

# Micro Connect

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## Research Report

### Releasing the investment value of SMEs in China through technological innovation

- **Daily Revenue Contract (DRC)** allows professional investors in the financial market to directly invest in China's small and micro consumer market, while allow SMEs to raise fund in an efficient manner.
- **Micro Connect** is an expert to release the value of SMEs. It focuses on investment of small stores in restaurants, retail, consumer services, and culture & sports.
- **Micro Connect China Feeder Fund ("MCCF")** enables professional investors to invest in a well-diversified portfolio of small stores.
- **Micro Connect (Macao) Financial Assets Exchange ("MCEX")** allows professional investors to build their customised DRC portfolio.

**Daily Revenue Contract (DRC): A gateway to accessing the universe of China's vibrant consumer economy.** SMEs' financial needs were previously overlooked by the financial market due to the high cost of information, despite the fact that they contributed more than 60% of GDP and more than 80% of employment. iResearch forecasted the shortfall between loan demand for SMEs and SME loans from financial institutions reached RMB 53.7 trillion in 2021. DRC is an innovative cash-flow based investment tool, neither debt nor equity. Financial investors can collect an agreed-upon portion of the daily revenue of the invested projects. Technology makes the automated repayment mechanism of DRC possible under the dominance of cashless payments, transparent transaction records, and the adoption of SaaS cloud ERP in China. DRC connects the capital market with the small and micro economy in China. It is believed the DRC could unlock the value of SMEs and push forward the development of SME financing in China.

**Micro Connect: An expert to release the value of the small and micro economy in China.** Micro Connect established a transparent revenue sharing investment tool based on the DRC and the automated revenue collection mechanism ("ARM") to tap into the flourishing small and micro economy in China. Micro Connect focuses on investment of restaurants, retail, services and culture & sport. Micro Connect could share revenue from small stores based on the ARM, and it does not involve a change in the ownership of the shares. Micro Connect makes small investments in many small stores to build a well-diversified portfolio with low exposure to the operational risks of particular stores, thanks to the operational independence among small stores.

**MCCF enables professional investors to invest in a well-diversified small store portfolio.** As of 7 Mar 2023, the fund invests in over 2,800 small stores in various consumer sectors, covering over 240 chained-brands. The fund has been well received by investors, and its performance has proven DRC investments to be high-return and low-risk. From the inception date (Feb 2022) to 31 Jan 2023, the return of MCCF reached 15.2%, with volatility of 3.6% and sharp ratio of 3.05x. DRC is a feasible investment tool to diversify the investment portfolio's risk thanks to the lower correlation between the return of DRC investment and equity indices.

**Micro Connect (Macao) Financial Assets Exchange ("MCEX") allows professional investors to customise a DRO portfolio.** Micro Connect will introduce the world's first DRO ("Daily Revenue Obligation") exchange, MCEX, to worldwide financial investors on 25 March 2023. The exchange links-up small stores with global capital. Professional investors can directly invest in DRO assets. MCEX will start the trial operation, and the official opening of the exchange is scheduled to touch down within 3-4 months. We will have a detailed introduction to the operation of the exchange soon afterwards.

*Risks: (1) the prolonged weak retail market sentiment which drags daily return of DRC; (2) the increase in the failure rate for DRCs, (3) Shorten than expected business life cycle of invested stores.*

#### About Micro Connect

Micro Connect is a new financial market platform connecting global capital with China's micro and small businesses. With a fund platform, structured product solutions, and an exchange platform in the planning, Micro Connect offers efficiency and liquidity in small business investing for global professional investors and offers a new alternative to impact investing.

# Daily Revenue Contract (DRC): An innovative financial tool to untap the value of vibrant consumer economy

## Daily Revenue Contract (DRC)

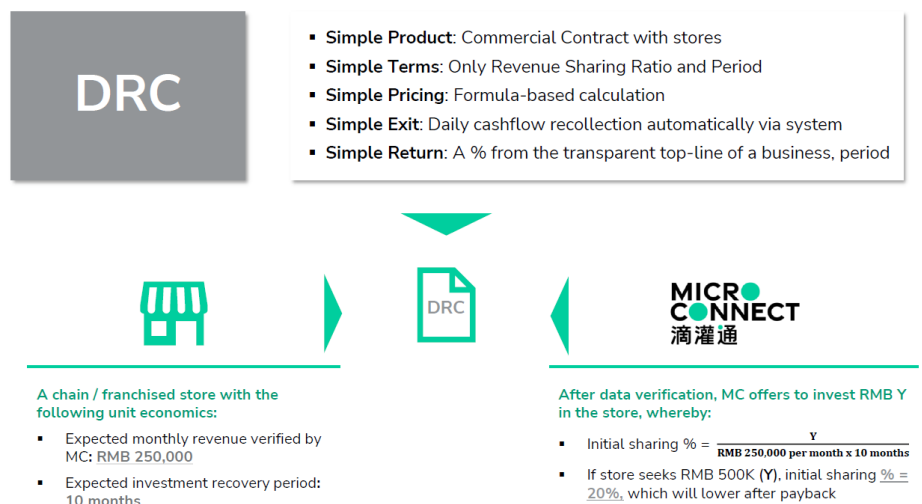
DRC is a contract under which investors can receive the future revenue flow of the company in which they have invested. It is tailored for investment in microenterprises, especially franchised retail businesses. It is neither debt nor equity and represents contractual entitlements to an agreed percentage of daily revenue share for an agreed time period from an invested store.

DRC may have lower seniority than Bond and Equity legally, but **they have the highest seniority in that they can directly collect a portion of every dollar of revenue generated from the invested project.**

Investors who invest in DRC could receive an agreed-portion of daily revenue from the invested store.

The payback period of a DRC varies in different consumer subsectors. Micro Connect anticipated the average payback period for an invested store to be around 22 months 16 Feb 2023.

### Exhibit 1. Micro Connect invests in small businesses with Daily Revenue Contract (DRC)



\*The above example is for reference only. The investment terms varies in different DRCs.

Source: Presentation material of Micro Connect

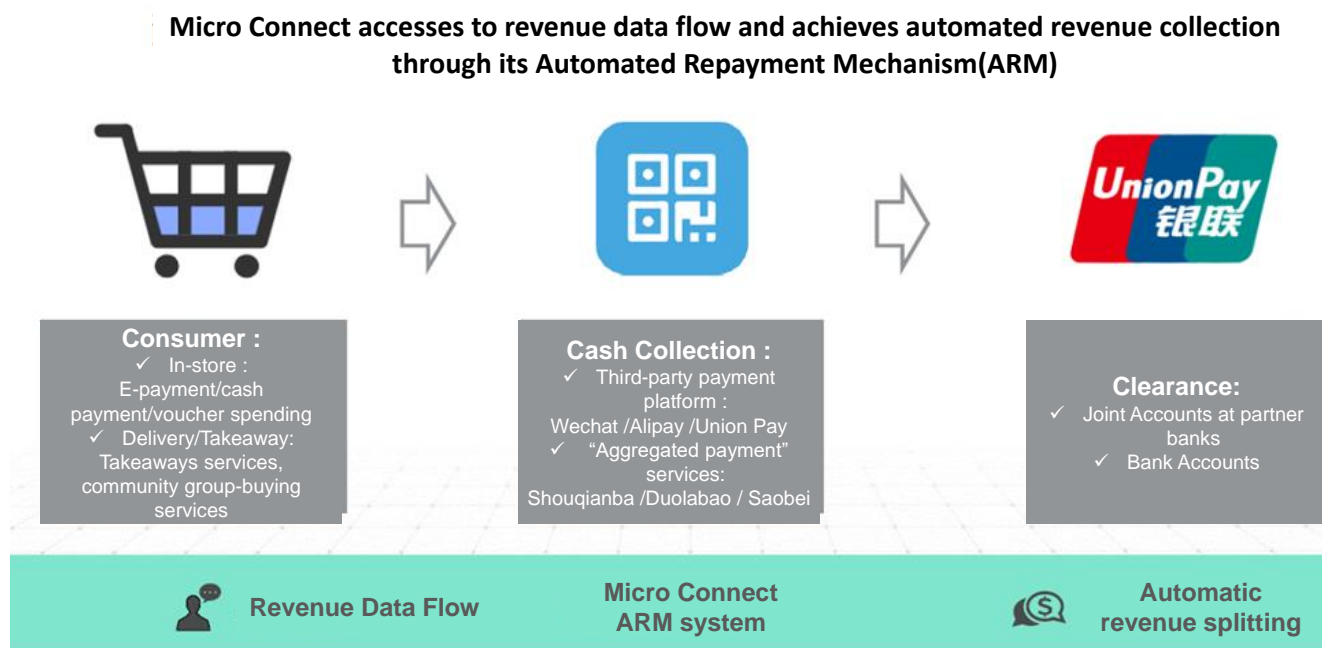
Digital infrastructure makes DRCs a feasible tool to invest in the grassroots economy

Technological innovations, such as the dominance of cashless payments, make it easier for financial institutions to evaluate SME operating performance and trace revenue details. It reduces the cost of evaluating the operating performance of SME and it also reduces the implicit cost, such as the time to process a loan application. As a result, it significantly increased the risk-to-reward ratio for financial institutions when they serve the financing needs of SMEs.

Micro Connect, who is a pioneer in bridging small and micro businesses with the capital market, has established an automated repayment mechanism ("ARM") based on the linkage to POS systems and SaaS platforms of invested companies. It is designed to automatically capture revenue from consumer-facing chain stores and franchises, and these businesses have already widely adopted digital payment.

Micro Connect can automatically calculate, capture, and distribute cash flows in DRC via connected systems with various POS, SaaS, and integrated payment systems.

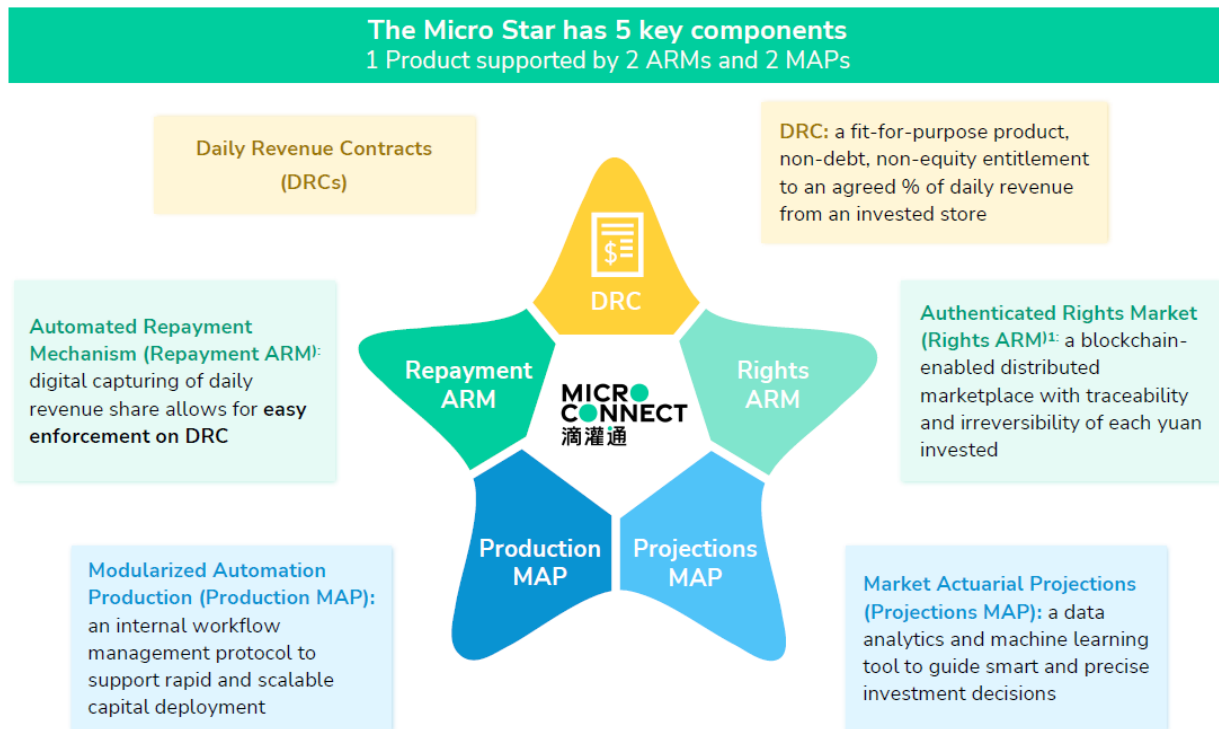
**Exhibit 2. How Micro Connect secures the receipt of investment return via the automated repayment system**



Sources: Micro Connect, Translated by OP Research

Micro Connect demands that companies that want to receive DRC investment to setup SaaS, direct access to digital payment systems, and obtain authorization for sharing revenue from the latter's business accounts. This is to enable Micro Connect to install an automated repayment system to automatically share revenue from invested companies.

**Exhibit 3. Micro Connect establishes “Micro Star”, which is a market operating system, to enable scalable and precision investment**



Source: Presentation material of Micro Connect

**Exhibit 4. Micro Connect establishes a whole-process evaluation and monitoring system**



Sources: Micro Connect, Translated by OP Research

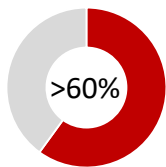
## DRC could un-tap the enormous value of vibrant consumer economy

China's small-and-micro businesses is an untapped blue ocean for financial and institutional investors.

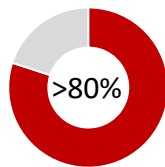
SMEs have an overwhelming contribution to China's GDP and employment. However, they are quite underserved by China's financial market. According to iResearch, only 29.9% of inclusive SMEs (unit: number) have received loan facilities from banks and financial institutions.

SMEs benefit from the elevated internal demand under China's emphasis on boosting the "inner circulation". They also benefit from the acceleration of urbanization and the lower operating barriers for new aspiring entrepreneurs under the digitization of the Chinese economy.

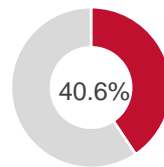
**Exhibit 5. SMEs' contribution to the China economy and some facts on SME financing**



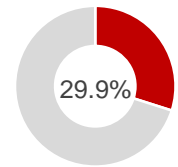
Small businesses account for >60% of China's GDP



Small businesses account for >80% of jobs



SME loans as % of total loan outstanding



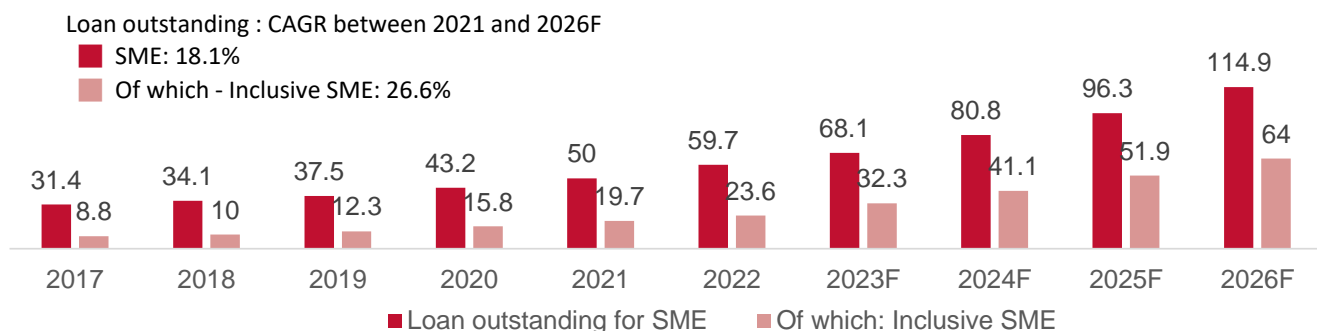
% of Inclusive SME receiving loan facilities as the total number of SME (unit: number)

Sources: PBOC's Governor Yi Gang's speech "Several prospective to improve the financial services for SME" (2018), People's Bank of China, China Banking and Insurance Regulatory Commission, State Administration for Market Regulation, PRC State Council, iResearch, 2021

### SME are being underserved in the financial market

Small-and-micro enterprises in China are eager for financial resources to expand their businesses. As of Dec 2022, the aggregate loan outstanding for SME reached RMB 59.7 trillion. iResearch expects the loan balance outstanding between 2021 and 2026E will grow at a CAGR of 18.1%.

**Exhibit 6. 2017-2026 China's SME Loan Balance and Inclusive SME Loan Balance (Unit: Trillion RMB)**

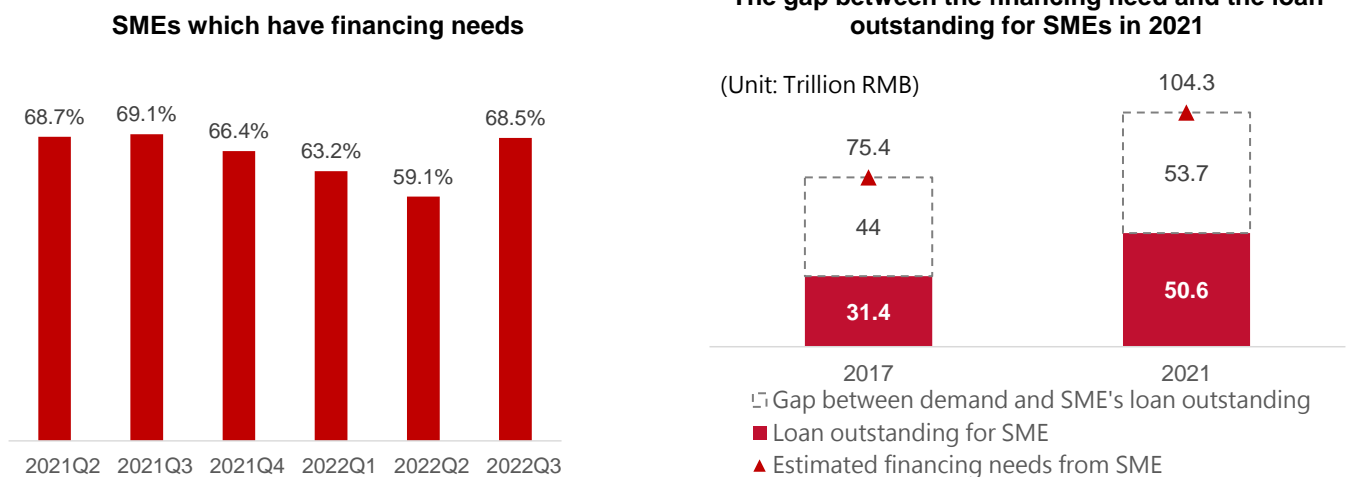


Sources: www.gov.cn, People's Bank of China, China Banking Association, China Banking and Insurance Regulatory Commission, iResearch

According to iResearch, there are huge financing needs for small-and-micro businesses. In 2021, out of 103mn small-stores, 66% of them had financing needs, but only 21% received loan facilities from banks and financial institutions.

SMEs often find them difficult to obtain financing from ordinary sources due to (1) lack of collateral, (2) lack of effective evaluation of the enterprise's credit standards, (3) no accounting standards and information disclosures that is satisfied by financial institutions. iResearch pointed out that there is a huge gap between the actual demand and the loans outstanding for SMEs.

**Exhibit 7. There is a huge shortfall between the SMEs' loan demand and the actual loan outstanding**



Sources: [www.gov.cn](http://www.gov.cn), People's bank of China, China Banking Association, China Banking and Insurance Regulatory Commission, Online Survey of Micro-and-small Enterprise, iResearch

DRC is increasingly adopted by small and micro enterprises because: (i) the investment target does not have rigid repayment obligations given it is a non-debt instrument; (ii) revenue sharing is limited to a fixed sharing ratio and a limited period; and (iii) incentives for stores given that DRC typically requires a lower revenue sharing ratio after the project begins to profit.

## Micro Connect – An expert to bridge capital market and the small and micro economy

Micro Connect is a specialist in tapping business opportunities in the China retail economy through the Daily Revenue Contract ("DRC") and the automated repayment collection system. It focuses on investing in brick-and-mortar stores, covering the entire consumer sector, such as restaurants, retail, services and culture & sport.

### Differentiated proposition

Micro Connect invests in the grassroots economy through the DRC. Compared to traditional asset classes, it has real-time revenue disclosure and prompt collection of investment returns.

#### Exhibit 8. Micro Connect offers professional investors a differentiated investment tool compared with traditional asset classes

	Daily Revenue Contract	Traditional Asset Classes
Size and Scale	Small individual investments in Huge number	Larger outlay per investment concentrated positions
Risk Characteristics	Fully diversified	Corporate level (issuers)
Entry Valuation	At Cost	Premium(equity multiples)
Disclosure	Daily, real time, automated	Prepared by intermediaries with time lag
Exits/ Returns	Immediate and Continuous	IPO or trade sale (equity) / maturity (credit)
Risk Management	Direct daily collection	Regulatory regimes
Deployment Model	Progressive and at store level	Stock picking / bond picking

Sources: Micro Connect, OP Research

### How DRC benefits investors

DRC provides financial investors a transparent, effective, and comprehensive daily revenue data flow. The information is disclosed at a much higher frequency than the listed company. DRC is an investment tool that has highly transparent data disclosure.

Investors can build a well-diversified portfolio with continuous revenue flow contribution by investing in pre-negotiated revenue-sharing contract of small stores. Thanks to the short payback period and continuous revenue flow of DRC, investors can make frequent reinvestments, which will eventually boost the investment return.

Micro Connect focuses on investing in the offline consumer economy, such as restaurants, groceries, salons, fitness rooms, bubble tea shops, etc.



### Exhibit 9. Comparison between Revenue Sharing, Equity Investment and Debt Investment

	Revenue sharing	Private Equity/ Venture Capital	Private Credit
Asset characteristic	<ol style="list-style-type: none"> <li>1. No collateral and guarantee</li> <li>2. Relative low degree of due diligence</li> <li>3. Real and complete shop data. May invest in new store</li> </ol>	<ol style="list-style-type: none"> <li>1. No collateral but have guarantee requirement(s)</li> <li>2. High degree of due diligence</li> <li>3. Highly imaginative and growth business</li> </ol>	<ol style="list-style-type: none"> <li>1. Need collateral(s) and guarantee(s)</li> <li>2. High degree of due diligence with opaque criteria</li> <li>3. Real and complete shop data. In most cases, private credit does not participate in a new store opening.</li> </ol>
Ownership	No share dilution	Own some shares	No share dilution
Management	<ol style="list-style-type: none"> <li>1. No intervention on operation</li> </ol>	<ol style="list-style-type: none"> <li>1. Have intervention on operation</li> <li>2. May assign their preferred board of director</li> </ol>	<ol style="list-style-type: none"> <li>1. No intervention on operation</li> </ol>
Return requirements	<ol style="list-style-type: none"> <li>1. No rigid obligation on revenue</li> <li>2. Revenue sharing in a limited period of time</li> <li>3. Expose to operating risk of invested store</li> </ol>	<ol style="list-style-type: none"> <li>1. No rigid obligation on revenue</li> <li>2. Permanent sharing of profit</li> <li>3. Expose to operating risk of invested store</li> <li>4. May have exit strategies other than IPO</li> </ol>	<ol style="list-style-type: none"> <li>1. Rigid requirement on interest and principal payment</li> <li>2. Must pay interest and principal on time</li> <li>3. Not relating to the operating performance</li> <li>4. May have collateral fee</li> </ol>
Direct Cash Flow	Yes	No	No
Return from Day 1	From the first day	No	Partial
Reinvestment with Cash Inflow	Yes	No	No
Reinvestment Frequency	High	Low	Low
Return Volatility	Stable	Large variance	Stable
Information disclosure	Complete and instant	Delay and limited	Delay and limited

Sources: Micro Connect, OP Research

### Exhibit 10. Impact of the following market events on the return of Revenue Sharing, Equity Investment and Debt Investment

	Revenue sharing	Private Equity/ Venture Capital	Private Credit
IPO	No impact	Potential high return (subject to entry valuation)	No impact
Remain private	No impact	0	No impact
Cease Operation	Lower return (partial / full Investment recovery by then)	-100%	Mitigated by collateral

Sources: Micro Connect, OP Research



## Micro Connect provides a new route for professional investors to invest in the small-and-micro economy

Micro Connect China Feeder Fund ("MCCF") allows professional financial investors to invest in a diversified DRC portfolio with stable return. After the opening of Micro Connect (Macao) Financial Assets Exchange ("MCEX"), professional financial investors can customize their DRO ("Daily Revenue Obligation") portfolio.

### Micro Connect China Feeder Fund

MCCF provides investors with stable annual income growth and capital appreciation by investing in a highly diversified portfolio of pre-negotiated revenue sharing contracts with PRC-based small businesses. As of 31 Jan 2023, the fund's assets under management (AUM) reached US\$80.20mn.

#### Exhibit 11. Key Highlight of Micro Connect China Feeder Fund (As of 16 Feb 2023)

##### Diversified Portfolio

- 2512 stores in 31 provinces and 167 cities, in 74 categories

##### Average investment per shop

- RMB322K

##### Payback period per shop investment

- Averagely 22 months

##### Sound Cashflow

- RMB1.64 avg.daily cash received per 1,000 RMB investment

##### Low Store Closure

- Store closure rate of 0.5%
- Store closed with 58% investment recovery rate

Sources: Micro Connect, OP Research

MCCF adopted the Discounted Cash Flow model to value the NAV monthly, which reflects the valuations of revenue distribution rights based on underlying revenue generated by stores.

The initial valuation is performed in accordance, with financial information provided by brand partners, with additional analysis to fine tune the financial projections of the invested store.

#### Exhibit 12. Key Features of the Micro Connect China Fund

##### Superior Returns

~15% RETURN

Expected Net Portfolio Annual Return

##### Lower Volatility

WELL DIVERSIFIED

Granular Diversification Across 100+ Sub-sectors Nationwide

##### Controlled Risk

REAL TIME TRANSPARENCY

Direct and Daily Revenue Collection

"EXIT" FROM DAY 1

Daily Cash Flow Recovery from Moment of Revenue Generation

COUNTER-CYCLICAL EXPOSURE

Focus on Consumer (Staples) Retail and Services sectors

UNCORRELATED RISK PROFILE

Against Traditional Asset Classes

Source: Presentation material of Micro Connect

From the inception date (Feb 2022) to 31 Jan 2023, the return of MCCF reached 15.2%.

MCCF's unique asset nature shields off external sentiment and volatility otherwise seen in traditional asset markets. The low correlation between the return of MCCF and stock indices makes MCCF a feasible tool to diversify the portfolio's risk.

**Exhibit 13. Return Characteristic of MCCF [From the inception date (Feb 2022) to 31 Jan 2023]**

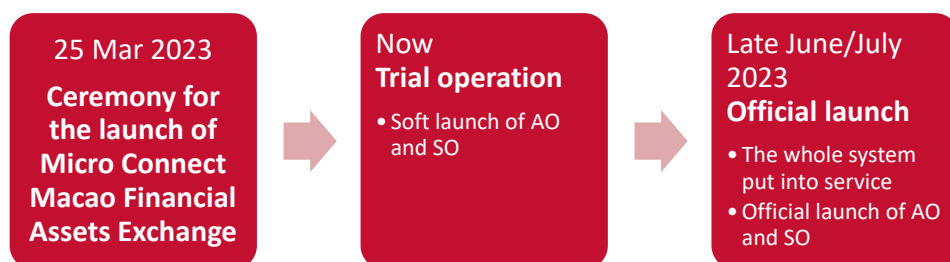
	MCCF	CSI 300	S&P China Bond
Volatility	3.6%	22.1%	7.9%
Sharpe ratio	3.05	-0.59	-1.48
Correlation of MCCF	N/A	0.01	0.20

Source: Presentation material of Micro Connect

*Micro Connect (Macao) Financial Assets Exchange – A marketplace to freely customise portfolio of DROs*

MCEX will begin trial operation from 25 Mar 2023. This is the world's first DRO exchange, which allows professional investors to invest an agreed portion of revenue flow over an agreed period of time.

**Exhibit 14. Expected schedule for the operation of MCEX**



Sources: Micro Connect, OP Research

The Exchange provides a highly efficient and transparent market platform that connects China's micro-economy with global capital, while offering new investment opportunities to global investors. In due course, the exchange plans to provide services related to the trading of other financial assets.

We understand the MCCF will transform into the Micro Connect Leadership Feeder Fund("Leadership Fund"). The Leadership Fund focuses on initial offerings of DROs and serves as a vetting mechanism as part of the listing process. The fund develops track records for investor disclosure (at least a 90-day tracking period) at subsequent AOs.

MCEX offers a complete new type of investment tool for the capital market to directly invest in China consumer sectors. The exchange is believed to accelerate the adoption of DRO and release the growth potential of small-and-micro economy.

## Appendix: About Micro Connect

Micro Connect is a new market infrastructure and financial technology platform that links global capital with China's small and micro businesses. The platform enables SMEs to access to capital market more easily at an affordable cost.

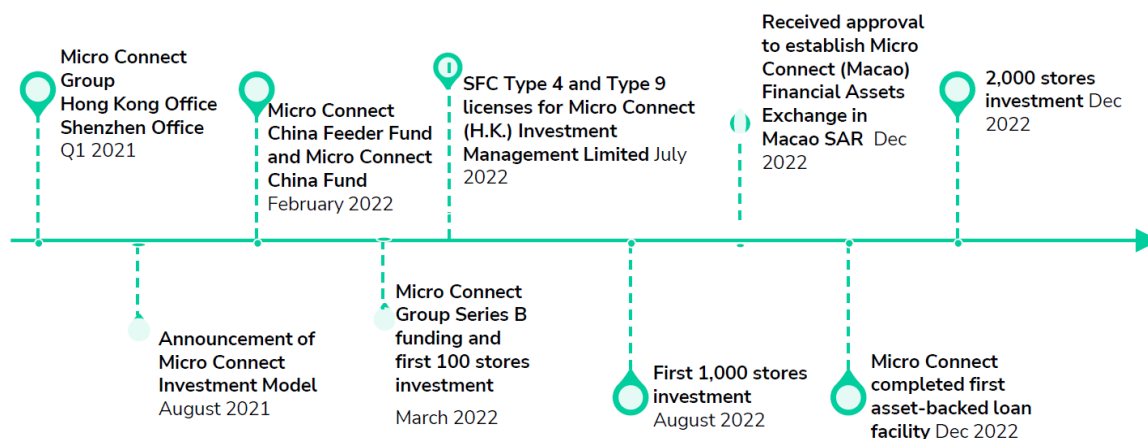
Micro Connect has created DRCs with enforcement of repayment ARMs. This allows Micro Connect and investors to collect investment returns in a secure way under China's digitalized economy.

### Exhibit 15. Micro Connect improves the financing access of small and micro enterprises



Source: Presentation material of Micro Connect

### Exhibit 16. Micro Connect's milestones



Source: Presentation material of Micro Connect

## Exhibit 17. Biographies of major management

Name	Position	Description
Mr. Charles Li	Founder and Group Chairman	<ul style="list-style-type: none"> <li>Market structure pioneer across asset classes</li> <li>Former Chief Executive at Hong Kong Exchanges and Clearing Limited(HKEX)</li> <li>Led the launch of Stock Connect, Bond Connect, HK Listing Reforms, LME Clear and acquisition of LME</li> <li>Served as Chairman at JPMorgan China and President at Merrill Lynch China prior to HKEX</li> </ul>
Mr. Gary Zhang	Founder and Group CEO	<ul style="list-style-type: none"> <li>Experienced cross border investment and asset management professional</li> <li>At the forefront of China's financial market reforms</li> <li>Founding Partner of Oriental Patron Financial Group, led the establishment of CSOP Asset Management</li> <li>Served in leadership roles with the PBOC Hainan Branch and Hainan Provincial Government prior to Oriental Patron</li> </ul>
Mr. Ramon Li	China CEO	<ul style="list-style-type: none"> <li>Leads Micro Connect's business expansions in China</li> <li>Served as COO at Tuhu , one of the China's leading auto aftermarket service providers</li> <li>Last served as Chief Development Officer at McDonald's China prior to joining Tuhu in 2019</li> </ul>

Sources: Micro Connect, OP Research

### Professional investment team.

Micro Connect has >160 professionals from >30 sectors. They are expertise in retail chain operations, investment, Fintech, physical stores, and major consumer industries.

## Exhibit 18. Micro Connect's professionals, where they from

ONSHORE (SHENZHEN)			OFFSHORE (HONG KONG)	
Business Development	Business Intelligence	Technology	Investor Relations	Portfolio Management
Real economy veterans with on-the-ground chain store opening experience	Experience in consumer industry business intelligence and analytics	Market infrastructure, fintech and platform development experience	Business development, capital markets and fundraising experience	Portfolio management, private equity and structured finance

Source: Presentation material of Micro Connect

### Fund raising

Micro Connect has received recognition and backing from global top-tier investors. In March 2022, it raised a USD 70mn Series B round from global top-tier investors.

## Exhibit 19. Micro Connect's Shareholders



Source: Presentation material of Micro Connect

## Micro Connect partners

### Exhibit 20. Micro Connect partners

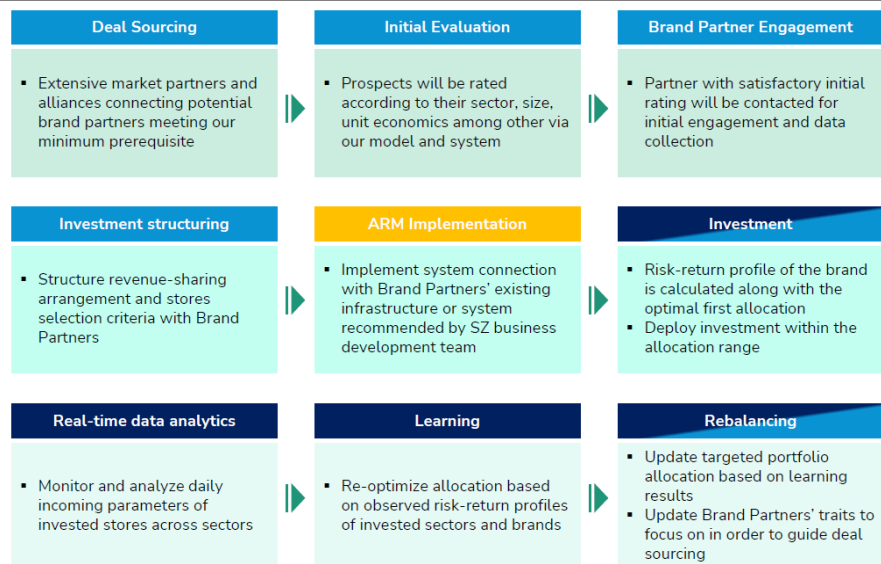


Sources: Micro Connect, Translated by OP Research

### Investment process

Micro Connect identifies brand partners (brands, chain stores, and franchises) as a feasible entry point to un-tap investment opportunities in the small and micro economy in China. Micro Connect leverages brand partners to achieve scale (they may have hundreds of small businesses), improve investment quality, and minimize payment risk with the enforcement of ARMs.

#### Exhibit 21. Investment process of Micro Connect



Source: Presentation material of Micro Connect

#### Micro Connect will not invest in companies with the following problems

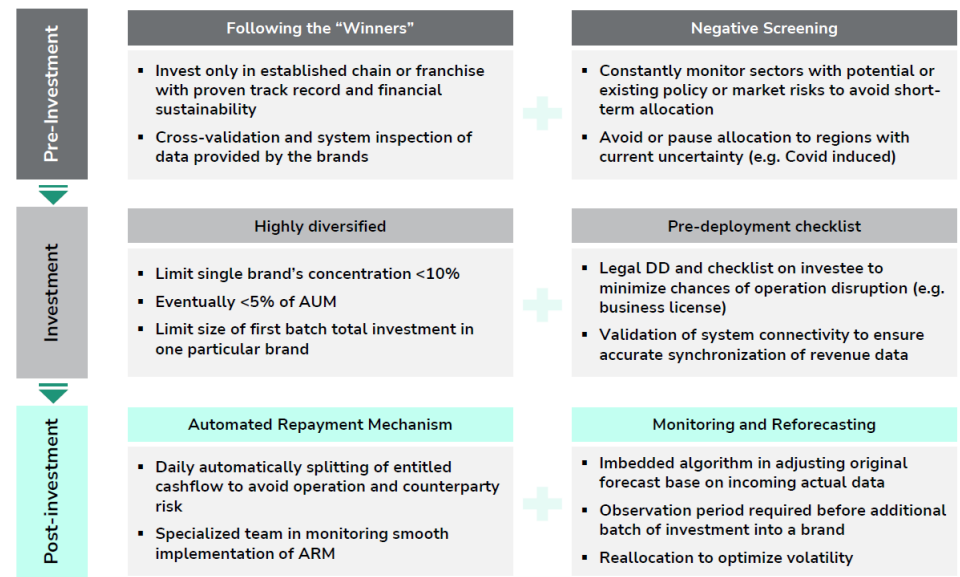
1. Falsification of data.
2. No strict control on franchised stores.
3. No dispute/ litigation risk.
4. Operating performance does not match with the modeling prediction.

#### Exhibit 22. How Micro Connect identifies investment opportunities of grassroots economy

Revenue/ system	<ol style="list-style-type: none"> <li>1. Micro Connect has full authority to monitor revenue data</li> <li>2. The invested companies must have a revenue recognition system, rules, and they must have complete revenue data. The system can directly export the operating data.</li> <li>3. It is a plus if the store/brand has self-developed IT systems.</li> </ol>
Compliance	<ol style="list-style-type: none"> <li>1. Relevant qualifications for different part of operation</li> <li>2. For franchise stores, it must have filed the relevant franchise licenses.</li> <li>3. The store must have a clear management system for accounts received in advance that complies with the regulations of the central and local governments.</li> </ol>
Business	<ol style="list-style-type: none"> <li>1. The invested brand must be established for more than 2 years</li> <li>2. The invested retail brand must have more than 10 stores, more is preferred.</li> <li>3. Micro Connect prefers to invest in brands and stores with which it has had previous cooperation.</li> </ol>
Revenue model	<ol style="list-style-type: none"> <li>1. Preferred investment amount for each invested store: between RMB200,000- RMB 2 mn</li> <li>2. % of capital funded by Micro Connect : At most 50%</li> <li>3. The revenue sharing period is shorter than the store leasing period</li> </ol>

Sources: Micro Connect, OP Research

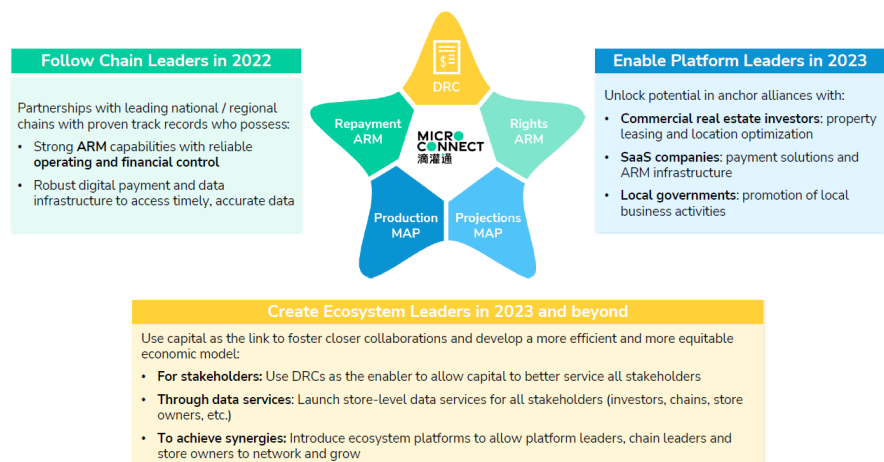
### Exhibit 23. Micro Connect's risk management system



Source: Presentation material of Micro Connect

### Micro Connect vision

### Exhibit 24. Micro Connect adopts a three pronged approach in our "Follow the Winners" strategy.



Source: Presentation material of Micro Connect



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<b>Buy (B)</b>	We expect this stock outperform the relevant benchmark greater than 15% over the next 12 months.
<b>Hold (H)</b>	We expect this stock to perform in line with the relevant benchmark over the next 12 months.
<b>Sell (S)</b>	We expect this stock to underperform the relevant benchmark greater than 15% over the next 12 month.
<b>Relevant Benchmark</b>	Represents the stock closing price as at the date quoted in this report.

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