Investment Officer of IBM Retirement Funds from 1986 to 1993; Member of the Investment Advisory Committee of the State of New York Common Retirement Fund since 1989; Member of the Investment Advisory Committee of the Howard Hughes Medical Institute from 1997 to 2000; Director, Duke Management Company since 1992 and Vice Chairman thereof since 1998; Director, LaSalle Street Fund from 1995 to 2001; Director, Kimco Realty Corporation since 1997; Member of the Investment Advisory Committee of the Virginia Retirement System since 1998 and Vice Chairman thereof since 2002; Director, Montpelier Foundation since 1998 and its Vice Chairman since 2000; Member of the Investment Committee of the Woodberry Forest School since 2000; Member of the Investment Committee of the National Trust for Historic Preservation since 2002

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Officers and Directors (unaudited) (continued)

| Name                               | Address & Age   | Position(s) Held with Fund | Length of Time Served | Principal Occupation(s) During Past 5 Years  |
|------------------------------------|---|----------------------------|-----------------------|--|
| Independent Directors* (concluded) |   |                            |                       |  |
| Herbert I. London                  | P.O. Box 9095<br>Princeton, NJ<br>08543-9095<br>Age: 65 | Director                   | 2002 to present       | John M. Olin Professor of Humanities, New York University since 1993 and Professor thereof since 1980; President, Hudson Institute since 1997 and Trustee thereof since 1980; Dean, Gallatin Division of New York University from 1976 to 1999; Distinguished Fellow, Herman Kahn Chair, Hudson Institute from 1984 to 1985; Director, Damon Corporation from 1991 to 1995; Overseer, Center for Naval Analyses from 1983 to 1993; Limited Partner, Hypertech LP since 1996. |
| Andre F. Perold                    | P.O. Box 9095<br>Princeton, NJ<br>08543-9095<br>Age: 52 | Director                   | 2002 to present       | Harvard Business School: George Gund Professor of Finance and Banking since 2000; Senior Associate Dean, Director of Faculty Recruiting since 2001; Finance Area Chair from 1996 to 2001; Sylvan C. Coleman Professor of Financial Management from 1991 to 2000; Director, Genbel Securities Limited and Gensec Bank from 1999 to 2003; Director, Stockba Inc. from 2000 to 2002; Director, Sanlam Limited from 2001 to 2003; Trustee, Commonfund from 1989 to 2002          |



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Director, Sanlam Investment Management from 1999 to 2001; Director, Bulldogresearch.com from 2000 to present; Director, Quantec Limited from 1991 to 1999; Director and Chairman of the Board of UNX Inc. since 2003

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 Roberta Cooper Ramo P.O. Box 9095 Princeton, NJ 08543-9095 Age: 61 Director 2002 to present Shareholder, Modrall, Sperling, Roehl, Harris & Sisk, P.A. since 1993; President, American Bar Association from 1995 to 1996 and Member of the Board of Governors thereof from 1994 to 1997; Shareholder, Poole, Kelly & Ramo, Attorneys at Law, P.C. from 1977 to 1993; Director, Coopers, Inc. from 1999; Director of ECMC Group (service provider to students, schools and lenders) since 2001; Director, United New Mexico Bank (now Wells Fargo) from 1999 to 1988; Director, First National Bank of New Mexico (now Wells Fargo) from 1975 to 1976.

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 Robert S. Salomon, Jr. P.O. Box 9095 Princeton, NJ 08543-9095 Age: 67 Director 1998 to present Principal of STI Management (investment adviser) since 1994; Chairman and CEO of Salomon Brothers Asset Management from 1992 until 1995; Chairman of Salomon Brothers equity mutual funds from 1992 until 1995; regular columnist with Forbes Magazine from 1992 to 2002; Director of Stock Research and Equity Strategist at Salomon Brothers from 1975 to 1991; Trustee, Commonfund from 1980 to 2001.

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 Stephen B. Swensrud P.O. Box 9095 Princeton, NJ 08543-9095 Age: 70 Director 1998 to present Chairman, Fernwood Associates (investment adviser) since 1996; Principal, Fernwood Associates (financial consultants) since 1975; Chairman of R.P.P. Corporation (manufacturing company) since 1978; Director of International Mobile Communications Incorporated (telecommunications company) since 1978.

\* The Director's term is unlimited. Directors serve until their resignation, removal or the year in which they turn 72.

CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004 29

[LOGO] Merrill Lynch Investment Managers

Officers and Directors (unaudited) (concluded)

| Name            | Address & Age                                  | Position(s) Held with Fund   | Length of Time Served               | Principal Occupation(s) During Past 5 Years   |
|-----------------|--|------------------------------|-------------------------------------|---|
| Fund Officers*  |  |                              |                                     |   |
| Donald C. Burke | P.O. Box 9011 Princeton, NJ 08543-9011 Age: 43 | Vice President and Treasurer | 1998 to present and 1999 to present | First Vice President of MLIM and FAM since 1997 since 1999; Senior Vice President and Treasurer of MLIM since 1999; Vice President of FAMD since 1999; Director of FAMD since 1990. |
| B. Daniel Evans | P.O. Box 9011 Princeton, NJ                    | Vice President               | 2002 to present                     | Director (Global Fixed Income) of MLIM since 2002 from 1995 to 2000.  |

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08543-9011  
Age: 60

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Elizabeth M. Phillips P.O. Box 9011 Vice President 1998 to present Director (Global Fixed Income) of MLIM since 2001 from 1994 to 2001.  
Princeton, NJ 08543-9011  
Age: 54

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Phillip S. Gillespie P.O. Box 9011 Secretary 2004 to present First Vice President of MLIM since 2001; Director 2001; Vice President from 1999 to 2000 and Attorney 1998.  
Princeton, NJ 08543-9011  
Age: 40

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\* Officers of the Fund serve at the pleasure of the Board of Directors.

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Custodian

State Street Bank and Trust Company  
P.O. Box 351  
Boston, MA 02101

Transfer Agent

EquiServe  
P.O. Box 43010  
Providence, RI 02940-3010  
1-800-426-5523

NYSE Symbol

CYE

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Electronic Delivery

The Fund offers electronic delivery of communications to its shareholders. In order to receive this service, you must register your account and provide us with e-mail information. To sign up for this service, simply access this Web site <http://www.icsdelivery.com/live> and follow the instructions. When you visit this site, you will obtain a personal identification number (PIN). You will need this PIN should you wish to update your e-mail address, choose to discontinue this service and/or make any other changes to the service. This service is not available for certain retirement accounts at this time.

CORPORATE HIGH YIELD FUND III, INC. MAY 31, 2004 31

[LOGO] Merrill Lynch Investment Managers [www.mlim.ml.com](http://www.mlim.ml.com)

Corporate High Yield Fund III, Inc. seeks to provide shareholders with current income by investing primarily in a diversified portfolio of fixed income securities that are rated in the lower rating categories of the established rating services (Ba or lower by Moody's Investors Service, Inc. or BB or lower by Standard & Poor's Corporation) or are unrated securities of comparable quality.

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This report, including the financial information herein, is transmitted to shareholders of Corporate High Yield Fund III, Inc. for their information. It is not a prospectus. The Fund has leveraged its Common Stock to provide Common Stock shareholders with a potentially higher rate of return. Leverage creates risk for Common Stock shareholders, including the likelihood of greater volatility of net asset value and market price of Common Stock shares, and the risk that fluctuations in short-term interest rates may reduce the Common Stock's yield. Past performance results shown in this report should not be considered a representation of future performance. Statements and other information herein are as dated and are subject to change.

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available (1) without charge, upon request, by calling toll-free 1-800-MER-FUND (1-800-637-3863); (2) at [www.mutualfunds.ml.com](http://www.mutualfunds.ml.com); and (3) on the Securities and Exchange Commission's Web site at <http://www.sec.gov>.

Corporate High Yield Fund III, Inc.  
Box 9011  
Princeton, NJ  
08543-9011

#COYIII -- 5/04

Item 2 - Code of Ethics - The registrant has adopted a code of ethics, as of the end of the period covered by this report, that applies to the registrant's principal executive officer, principal financial officer and principal accounting officer, or persons performing similar functions. A copy of the code of ethics is available without charge upon request by calling toll-free 1-800-MER-FUND (1-800-637-3863).

Item 3 - Audit Committee Financial Expert - The registrant's board of directors has determined that (i) the registrant has the following audit committee financial experts serving on its audit committee and (ii) each audit committee financial expert is independent: (1) Joe Grills, (2) Andre F. Perold, (3) Robert S. Salomon, Jr., and (4) Stephen B. Swensrud.

### Item 4 - Principal Accountant Fees and Services

|                  |  |
|------------------|--|
| (a) Audit Fees - | Fiscal Year Ending May 31, 2004 - \$35,000 |
|                  | Fiscal Year Ending May 31, 2003 - \$35,000 |

|                          |   |
|--------------------------|---|
| (b) Audit-Related Fees - | Fiscal Year Ending May 31, 2004 - \$7,500 |
|                          | Fiscal Year Ending May 31, 2003 - \$7,500 |

The nature of the services include assurance and related services reasonably related to the performance of the audit of financial statements not included in Audit Fees.

|                |   |
|----------------|---|
| (c) Tax Fees - | Fiscal Year Ending May 31, 2004 - \$5,200 |
|                | Fiscal Year Ending May 31, 2003 - \$4,800 |

The nature of the services include tax compliance, tax advice and tax planning.

|                      |                                       |
|----------------------|---------------------------------------|
| (d) All Other Fees - | Fiscal Year Ending May 31, 2004 - \$0 |
|                      | Fiscal Year Ending May 31, 2003 - \$0 |

(e) (1) The registrant's audit committee (the "Committee") has adopted

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policies and procedures with regard to the pre-approval of services. Audit, audit-related and tax compliance services provided to the registrant on an annual basis require specific pre-approval by the Committee. The Committee also must approve other non-audit services provided to the registrant and those non-audit services provided to the registrant's affiliated service providers that relate directly to the operations and the financial reporting of the registrant. Certain of these non-audit services that the Committee believes are a) consistent with the SEC's auditor independence rules and b) routine and recurring services that will not impair the independence of the independent accountants may be approved by the Committee without consideration on a specific case-by-case basis ("general pre-approval"). However, such services will only be deemed pre-approved provided that any individual project does not exceed \$5,000 attributable to the registrant or \$50,000 for the project as a whole. Any proposed services exceeding the pre-approved cost levels will require specific pre-approval by the Committee, as will any other services not subject to general pre-approval (e.g., unanticipated but permissible services). The Committee is informed of each service approved subject to general pre-approval at the next regularly scheduled in-person board meeting.

(e) (2) 0%

(f) Not Applicable

(g) Fiscal Year Ending May 31, 2004 - \$16,581,086  
Fiscal Year Ending May 31, 2003 - \$17,622,606

(h) The registrant's audit committee has considered and determined that the provision of non-audit services that were rendered to the registrant's investment adviser and any entity controlling, controlled by, or under common control with the investment adviser that provides ongoing services to the registrant that were not pre-approved pursuant to paragraph (c) (7) (ii) of Rule 2-01 of Regulation S-X is compatible with maintaining the principal accountant's independence.

Regulation S-X Rule 2-01(c) (7) (ii) - \$541,640, 0%

Item 5 - Audit Committee of Listed Registrants - The following individuals are members of the registrant's separately-designated standing audit committee established in accordance with Section 3(a) (58) (A) of the Exchange Act (15 U.S.C. 78c(a) (58) (A)):

James H. Bodurtha  
Joe Grills  
Herbert I. London  
Andre F. Perold  
Roberta Cooper Ramo  
Robert S. Solomon, Jr.  
Stephen B. Swensrud

Item 6 - Schedule of Investments - Not Applicable

Item 7 - Disclosure of Proxy Voting Policies and Procedures for Closed-End Management Investment Companies -  
Proxy Voting Policies and Procedures

Each Fund's Board of Directors/Trustees has delegated to Merrill Lynch Investment Managers, L.P. and/or Fund Asset Management, L.P. (the "Investment Adviser") authority to vote all proxies relating to the

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Fund's portfolio securities. The Investment Adviser has adopted policies and procedures ("Proxy Voting Procedures") with respect to the voting of proxies related to the portfolio securities held in the account of one or more of its clients, including a Fund. Pursuant to these Proxy Voting Procedures, the Investment Adviser's primary objective when voting proxies is to make proxy voting decisions solely in the best interests of each Fund and its shareholders, and to act in a manner that the Investment Adviser believes is most likely to enhance the economic value of the securities held by the Fund. The Proxy Voting Procedures are designed to ensure that that the Investment Adviser considers the interests of its clients, including the Funds, and not the interests of the Investment Adviser, when voting proxies and that real (or perceived) material conflicts that may arise between the Investment Adviser's interest and those of the Investment Adviser's clients are properly addressed and resolved.

In order to implement the Proxy Voting Procedures, the Investment Adviser has formed a Proxy Voting Committee (the "Committee"). The Committee is comprised of the Investment Adviser's Chief Investment Officer (the "CIO"), one or more other senior investment professionals appointed by the CIO, portfolio managers and investment analysts appointed by the CIO and any other personnel the CIO deems appropriate. The Committee will also include two non-voting representatives from the Investment Adviser's Legal department appointed by the Investment Adviser's General Counsel. The Committee's membership shall be limited to full-time employees of the Investment Adviser. No person with any investment banking, trading, retail brokerage or research

responsibilities for the Investment Adviser's affiliates may serve as a member of the Committee or participate in its decision making (except to the extent such person is asked by the Committee to present information to the Committee, on the same basis as other interested knowledgeable parties not affiliated with the Investment Adviser might be asked to do so). The Committee determines how to vote the proxies of all clients, including a Fund, that have delegated proxy voting authority to the Investment Adviser and seeks to ensure that all votes are consistent with the best interests of those clients and are free from unwarranted and inappropriate influences. The Committee establishes general proxy voting policies for the Investment Adviser and is responsible for determining how those policies are applied to specific proxy votes, in light of each issuer's unique structure, management, strategic options and, in certain circumstances, probable economic and other anticipated consequences of alternate actions. In so doing, the Committee may determine to vote a particular proxy in a manner contrary to its generally stated policies. In addition, the Committee will be responsible for ensuring that all reporting and recordkeeping requirements related to proxy voting are fulfilled.

The Committee may determine that the subject matter of a recurring proxy issue is not suitable for general voting policies and requires a case-by-case determination. In such cases, the Committee may elect not to adopt a specific voting policy applicable to that issue. The Investment Adviser believes that certain proxy voting issues require investment analysis - such as approval of mergers and other significant corporate transactions - akin to investment decisions, and are, therefore, not suitable for general guidelines. The Committee may elect to adopt a common position for the Investment Adviser on certain proxy votes that are akin to investment decisions, or determine to permit the portfolio manager to make individual decisions on how best to maximize economic value for a Fund (similar to normal buy/sell investment

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decisions made by such portfolio managers). While it is expected that the Investment Adviser will generally seek to vote proxies over which the Investment Adviser exercises voting authority in a uniform manner for all the Investment Adviser's clients, the Committee, in conjunction with a Fund's portfolio manager, may determine that the Fund's specific circumstances require that its proxies be voted differently.

To assist the Investment Adviser in voting proxies, the Committee has retained Institutional Shareholder Services ("ISS"). ISS is an independent adviser that specializes in providing a variety of fiduciary-level proxy-related services to institutional investment managers, plan sponsors, custodians, consultants, and other institutional investors. The services provided to the Investment Adviser by ISS include in-depth research, voting recommendations (although the Investment Adviser is not obligated to follow such recommendations), vote execution, and recordkeeping. ISS will also assist the Fund in fulfilling its reporting and recordkeeping obligations under the Investment Company Act.

The Investment Adviser's Proxy Voting Procedures also address special circumstances that can arise in connection with proxy voting. For instance, under the Proxy Voting Procedures, the Investment Adviser generally will not seek to vote proxies related to portfolio securities that are on loan, although it may do so under certain circumstances. In addition, the Investment Adviser will vote proxies related to securities of foreign issuers only on a best efforts basis and may elect not to vote at all in certain countries where the Committee determines that the costs associated with voting generally outweigh the benefits. The Committee may at any time override these general policies if it determines that such action is in the best interests of a Fund.

From time to time, the Investment Adviser may be required to vote proxies in respect of an issuer where an affiliate of the Investment Adviser (each, an "Affiliate"), or a money management or other client of the Investment Adviser (each, a "Client") is involved. The Proxy Voting Procedures and the Investment Adviser's adherence to those procedures are designed to address such conflicts of interest. The Committee intends to strictly adhere to the Proxy Voting Procedures in all proxy matters, including matters involving Affiliates and Clients. If, however, an issue representing a non-routine matter that is material to an Affiliate or a widely known Client is involved such that the Committee does not reasonably believe it is able to follow its guidelines (or if the particular proxy matter is not addressed by the guidelines) and vote impartially, the Committee may, in its discretion for the purposes of ensuring that an independent determination is reached, retain an independent fiduciary to advise the Committee on how to vote or to cast votes on behalf of the Investment Adviser's clients.

In the event that the Committee determines not to retain an independent fiduciary, or it does not follow the advice of such an independent fiduciary, the powers of the Committee shall pass to a subcommittee, appointed by the CIO (with advice from the Secretary of the Committee), consisting solely of Committee members selected by the CIO. The CIO shall appoint to the subcommittee, where appropriate, only persons whose job responsibilities do not include contact with the Client and whose job evaluations would not be affected by the Investment Adviser's relationship with the Client (or failure to retain such relationship). The subcommittee shall determine whether and how to vote all proxies on behalf of the Investment Adviser's clients or, if the proxy matter is, in their judgment, akin to an investment decision, to defer to the applicable portfolio managers, provided that, if the subcommittee

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determines to alter the Investment Adviser's normal voting guidelines or, on matters where the Investment Adviser's policy is case-by-case, does not follow the voting recommendation of any proxy voting service or other independent fiduciary that may be retained to provide research or advice to the Investment Adviser on that matter, no proxies relating to the Client may be voted unless the Secretary, or in the Secretary's absence, the Assistant Secretary of the Committee concurs that the subcommittee's determination is consistent with the Investment Adviser's fiduciary duties

In addition to the general principles outlined above, the Investment Adviser has adopted voting guidelines with respect to certain recurring proxy issues that are not expected to involve unusual circumstances. These policies are guidelines only, and the Investment Adviser may elect to vote differently from the recommendation set forth in a voting guideline if the Committee determines that it is in a Fund's best interest to do so. In addition, the guidelines may be reviewed at any time upon the request of a Committee member and may be amended or deleted upon the vote of a majority of Committee members present at a Committee meeting at which there is a quorum.

The Investment Adviser has adopted specific voting guidelines with respect to the following proxy issues:

- o Proposals related to the composition of the Board of Directors of issuers other than investment companies. As a general matter, the Committee believes that a company's Board of Directors (rather than shareholders) is most likely to have access to important, nonpublic information regarding a company's business and prospects, and is therefore best-positioned to set corporate policy and oversee management. The Committee, therefore, believes that the foundation of good corporate governance is the election of qualified, independent corporate directors who are likely to diligently represent the interests of shareholders and oversee management of the corporation in a manner that will seek to maximize shareholder value over time. In individual cases, the Committee may look at a nominee's history of representing shareholder interests as a director of other companies or other factors, to the extent the Committee deems relevant.
- o Proposals related to the selection of an issuer's independent auditors. As a general matter, the Committee believes that corporate auditors have a responsibility to represent the interests of shareholders and provide an independent view on the propriety of financial reporting decisions of corporate management. While the Committee will generally defer to a corporation's choice of auditor, in individual cases, the Committee may look at an auditors' history of representing shareholder interests as auditor of other companies, to the extent the Committee deems relevant.
- o Proposals related to management compensation and employee benefits. As a general matter, the Committee favors disclosure of an issuer's compensation and benefit policies and opposes excessive compensation, but believes that compensation matters are normally best determined by an issuer's board of directors, rather than shareholders. Proposals to "micro-manage" an issuer's compensation practices or to set arbitrary restrictions on compensation or benefits will, therefore, generally not be supported.
- o Proposals related to requests, principally from management, for approval of amendments that would alter an issuer's capital structure. As a general matter, the Committee will support requests that enhance the rights of common shareholders and oppose requests that appear to be unreasonably dilutive.

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- o Proposals related to requests for approval of amendments to an issuer's charter or by-laws. As a general matter, the Committee opposes poison pill provisions.
- o Routine proposals related to requests regarding the formalities of corporate meetings.
- o Proposals related to proxy issues associated solely with holdings of investment company shares. As with other types of companies, the Committee believes that a fund's Board of Directors (rather than its shareholders) is best-positioned to set fund policy and oversee management. However, the Committee opposes granting Boards of Directors authority over certain matters, such as changes to a fund's investment objective, that the Investment Company Act envisions will be approved directly by shareholders.
- o Proposals related to limiting corporate conduct in some manner that relates to the shareholder's environmental or social concerns. The Committee generally believes that annual shareholder meetings are inappropriate forums for discussion of larger social issues, and opposes shareholder resolutions "micromanaging" corporate conduct or requesting release of information that would not help a shareholder evaluate an investment in the corporation as an economic matter. While the Committee is generally supportive of proposals to require corporate disclosure of matters that seem relevant and material to the economic interests of shareholders, the Committee is generally not supportive of proposals to require disclosure of corporate matters for other purposes.

Item 8 - Purchases of Equity Securities by Closed-End Management Investment Company and Affiliated Purchasers - Not Applicable

Item 9 - Submission of Matters to a Vote of Security Holders - Not Applicable

Item 10 - Controls and Procedures

10(a) - The registrant's certifying officers have reasonably designed such disclosure controls and procedures to ensure material information relating to the registrant is made known to us by others particularly during the period in which this report is being prepared. The registrant's certifying officers have determined that the registrant's disclosure controls and procedures are effective based on our evaluation of these controls and procedures as of a date within 90 days prior to the filing date of this report.

10(b) - There were no changes in the registrant's internal control over financial reporting (as defined in Rule 30a-3(d) under the Act (17 CFR 270.30a-3(d)) that occurred during the second fiscal half-year of the period covered by this report that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

Item 11 - Exhibits attached hereto

11(a) (1) - Code of Ethics - See Item 2

11(a) (2) - Certifications - Attached hereto

11(a) (3) - Not Applicable

11(b) - Certifications - Attached hereto



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Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Corporate High Yield Fund III, Inc.

By: /s/ Terry K. Glenn

-----  
Terry K. Glenn,  
President of  
Corporate High Yield Fund III, Inc.

Date: July 19, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934 and the Investment Company Act of 1940, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Terry K. Glenn

-----  
Terry K. Glenn,  
President of  
Corporate High Yield Fund III, Inc.

Date: July 19, 2004

By: /s/ Donald C. Burke

-----  
Donald C. Burke,  
Chief Financial Officer of  
Corporate High Yield Fund III, Inc.

Date: July 19, 2004