



ARGYLE STREET MANAGEMENT LIMITED

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Unlocking value for all shareholders

China Merchants China Direct Investments Limited

招商局中國基金 (133 HK)

5 January 2024

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All share price data are as at 2 January 2024



Executive summary

- **China Merchants China Direct Investments Limited (“Fund”)** is a Hong Kong-listed closed-end fund managed by a **Manager** that is affiliated with the China Merchants Group
- The Fund has a concentrated portfolio of investments
 - Its largest single asset is A-shares of China Merchant Bank (**“CMB”**, stock code:600036), which accounts for 34% of the Fund’s total assets as at September 2023
- Over the past 20 years, the share price of the Fund trades at increasingly large discount to its net asset value. Currently, its price-to-net-asset-value ratio is 0.27x*
- We, **Argyle Street Management****, own 6% shares in the Fund (through various entities managed by us) as at 2 January 2024
- We propose a **simple win-win solution for both the shareholders and the Manager** that will:
 - increase shareholder value by 112% almost instantly
 - increase the Manager’s total fee income in the next three years
 - rationalize the fees charged by the Manager
 - reduce the concentration risks taken by the Fund
- To achieve these goals, we propose that:
 - the Fund shall **sell its large listed positions** (including CMB) and return capital to shareholders
 - the Manager will **reset the management fee rates**
 - A **10% Special Distribution Fee** shall be awarded to the Manager

* Net Asset value per share is HK\$ 28.68 as of 30 November 2023

** through the entities managed by us



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About China Merchants China Direct Investments Limited

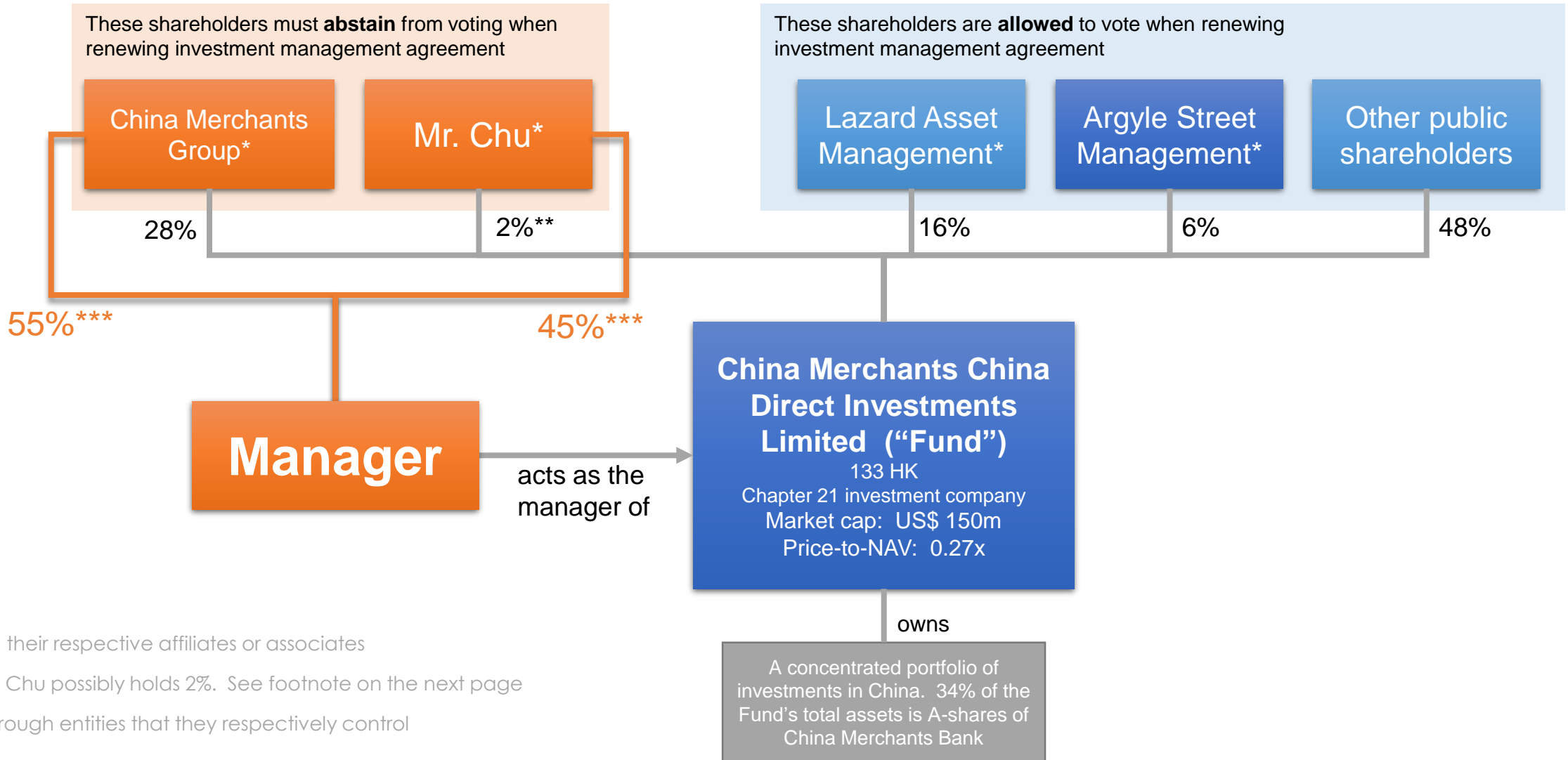


About the Fund

- **China Merchants China Direct Investments Limited** (招商局中國基金, 133 HK, the “Fund”) is a Hong Kong-listed “Chapter 21” closed-end investment company (market cap: US\$ 150m)
- The Fund is managed by a fund manager called **China Merchants China Investment Management Limited (“Manager”)** through an “investment management agreement” (“IMA”) that needs be renewed every three years
- The Fund owns a concentrated portfolio of investments in financial services, technology and media sectors in China
 - The Fund’s single largest investment is A-shares of **China Merchants Bank (“CMB”)**, which accounts for 34% of the Fund’s total assets as at September 2023
- As at 2 January 2024, the share price of the Fund is HK\$ 7.66, vs. its net asset value (“NAV”) per share of HK\$ 28.68 as at 30 November 2023, imply price-to-NAV ratio of merely 0.27x
- The Manager charges the Fund management fees of 1.5-2.0% per year, plus a performance fee of 8%



The shareholding structure of the Fund and the Manager



* and their respective affiliates or associates

** Mr. Chu possibly holds 2%. See footnote on the next page

*** through entities that they respectively control



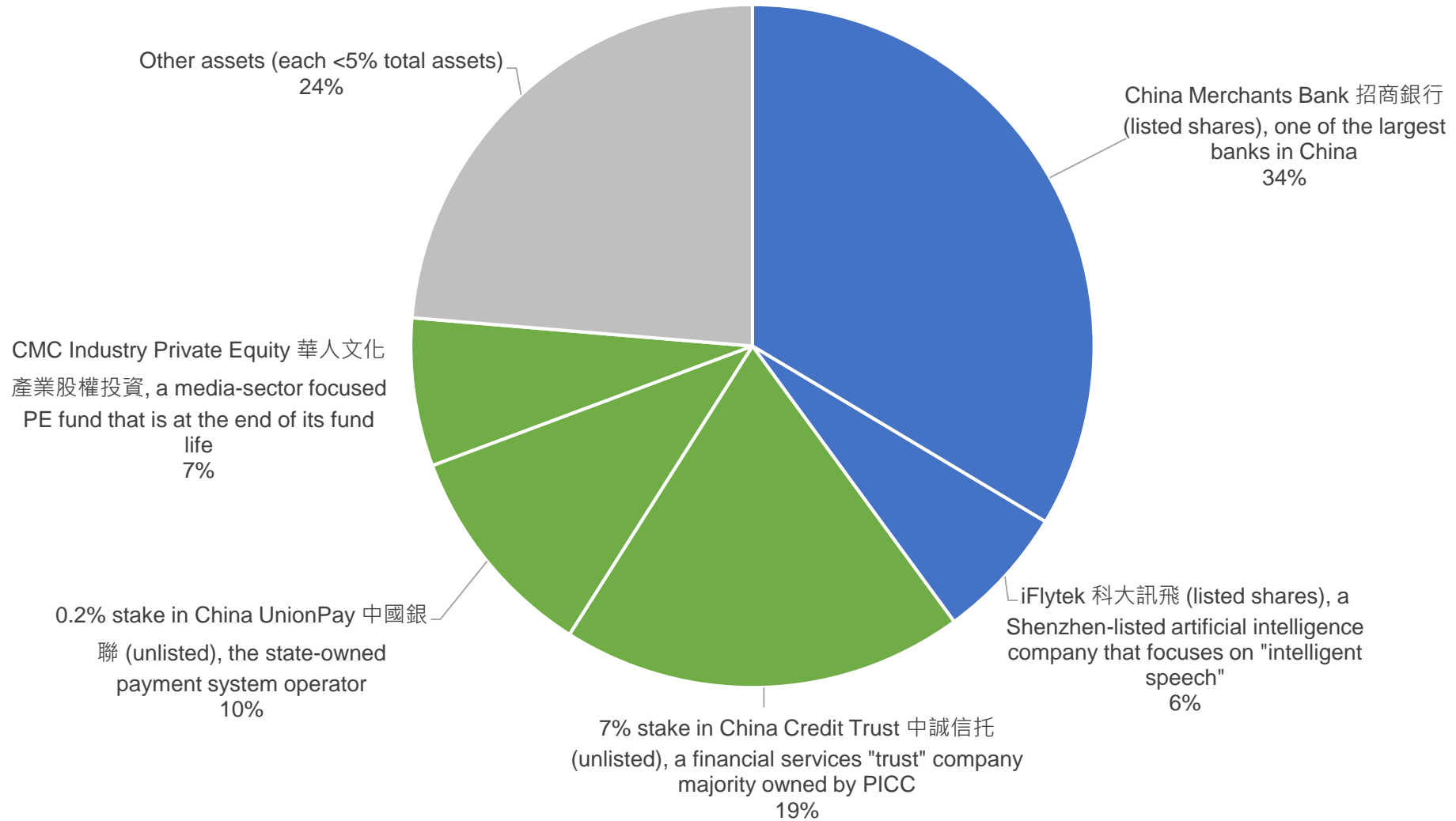
The shareholding structure of the Fund and the Manager (cont'd)

- Shareholding structure:
 - **China Merchants Group** (through associates) currently owns 27.6% shares in the fund
 - It also controls 55% stake in the Manager
 - Mr. Victor Chu (“**Mr. Chu**”), another founder of the Fund, possibly owns 2.0%* in the Fund (through his associates). At the same time, he also controls 45% stake in the Manager
 - **Lazard Asset Management (“Lazard”)** owns 15.9% in the Fund
 - We, **Argyle Street Management (“ASM”)**, own 6.0% shares in the Fund (through various entities managed by us) as at 2 January 2024
 - As a result, the Manager is a “connected person” of the Fund. For the Manager to renew its IMA and continue to charge fees, approval by independent shareholders is required
 - The current IMA will expire on 31 December 2024 (i.e. a year from now)
 - We expect that a renewal of the IMA will be proposed in late-2024, and a shareholder meeting will take place (like it did in late 2021)
 - **China Merchants Group and Mr. Chu (and their respective associates) are required to abstain from voting at the shareholder meeting**

* According to annual report in 2020, Mr. Chu owned 3,030,024 shares, or 2% shares, in the Fund. However, he resigned in 2021 and no longer discloses his interests in annual reports. On the other hand, FE Securities, of which Mr. Chu is a responsible officer, currently holds 3,045,664 shares in the Fund as a CCASS participant. See <https://webb-site.com/ccass/chistory.asp?i=291&part=21>. It is possible (but not certain) that Mr. Chu still owns 2% shares

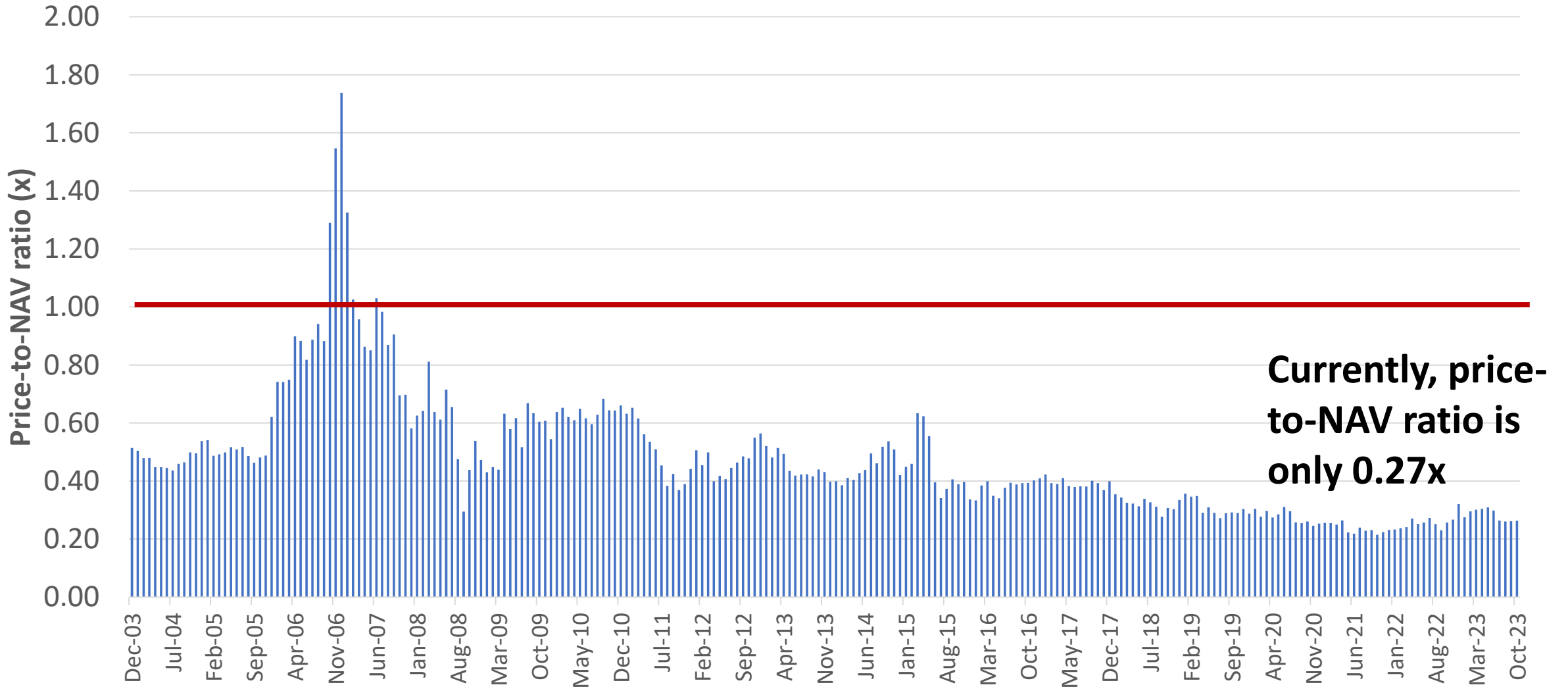


Breakdown of the total assets of the Fund (September 2023)





The Fund's share price trades at increasingly steep discount to net asset value





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Our objectives and proposal



Our objectives

- **Continuity:**
 - The Manager has been managing the Fund since 1993. We are in favour of continuity
 - We believe that it is in all shareholders' interest for the Fund to continue to hire the Manager, if the following objectives are achieved
- **Unlocking value:**
 - Over the years, the Fund's share price has been trading at increasingly steep discount to its NAV per share
 - There are simple strategies that the Fund can pursue to unlock and maximize value for all shareholders almost instantly
- **Sensible diversification:** the Fund's portfolio needs be sensibly diversified without excessive concentration on any single investment
- **Market-level fee rate:** the fees charged by the Manager needs be in line with market levels and commensurate with the Fund's track record as well as the type of investments held by the Fund



Our proposal

ASM believes that the following proposal is a win-win solution for the Manager and all shareholders, and is prepared to vote in favour of an IMA that has all of the following elements

- **Sell listed shares and return capital**

- Listed shares of CMB account for 34% of the Fund's total assets*
- Listed shares of iFlytek Co. Ltd (“iFlytek”, 科大訊飛), a Shenzhen-listed technology company that focuses on “intelligent speech”, account for 6% of the Fund's total assets*
- Both CMB and iFlytek shares are large-cap stocks and extremely liquid. The Fund can easily sell its shares at market in a matter of days
- **We propose that the Fund shall sell all of its shares in CMB and iFlytek in 1Q2025, and use all the sale proceeds to return capital to shareholders**
- **The return of capital can be done in the form of dividends, capital reduction or share buyback offers (at a price close to NAV per share)**
- We recognize that both CMB and iFlytek are successful investments by the Fund
- However, if shareholders want exposure to CMB and iFlytek, they can easily buy these shares at market themselves (without paying any management and performance fees), instead of gaining indirect exposure by owning illiquid shares of the Fund

*As at September 2023



Our proposal (continued)

ASM believes that the following proposal is a win-win solution for the Manager and all shareholders, and is prepared to vote in favour of an IMA that has all of the following elements

- **Reduce management fee rate by half**
 - Currently, the Manager charges the Fund 2.0% p.a. management fee on non-listed assets and at least 1.5% p.a. management fee on listed shares
 - That is on top of performance fees at a rate of 8% (subject to high water mark)
 - As a fund manager ourselves, we recognize that management fee is an important source of income for the Manager.
 - However, we feel that the current fee rates are far too high. The high fees could be one possible reason why share price is trading at a large discount to NAV
 - Management fee rates are declining globally:
 - In July 2023, CSRC, the securities regulator, launched a program to reduce the fee rates of publicly-offered investment funds to 1.2% per year
 - Blackstone's upcoming Private Equity Strategies Fund charges management fee 1.25% per year
 - **We propose that Fund's management fee rate shall be reduced to half of the current level**
 - To incentivize good performance, we propose that the current performance fee rate of 8% shall be maintained. However, the **current high water mark (which was achieved in 2021) shall stay intact and not be reset**

* Source: <https://www.sec.gov/Archives/edgar/data/1930054/000119312523274483/d553632d10q1.pdf>



Our proposal (continued)

ASM believes that the following proposal is a win-win solution for the Manager and all shareholders, and is prepared to vote in favour of an IMA that has all of the following elements

- **New fee for the Manager: Special Distribution Fee**
 - We recognize that our proposal will significantly reduce the Manager's management fee income
 - To compensate for that and to incentivize timely disposal of assets, we propose to introduce a **new one-off "Special Distribution Fee"** for the Manager
 - If the Fund sells ALL of its CMB and iFlytek shares and returns capital to the Fund's shareholders by 1Q2025 (i.e. during the first three months of the new IMA), then the Fund will pay the Manager an Special Distribution Fee, which is **10% of the cash distributions received by the shareholders**



Summary: comparison of the current IMA and ASM's proposal

	Current IMA	ASM's proposal
Term	2022-2024	2025-2027
Management fee (per year)		
Unlisted securities, or listed securities that are subject to lockup)	2%	1%
Listed securities (for the first year after lockup)	1.75%	0.88%
Other listed securities	1.5%	0.75%
Performance fee	8%	8% (no change)
High water mark	US\$ 806m (achieved in 2021)	US\$ 806m
Asset sale and capital return	-	All CMB and iFlytek shares shall be sold and proceeds shall be returned to shareholders in 1Q2025
Special Distribution Fee for the Manager	-	10% of the distributions received by shareholders arising from the sale of CMB and iFlytek shares



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Results: win-win outcome



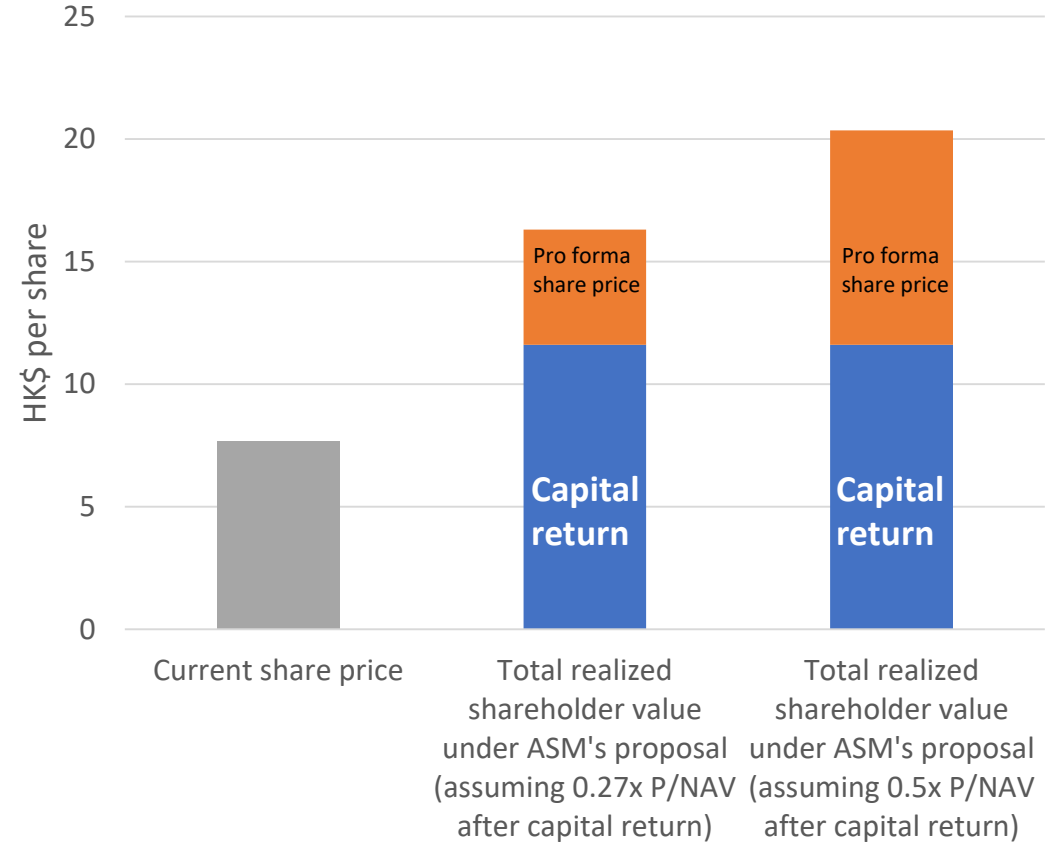
Assumptions

- Under our win-win proposal, **total realized shareholder value increases by 112% almost instantly, while Manager will earn more fees**
- Our calculations conservative assume that:
 - the Fund's portfolio achieves **0% performance** between 2023Q3 and 2027 (a conceivable scenario due to the slowdown of China)
 - when the Fund sells CMB and iFlytek shares, it will need to use some of the sale proceeds to pay capital gain taxes in China
 - The Fund does not provide a breakdown of these deferred tax liabilities
 - We estimate and assume that CMB and iFlytek are associated with **US\$ 50m tax liabilities**
 - 90% of remaining proceeds shall be paid to all shareholders (the remaining 10% is retained by the Fund for funding operating expenses)



Under our proposal, total shareholder value increases by 112%+

- Using the same assumption as the previous page, shareholders will receive US\$ 226m one-off distribution, after the sale of CMB and iFlytek shares
- That translates to **capital return of HK\$ 11.6* per share**
- After the cash distribution (and the payment of the Special Distribution Fee to the Manager), we estimate that residual NAV of the Fund will be US\$ 341m, which translates to HK\$ 17.5 per share
- Even assuming that the market values the residual NAV at the current price-to-NAV ratio of 0.27x, the *pro forma* share price of the Fund will be HK\$ 4.7 (= HK\$ 17.5 x 0.27)
- **Total realized shareholder value will therefore be HK\$ 11.6 + HK\$ 4.7 = HK\$ 16.2 per share, which is 112% higher than the current share price of HK\$ 7.66**
- We believe that the price-to-NAV ratio will increase after the capital return, and the pro forma share price will therefore be even higher
- Assuming post-capital-return P/NAV of 0.5x, the pro forma share price of the Fund will be HK\$ 8.7 (= \$17.5 x 0.5), **implying total realized shareholder value of HK\$ 11.6 + HK\$ 8.7 = HK\$ 20.3 per share, which is 165% higher than current share price**



*USD/HKD=7.8



Under our proposal, the Manager will earn more fees

- **If the IMA is renewed with identical terms as the current IMA:**
 - We estimate that the Manager will earn \$10.4m management fees per year, or **\$31.2m in aggregate in 2025-27**
- **However, if the IMA is renewed with the terms proposed by ASM:**
 - We estimate that the Manager will earn \$3.33m management fee per year, or \$10.0m in aggregate during 2025-27
 - The decline of management fees is due to smaller fund size and lower fee rates
 - However, the Fund will realize \$251m from the one-off disposal of CMB and iFlytek shares. We estimate that shareholders will receive \$226m one-off distribution. Once the proceeds are distributed to shareholders, the Manager will earn \$22.6m one-off Special Distribution Fee in 1Q2025
 - Altogether, the Manager will earn **\$32.6m fees under ASM's proposal in 2025-27**
- We can provide a financial model of our calculations upon request



Comparison of the manager's fee income

US\$ m	Fee income if the terms of the current IMA is maintained*	Fee income if ASM's proposal is adopted*
Special Distribution Fee (in 1Q2025)	0	22.6
FY2025 management fee	10.4	3.3
FY2026 management fee	10.4	3.3
FY2027 management fee	10.4	3.3
Total (2025-2027)	31.2	32.6

**Superior proposal
for the Manager**

* Estimated based on the assumptions in the previous page



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Appendix



Key sources

- Annual report 2022 of the Fund
- <https://doc.irasia.com/listco/hk/cmcdi/annual/2022/ar2022.pdf>
- Breakdown of the Fund's total assets (September 2023)
- <https://doc.irasia.com/listco/hk/cmcdi/announcement/a231013a.pdf>
- History of net asset value
- <https://www.cmcdi.com.hk/eng/ir/highlights.htm>
- The last renewal of the IMA in 2021 (contains the commercial terms of the IMA)
- <https://doc.irasia.com/listco/hk/cmcdi/circulars/c211105a.pdf>
- The Fund's portfolio
- <https://www.cmcdi.com.hk/eng/portfolio/overview.htm>



About us

- **Argyle Street Management (ASM)** is a Hong Kong-based fund manager
- We focus on undervalued, high-quality assets in Asia with a viable path of unlocking value
- Our activism in these companies has resulted in various corporate actions that have created value for all shareholders:

Target company	Jurisdiction	Bloomberg ticker	Corporate actions that followed ASM's activism
HSBC China Dragon Fund	Hong Kong	820 HK	Portfolio liquidation of a closed-end fund
China Motor Bus	Hong Kong	26 HK	Sale of major assets, large special dividends, appointment of new CEO
ENM Holdings	Hong Kong	128 HK	Removal of underperforming directors
Asiasec Properties (fka Dan Form)	Hong Kong	271 HK	Share buyback, increased dividends, takeover by strategic investor
Guangdong Development Fund	UK	Delisted (UK)	Portfolio liquidation of a closed-end fund
Asia Resource Minerals (fka Bumi plc)	UK	Delisted (UK)	Takeover by strategic investor, successful debt restructuring
Toshiba Corporation	Japan	6588 JP	Takeover by strategic investor
Sankyo Seiko	Japan	8018 JP	Increased dividends
TTK	Japan	Delisted	Takeover by strategic investor
Mitsui Life	Japan	Private company	Takeover by strategic investor
TIH Limited (fka Transpac)	Singapore	TIH SP	Portfolio liquidation of a closed-end fund
CEI Limited	Singapore	Delisted	Takeover by strategic investor
United Fiber System	Singapore	Delisted	Reverse takeover by strategic investor
Mount Gibson Iron	Australia	MGX AU	Appointment of new directors, special dividends
BTS Group	Thailand	BTS TB	Successful debt restructuring
Catcher Technology	Taiwan	2474 TT	Investigation by regulator on corporate governance issues



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Investments in alternative investments such as the ASM funds are speculative, entail substantial risk and are not intended as a complete investment program. The profitability and return of alternative investments are dependent upon numerous factors which may include the active management of (i) securities both long and short across global markets including, but not limited to, equities, foreign exchange, fixed income, commodities, futures, options, swaps and other derivative instruments as well as (ii) special opportunities in areas such as distressed debt, structured lending and private equity investments. Exchange rate fluctuations may affect returns. There is no assurance that an ASM fund's investment objective will be attained. Opportunities for redemption and transferability of interests in alternative investments are restricted or may be not possible at all. As such an investor may not have access to capital when it is needed by such investor. There are restrictions on the sale of ASM fund interests. There is no secondary market for interests in many alternative investments, including investments in the ASM funds, and none is expected to develop.

Alternative investments are designed only for sophisticated investors who are able to bear the economic risk of losing all of their investment. Generally speaking, without regard to ASM or any ASM Funds, alternative investments: (1) often engage in leveraging and other speculative investment practices that may increase the risk of investment loss; (2) can be highly illiquid; (3) are not required to provide periodic pricing or valuation information to investors; (4) may involve complex tax structures and delays in distributing important tax information; (5) are not subject to the same regulatory requirements as mutual funds; and (6) often charge higher fees than mutual funds.

ASM strongly encourages investors to obtain independent advice from their own legal, accounting, business, investment and tax advisers regarding an investment in any ASM fund. Investors are also urged to take appropriate advice regarding any applicable legal requirements and any applicable taxation and exchange control regulations in the country of their citizenship, residence or domicile which may be relevant to the subscription, purchase, holding, exchange, redemption or disposal of any ASM Fund.

Use of indexes

Any market index information shown herein is included to show relative market performance for the periods indicated and not as standards of comparison, since these are unmanaged, broadly based indices which differ in numerous respects from the portfolio composition of the Fund. Standard indexes do not represent benchmarks but are listed to show the general trends in the markets covered by those indices and any hedge fund indices are included to reflect trends of various strategies which the ASM funds may pursue. It is not possible to invest directly into an index. Market index information was compiled from sources that ASM believes to be reliable. No representation or guarantee is made hereby with respect to the accuracy or completeness of such data. Index performance does not reflect fees and expenses.



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Performance

Where applicable and unless otherwise indicated, “gross IRR” and “net IRR” mean an aggregate, annual, compound, gross or net, as applicable, internal rate of return on investments. Gross IRRs and other gross multiples do not reflect management fees, “carried interest,” taxes or transaction costs in connection with the disposition of unrealized investments and other expenses that are borne by investors in the Fund and the other Argyle Street Management funds, which will reduce returns and in the aggregate are expected to be substantial. For a description of such fees, “carried interest,” and expenses with respect to the Fund, please see the Memorandum. Net IRRs and net multiples are calculated net of management fees, “carried interest,” taxes and transaction costs in connection with the disposition of investments (other than taxes borne by individual investors).

While the projected returns and valuations of unrealized or partially unrealized investments in this Presentation are based on assumptions that ASM believes are reasonable under the circumstances, the actual realized proceeds on unrealized (or partially unrealized) investments will depend on, among other factors, future operating results of the portfolio companies, the value of the assets and market conditions at the time of disposition, any related transaction costs and the timing and manner of sale, all of which may differ from the assumptions on which the valuations reflected in the historical investment performance data contained herein are based. Accordingly, the actual realized proceeds on these unrealized (or partially unrealized) investments may differ materially from the returns indicated herein.

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