SMARTCAP VENTURE CAPITAL FUND

Annual Report 2022

SMARTCAP VENTURE CAPITAL FUND
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Beginning of the financial year	1 January 2022
End of the financial year	31 December 2022

Name of the Fund	SmartCap Venture Capital Fund
Management company	AS SmartCap
Fund manager	Sille Pettai

Type and principal activity of the Fund	A common closed-ended alternative investment fund whose assets are invested in Estonian-focused venture capital funds that develop innovative Estonian companies with international growth potential or in international venture capital funds that have a significant component that adds value to the Estonian ecosystem of innovative companies with international growth potential, therethrough supporting changes that help modernise the Estonian economy and develop the local capital market.

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Management report

SmartCap Venture Capital Fund (hereinafter the Venture Capital Fund) is a common closed-ended alternative investment fund that is managed by AS SmartCap (hereinafter SmartCap), a small fund management company operating under the authorisation issued by the Estonian Financial Supervision Authority. The assets of the Venture Capital Fund are invested in Estonian-focused venture capital funds that develop innovative Estonian companies with international growth potential or in international venture capital funds that have a significant component that adds value to the Estonian ecosystem of innovative companies with international growth potential, therethrough supporting changes that help modernise the Estonian economy and develop the local capital market.

As at 31 December 2022, the volume of assets of the Venture Capital Fund amounted to 92 million euros (Figure 1) and the investment portfolio of the Venture Capital Fund included four Estonian-focused early-stage venture capital funds. As at the end of 2022, investments of the Venture Capital Fund had reached, through venture capital funds and direct investments, in total approximately 117 companies whose total turnover in 2022 exceeded for the first time one billion euros, amounting to 1.32 billion euros. As at the end of the year, these companies provided jobs to almost 3,200 people in Estonia, on whose remuneration labour taxes were paid in the amount of approximately 70 million euros during the year.

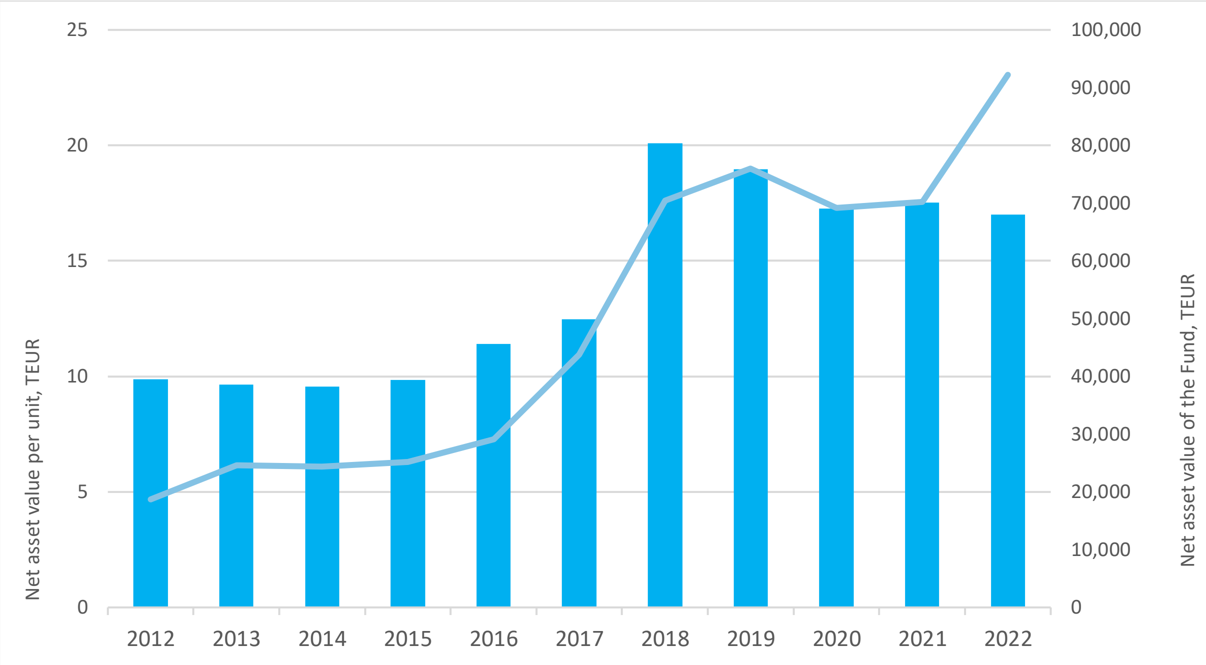

Figure 1. Dynamics of the net asset value of the Venture Capital Fund as from its foundation

In 2022, the principal activities were:

- The Venture Capital Fund completed making an investment in the Superangel Two venture capital fund.
- Discussions with the State on allocating additional capital for financing new investment programmes of SmartCap.

The Venture Capital Fund invested 15 million euros in the Superangel Two venture capital fund, which was selected in a call carried out earlier in order to find a private fund management company for a venture capital fund that will be established and will focus on high-tech companies.

SmartCap also continued its negotiations with the State in order to create new opportunities for making venture capital investments and improving financing opportunities. Part of the new financing of the Venture Capital Fund is related to the agreement signed in June 2022 by 22 NATO member states, pursuant to which a NATO's billion euro Innovation Fund will be established for developing civil and military-use deep technologies. The Estonian State has decided to invest nearly 30 million euros in the NATO Innovation Fund, and this investment will be made through SmartCap Venture Capital Fund.

The assets of the Venture Capital Fund are invested based on the fund of funds model in early-stage investment funds whose objectives and investment policy are suitable for the investment principles of the Venture Capital Fund. In 2023, SmartCap plans to complete its investment in the NATO Innovation Fund. SmartCap is also making preparations for launching new venture capital investments and financing opportunities.

ENVIRONMENTAL INFORMATION

The assets of the Venture Capital Fund are invested following the principles of responsible investment. This means that investment decisions are adopted taking into account sustainability, i.e. environmental, social and corporate governance, risks. As the Venture Capital Fund operates on the basis of the fund of funds model and is not directly open to the target companies, the sustainability impact of the Venture Capital Fund is only reflected through investments in other funds. In order to reduce the sustainability risk, risk considerations are embedded in the investment decisions of the Venture Capital Fund – the Venture Capital Fund will only invest assets in funds that also understand and integrate responsible investment principles into their own operations. In the case of the investment, which was included in the portfolio in 2022, account was taken of the sustainability risk and the corresponding management company was required to set up a responsible investment management system to address sustainability risks at the level of target companies.

Signatures of management board of management company to annual report of SmartCap Venture Capital Fund for 2022

The management board of SmartCap has prepared the annual report of SmartCap Venture Capital Fund for 2022, which consists of the management report and the financial statements (incl. notes thereto) to which the sworn auditor's report has been appended.

/digitally signed/

Sille Pettai

AS SmartCap

Fund Manager

Member of Management Board

/digitally signed/

Mari Vavulski

AS SmartCap

Member of Management Board

Tallinn, 19 May 2023

Financial statements

Statement of financial position

(in euros)

	Note	31.12.2022	31.12.2021
ASSETS			
Cash and cash equivalents	5	40,425,898	15,733,690
Financial investments at fair value with changes through profit or loss	6	51,990,789	54,474,597
Accrued income	10	24,630	0
TOTAL ASSETS		**92,441,317**	**70,208,287**
LIABILITIES			
Short-term liabilities			
Payables and prepayments	7	220,484	180,861
Total short-term liabilities		**220,484**	**180,861**
TOTAL LIABILITIES		**220,484**	**180,861**
Net asset value of the Fund attributable to unit-holders	**9**	**92,220,833**	**70,027,426**

› The notes on pages 11 to 29 are an integral part of these financial statements.

Income and expense statement

(in euros)

	Note	2022	2021
INCOME			
Interest income		55,277	18,502
Dividends		361,270	17,306
Realised profit/loss on sale of financial assets		340,135	0
Net profit/loss on financial assets and liabilities recognised at fair value through profit or loss	6	– 2,748,348	1,551,493
Total income		**– 1,991,666**	**1,587,301**
EXPENSES			
Management fees	7, 8, 10	– 765,004	– 684,846
Other expenses	8	– 49,923	– 42,847
Operating expenses	**8**	**– 814,927**	**– 727,693**
PROFIT/LOSS OF THE FUND		**– 2,806,593**	**859,608**

› The notes on pages 11 to 29 are an integral part of these financial statements.

Statement of changes in net asset value of Fund

(in euros)

	2022	2021
Net asset value of the Fund at the beginning of the reporting period	**70,027,426**	**69,167,818**
Cash received from subscription of units	25,000,000	0
Profit/loss of the Fund	− 2,806,593	859,608
Net asset value of the Fund at the end of the reporting period	**92,220,833**	**70,027,426**
Number of units outstanding at the end of the reporting period	5422.495	4003.779
Net asset value per unit at the end of the reporting period	17,007.0849	17,490.3324

› The notes on pages 11 to 29 are an integral part of these financial statements.

Statement of cash flows

(in euros)

	Note	2022	2021
Cash flows from Fund's operating activities			
Administrative and other operating expenses paid		– 775,305	– 732,816
Capital calls paid	6	– 663,654	– 1,291,501
Capital returned		739,250	0
Inflows and outflows of term deposits		0	12,000,000
Interest received		30,647	19,518
Dividends		361,270	17,306
Total cash flows from Fund's operating activities		– **307,792**	**10,012,507**
Cash flows from Fund's financing activities			
Received from issue of units	10	25,000,000	0
Total cash flows from Fund's financing activities		**25,000,000**	**0**
TOTAL CASH FLOWS		**24,692,208**	**10,012,507**
Cash and cash equivalents at the beginning of the period	**5**	**15,733,690**	**5,721,183**
Change in cash and cash equivalents		24,692,208	10,012,507
Cash and cash equivalents at the end of the period	**5**	**40,425,898**	**15,733,690**

› The notes on pages 11 to 29 are an integral part of these financial statements.

Notes to financial statements

Note 1. General information

Established on 20 February 2012, SmartCap Venture Capital Fund (hereinafter also the Venture Capital Fund) is a closed-ended non-public common investment fund (alternative fund). The Venture Capital Fund is comprised of money raised through issue of units and other assets received from investing such money, owned collectively by investors and managed by management company SmartCap, registered office at Sepise 7, Tallinn. Supervision over the Venture Capital Fund is exercised by the Estonian Financial Supervision Authority.

The financial year of the Fund begins on 1 January and ends on 31 December. The financial statements have been prepared in euros.

Note 2. Summary of significant accounting and reporting policies

A summary of significant accounting and reporting policies applied in the preparation of these financial statements is set out below. These accounting and reporting policies have been consistently applied to all the reporting periods, unless otherwise stated.

2.1. Fundamentals of accounting

The financial statements of the Venture Capital Fund have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the European Union (IFRS EU). The financial reporting policies of investment funds have been provided for in the Investment Funds Act and in the Accounting Act. The financial statements have been prepared taking into account the procedure for establishment of the net asset value of the Fund as established by AS SmartCap.

Management judgments and estimates

The preparation of financial statements in accordance with the International Financial Reporting Standards (IFRS EU) requires the management to make estimates, judgments and assumptions that affect the balances of income, expenses, assets and liabilities and presentation of contingent assets and liabilities as at the reporting date. Estimates and related assumptions are based on past experience and various other factors which are considered reasonable under the circumstances. Based on the results obtained, judgments are made about the carrying amounts of assets and liabilities that are not apparent from other sources. Although these estimates have been made to the best knowledge of the management, the subsequent actual result may differ from the assumptions made. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that reporting year or in the year of the revision and next years if the revision affects both current and future reporting years. Those areas requiring more complex estimates and where accounting estimates and assumptions made have a significant impact on the information recognised in the financial statements are disclosed separately in Note 4.

2.2 New or revised standards and interpretations

Effective revised standards

The new standards, interpretations and revisions effective for the reporting period that began on 1 January 2022 have no material impact on the financial statements of the Venture Capital Fund for the reporting period ended on 31 December 2022.

Certain new or revised standards and interpretations have been issued that are mandatory for the annual periods of the Venture Capital Fund beginning on or after 1 January 2023, and which the Venture Capital Fund has not early adopted:

Amendments to IAS 1 *Presentation of Financial Statements*
(Effective for annual periods beginning on or after 1 January 2023; to be applied retrospectively. Early application is permitted.)

The amendments clarify that the classification of liabilities as current or non-current is based solely on the entity's right to defer settlement at the end of the reporting period. The company's right to defer settlement for at least 12 months from the reporting date need not be unconditional but must have substance. The classification is not affected by management's intentions or expectations about whether and when the entity will exercise its right. The amendments also clarify the situations that are considered settlement of a liability. The Venture Capital Fund does not expect the amendments to have a material impact on its financial statements when initially applied.

Amendments to IAS 1 *Presentation of Financial Statements* and IFRS Practice Statement 2 *Making Materiality Judgements*
(Effective for annual periods beginning on or after 1 January 2023. Early application is permitted.)

The amendments to IAS 1 aim to help entities provide accounting policy disclosures that are more useful by:

- requiring companies to disclose their material accounting policies rather than their significant accounting policies;
- clarifying that accounting policies related to immaterial transactions, other events or conditions are themselves immaterial and as such need not be disclosed; and
- clarifying that not all accounting policies that relate to material transactions, other events or conditions are themselves material to a company's financial statements.

The Board also amended IFRS Practice Statement 2 to include guidance and two additional examples on the application of materiality to accounting policy disclosures.

The amendments are consistent with the refined definition of material:

“Accounting policy information is material if, when considered together with other information included in an entity’s financial statements, it can reasonably be expected to influence decisions that the primary users of general purpose financial statements make on the basis of those financial statements”.

The Venture Capital Fund does not expect the amendments to have a material impact on its financial statements when initially applied.

Amendments to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
(Effective for annual periods beginning on or after 1 January 2023; to be applied prospectively. Early application is permitted.)

The amendments introduce a new definition for accounting estimates: clarifying that they are monetary amounts in the financial statements that are subject to measurement uncertainty. The amendments also clarify the relationship between accounting policies and accounting estimates by specifying that a company develops an accounting estimate to achieve the objective set out by an accounting policy.

The amendments are not expected to have a material impact on the Venture Capital Fund as these amendments provide guidance in determining whether changes are to be treated as changes in estimates, changes in policies, or errors.

Amendments to IAS 12 *Income Taxes*
(Effective for annual periods beginning on or after 1 January 2023. Early application is permitted.)

The amendments clarify the accounting for deferred tax on transactions that involve recognising both an asset and a liability with a single tax treatment related to both. The amendments narrow the scope of the initial recognition exemption (IRE) so that it does not apply to transactions that give rise to equal and offsetting temporary differences. As a result, companies will need to recognise a deferred tax asset and a deferred tax liability for temporary differences arising on initial recognition of a lease and a decommissioning provision.

The Venture Capital Fund does not expect the amendments to have a material impact on its financial statements when initially applied.

Amendments to IAS 1 *Classification of Liabilities as Current or Non-current – Deferral of Effective Date*
(Effective for annual periods beginning on or after 1 January 2023. These amendments are not yet endorsed by the EU.)

The amendments to IAS 1 on the classification of liabilities as current or non-current were issued in January 2020 with an original effective data of 1 January 2022. However, in response to the COVID-19 pandemic, the effective date was deferred by one year to provide companies with more time to implement the classification changes resulting from the amended guidance.

The Venture Capital Fund does not expect the amendments to have a material impact on its financial statements when initially applied.

Amendments to IFRS 16 *Leases: Lease Liability in a Sale and Leaseback*
(Effective for annual periods beginning on or after 1 January 2024; to be applied retrospectively to the date when the entity initially applied IFRS 16. Early application is permitted. These amendments are not yet endorsed by the EU.)

Amendments to IFRS 16 *Leases* impact how a seller-lessee accounts for variable lease payments that arise in a sale-and-leaseback transaction. The amendments introduce a new accounting model for variable payments.

The amendments confirm the following:

- On initial recognition, the seller-lessee includes variable lease payments when it measures a lease liability arising from a sale-and-leaseback transaction.
- After initial recognition, the seller-lessee applies the general requirements for subsequent accounting of the lease liability such that it recognises no gain or loss relating to the right of use it retains.

A seller-lessee may adopt different approaches that satisfy the new requirements on subsequent measurement.

The Venture Capital Fund does not expect the amendments to have a material impact on its financial statements when initially applied.

<u>Other amendments</u>

Other new standards, amendments to standards and interpretations that are not yet effective are not expected to have a significant impact on the financial statements of the Venture Capital Fund.

2.3. Recognition of foreign currency transactions

The functional currency of the Fund is the euro. The presentation currency of the financial statements of the Venture Capital Fund is also the euro.

Foreign currency transactions are recognised on the basis of the official exchange rates quoted by the European Central Bank on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are revalued in the functional currency on the balance sheet date on the basis of the exchange rates quoted by the European Central Bank on the balance sheet date. Exchange gains and losses resulting from the revaluation are recognised in the income and expense statement of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies, which are measured at fair value, are revalued in the functional currency on the basis of the exchange rates quoted by the European Central Bank on the day when the fair value was determined.

2.4. Financial assets

2.4.1. Classification

The financial assets of the Venture Capital Fund are classified into the following categories:

- At fair value with changes through profit or loss
  The Venture Capital Fund recognises venture capital investments in venture capital funds (hereinafter financial investments) at fair value with changes through profit or loss.
- At amortised cost
  The financial assets the purpose of which is to hold financial assets for collecting contract-based cash flows and the contractual terms of which give rise on specified dates to cash flows that are solely payments of principal and interest (SPPI) on the principal amount outstanding are recognised at amortised cost. The following financial assets are recognised in this category: “Cash and cash equivalents”, “Term deposits” and “Other short-term receivables”.

The classification of financial assets is based on the business model for managing the financial asset and the contractual cash flow characteristics of the financial asset. The category of a financial asset is determined by the fund manager upon the initial recognition of the financial asset.

2.4.2. Recognition and measurement

Regular purchases and sales of financial assets are recognised and derecognised, as applicable, using trade date accounting. The Venture Capital Fund derecognises financial assets when the contractual rights to receive cash flows from the financial assets have expired or have been transferred and a significant part of the risks and rewards of ownership related to the financial assets have also transferred.

(a) Financial assets recognised at amortised cost

Financial assets of this category are initially recognised at fair value plus transaction costs. Subsequently, they are recognised at amortised cost using the effective interest rate. Interest income from loans and receivables is recognised in the income and expense statement under “Interest income”.

(b) Financial investments

The financial assets recognised at fair value with changes through profit or loss are initially recognised at fair value and the transaction costs attributable to acquisition are recognised as expenses in the income and expense statement. Subsequently, the financial assets recognised at fair value with changes through profit or loss are recognised at fair value. Changes in fair value are recognised in the income and expense statement under “Profit/loss on financial assets at fair value with changes through profit or loss” in the period when they occur.

In the case of investees, AS SmartCap assesses whether the Venture Capital Fund has a significant influence over the investee. Significant influence is generally presumed to exist when the Venture Capital Fund owns 20% to 50% of the voting shares in the company.

In exceptional circumstances, significant influence may also exist if the share is less than 20%. The existence of significant influence is usually characterised by the following factors:

(a) membership in the executive management or senior management body of the investee;

(b) power to participate in the operating policy decisions of the investee;

(c) major transactions between the investor and the investee;

(d) partial overlapping of managements of the investor and the investee;

(e) exchange of technical information between the investor and the investee.

Investments in associates are recognised similarly to other investees at fair value with changes through profit or loss in accordance with the exception concerning the recognition of associates in the financial statements of venture capital companies as set out in IAS 28 *Investments in Associates*. An investment in an associate is initially recognised at fair value and the transaction costs attributable to acquisition are recognised as expenses in the income and expense statement.

2.5. Netting

Financial assets and financial liabilities are offset and presented net in the balance sheet only if the Venture Capital Fund has a legally enforceable right and an intention to settle on a net basis or realise the assets and liabilities simultaneously. The Venture Capital Fund has not applied netting of assets and liabilities during the reporting period or comparative period.

2.6. Cash and cash equivalents

Cash and cash equivalents in the balance sheet and statement of cash flows include balances of current accounts (excluding overdraft), balances of overnight deposits, term deposits of up to three months and investments in money market funds and other highly liquid funds, provided that the Venture Capital Fund invests in financial assets that comply with the definition of cash and cash equivalents.

Interest earned on the balance of the current account and on deposits is recognised in the income and expense statement under “Interest income”.

2.7. Receivables and prepayments

Short-term receivables are recognised at amortised cost. The amortised cost of short-term receivables is generally equal to their nominal value (less any refunds received or write-downs made), due to which short-term receivables are recognised in the balance sheet in the amount that is likely to be received. In order to calculate the amortised cost of long-term financial assets, the financial assets are initially recognised at fair value of the consideration to be received, and in subsequent periods interest income is calculated using the effective interest rate method.

2.8. Impairment of financial assets

If the Venture Capital Fund has financial assets that are not recognised at their fair value with changes through profit or loss, it is assessed at each reporting date whether there are any indications to impairment compared to the carrying amount of the assets. The following may indicate impairment of financial assets:

- financial difficulties of issuer, indications to the possible bankruptcy of the issuer;
- default of interest or principal payments or late payment by the issuer;
- disappearance of an active market of the financial asset;
- other significant events that may indicate impairment.

The impairment requirements are based on the expected credit loss model. The carrying amount of an asset is reduced by the expected credit loss. The loss is recognised in the income and expense statement. The assessment of the expected credit loss is unbiased and probability-weighted and incorporates all available information which is relevant to the assessment. Upon impairment of financial assets, interest income from the assets continues to be recognised in the same way. If the expected credit loss on impairment of assets reduces and the reduction can be objectively related to an event occurring after the impairment was recognised, the impairment loss recognised before is reversed.

2.9. Accrued income

Accrued income includes accrued but unearned income, incl. interest.

2.10. Financial liabilities

All financial liabilities (trade creditors, accrued expenses and other short-term and long-term payables) are recognised at amortised cost. The amortised cost of short-term financial liabilities is generally equal to their nominal value, due to which short-term financial liabilities are recognised in the balance sheet in the amount subject to payment. In order to calculate the amortised cost of long-term financial liabilities, they are initially recognised at fair value of the consideration received (less any transaction costs), taking into account the interest expenses to be incurred on the liabilities in subsequent periods, using the effective interest method.

A financial liability is classified as short-term if its payment term is within twelve months as of the balance sheet date or if the Venture Capital Fund has no unconditional right to postpone the payment of the liability for more than 12 months after the balance sheet date or if the lender had the right to recall the financial liability on the balance sheet date due to a breach of the terms and conditions provided for in the loan agreement.

2.11. Transactions with related parties

Upon preparation of the interim financial statements, the following are deemed related parties: associates, SmartCap and its executive and senior management as well as other persons and undertakings who can control or significantly influence the financial and business decisions of the Venture Capital Fund. As the units of the Venture Capital Fund are fully owned by the Republic of Estonia, related parties of the Venture Capital Fund are also deemed to include entities under the control or significant influence of the State.

2.12. Income

› Interest income

Interest income is recognised if the receipt of the income is likely and the amount of the income can be reliably measured. Interest income is recognised using the effective interest rate of assets unless the receipt of interest is uncertain. In the latter case, interest income is accounted for on a cash basis.

2.13. Calculation of net asset value of the Venture Capital Fund

The net asset value of the Venture Capital Fund is established in accordance with the Investment Funds Act, the internal rules of procedure of SmartCap and the rules of the Venture Capital Fund.

The net asset value (NAV) of the Venture Capital Fund is determined by calculating the market value of the total assets of the Venture Capital Fund and deducting therefrom the liabilities of the Venture Capital Fund. The net asset value per unit is calculated by dividing the total net asset value by the number of units outstanding.

2.14. Fund units

The Venture Capital Fund has issued one class of units that give the unit-holder the right to a pro rata share of the net assets of the Venture Capital Fund upon liquidation of the Venture Capital Fund. The units entail no other contractual obligations other than redemption thereof upon liquidation of the Venture Capital Fund. The units are recognised under equity because the following criteria of IAS 32 are met:

- the units entitle the holder to receive a pro rata share of the net assets (i.e. of the total net asset value) of the Venture Capital Fund upon liquidation of the Venture Capital Fund. The net asset value of the Venture Capital Fund is calculated by deducting the liabilities of the Venture Capital Fund from the market value of the assets of the Venture Capital Fund. A pro rata share is calculated as follows: the total net asset value of the Venture Capital Fund is divided by the number of all the units issued and the amount received is multiplied by the number of the units held by each unit-holder;
- the units are subordinate to all other debt or other instruments issued by the Venture Capital Fund;
- the rights attaching to all units (incl. the right to receive consideration according to the pro rata share in the net assets) are identical;
- The Venture Capital Fund has no other financial instruments or contracts the cash flows attributable to which are based substantially on the profit, the changes in the net assets or the change in the fair value of the net assets recognised in/off the balance sheet, as a result of which the return of unit-holders would be substantially restricted or fixed.

If the terms and conditions related to units change so that the criteria listed above are no longer met, the units will be classified into financial liabilities as of the day when these terms and conditions are no longer met. A financial liability is recognised at fair value of the transaction date. If there is a difference between the carrying amount of an equity instrument and the fair value of a liability, the difference is recognised in equity.

Direct expenses related to the issue of new units are recognised in equity as a reduction of the amount paid for the units. If the Venture Capital Fund redeems its own units, the equity belonging to unit-holders is reduced by the consideration received less expenses directly attributable to the sale.

2.15. Events after the reporting date

No material circumstances have occurred between the reporting date of 31 December 2022 and the date of preparation of the financial statements that would affect the valuation of assets and liabilities in the financial statements or transactions conducted in previous periods.

Note 3. Risk management

SmartCap has adopted risk management rules which establish the principles, organisation and organisational structure of risk management in SmartCap. The risk management framework maps the risks associated with investing activities and determines the risks and the extent thereof that the company is ready to take in order to achieve the objectives of the Venture Capital Fund.

The Venture Capital Fund is an early-stage venture capital fund and the investments that it makes are inherently of a high risk level and arise from:

- early stage of development of investees (start-ups), due to which their business models and revenue generation capacity have not yet been proved and therefore several investees may experience a failure in their business activities;
- concentration of investments of a similarly high risk level in the Venture Capital Fund;
- low level of liquidity of long-term non-tradable instruments in the investment portfolio, due to which the moment of exit from such an investment may have a significant impact on the return on investments and the return of the Venture Capital Fund in its entirety.

The general risk associated with the Venture Capital Fund from the point of view of the activities of SmartCap is the fall of the volume of assets of the Venture Capital Fund to a critical level, which makes the management of the Venture Capital Fund economically unreasonably expensive, and/or a lower than expected return on invested capital, due to which a unit-holder of the Venture Capital Fund does not receive the return that they expected on their investment or, in the worst-case scenario, does not earn back even the capital that they invested.

In order to mitigate risks, an in-depth analysis of the potential investees of the Venture Capital Fund is performed before an investment is made. Risks of the Venture Capital Fund are managed by subjecting the risk profile to an annual review, approval by the supervisory board and constant monitoring.

For the purpose of spreading risks, the rules of the Venture Capital Fund have established restrictions on investing assets of the Venture Capital Fund in respect of the volume of assets thereof in order to (i) prevent a significant negative impact that may result from the materialisation of an individual investment risk on one hand and (ii) ensure that there is a sufficient number of investees in the Venture Capital Fund that is needed to generate the required revenue on the other hand.

Upon investing capital and managing investments of the Venture Capital Fund, SmartCap takes into account the following specific risks associated with the investments of the Venture Capital Fund:

- **Investment risk** – the risk that the value of an investment may change negatively due to circumstances related to the issuer, including due to environmental, social or corporate governance circumstances (i.e. due to the sustainability risk). The term "issuer" also covers the persons who have established an investee, issued securities of an investee or otherwise have control over an investee, which is not a security pursuant to the law in force, but in which the Venture Capital Fund has invested.

- **Strategic risk** – the risk that a loss may be incurred due to unfeasibility or incomplete realisation of the investment policy of the Venture Capital Fund or the impact of competition, the operating environment or supervision.

- **Market risk** – the risk that the value of an investee of the Venture Capital Fund may fall due to unfavourable changes on the market.

- **Concentration risk** – the risk that the value of investments of the Venture Capital Fund may fall for the reason that the Venture Capital Fund is excessively dependent on a group or source of certain risk factors.

- **Counterparty risk (incl. credit risk)** – the risk that the party who has financial or other obligations in respect of the Venture Capital Fund fails to perform their corresponding obligations or becomes insolvent.

- **Operational risk** – the risk that the Venture Capital Fund incurs direct or indirect losses from the inadequacy of the activities of the employees, processes or systems, the fact that they are not functioning as expected, or external events.[1]

- **Reputational risk** – the risk that negative public attention to the Venture Capital Fund (or SmartCap), irrespective of whether it is warranted, damages the activities of SmartCap due to loss of investments; loss of partners, business or other operating opportunities; emergence of legal or other additional expenses; difficulties in finding employees or another similar circumstance. Reputational risk usually materialises as a result of other risks (e.g. operational or strategic risk).

- **Liquidity risk** – the risk that the Venture Capital Fund is unable to perform its contractual obligations when due and this arises from differences between the due dates of assets and liabilities.

SmartCap views the levels of investment risk, market risk and concentration risk as relatively high due to the specificity of the investments of the Venture Capital Fund. SmartCap does not aim to avoid those risks but rather to manage them appropriately and actively.

[1] The exact content of operational risk is defined pursuant to Annexes 1 and 2 to the advisory guideline of the Financial Supervision Authority "Requirements regarding the arrangement of operational risk management". Said guideline is accessible online at: https://www.fi.ee/et/juhendid/pangandus-ja-krediit/nouded-operatsiooniriski-juhtimise-korraldamiseks.

In order to mitigate the investment risk, co-investors are involved in all investments of the Venture Capital Fund to ensure that investments are made under market conditions. The activities of the issuers of the securities (or of assets other than securities) forming part of the assets of the Venture Capital Fund are constantly subjected to an additional analysis and monitoring. Investment-related decisions are made on the basis of adequate and relevant information, collecting to this end the required amount of information and analysing it in proper detail from the economic, financial and legal point of view. Where necessary and possible, the representatives of SmartCap are members of the issuer's supervisory board or other body and participate in the work of such body for the purpose of additional management of the investment risk.

The sustainability risk of the Venture Capital Fund manifests itself through investments in other investment funds. In order to manage a possible negative social or corporate governance sustainability risk, the Venture Capital Fund only makes investments in such investment funds that have adequate investment management systems in place (incl. do not breach employee-related rights, are not engaged in money laundering, corruption or financial offences, and do not otherwise apply unethical or unprofessional governance practices). The sustainability risk of the Venture Capital Fund can manifest itself through the investing activities of a sub-fund if sustainability due diligence obligations are not implemented in the course thereof or if they are not implemented in sufficient detail. In order to mitigate this sustainability risk, the circumstances related to this risk are taken into account when investment decisions are made. SmartCap is also an "active owner" to manage sustainability risks.

SmartCap mitigates the concentration risk by complying with the investment restrictions provided for in the rules of the Venture Capital Fund and other possible risk-spreading requirements. The concentration risk also reduces by successful implementation of the SmartCap strategy and raising additional capital to the Venture Capital Fund.

3.1. Market risk

Market risk is the risk that adverse changes in market prices, incl. in foreign exchange rates, interest rates and market prices of securities, result in losses for the Venture Capital Fund. As the investments of the Venture Capital Fund are made in securities that are not traded on an open market, the Venture Capital Fund is directly exposed to the market risk arising from its positions in securities only at the moment of acquisition thereof and exit therefrom and indirectly through revaluation, which takes into account intermediate investment rounds and the impacts of interest rate fluctuations on cash flow-based revaluation models. As the investment universe of the Venture Capital Fund is geographically limited to Estonia, the Fund is not directly exposed to the currency risk.

The market risk of the Venture Capital Fund is managed by subjecting the risk profile to an annual review, approval by the supervisory board and constant monitoring. In accordance with the risk profile, the Fund mitigates the potential negative impact of market prices on the long-term return by spreading investment and exit periods over time (spreading investments over years) and allowing for the extension of the investment and exit periods of fund investments already made.

As at 31 December 2022, the exposure of the Fund to the investment and exit risk was as follows (mln euros):

	31.12.2022	31.12.2021
Outstanding investment commitments	14,715,310	565,349
Exit stage investments at carrying amount	42,796,005	48,358,934

3.2. Credit risk

Credit risk is the risk that the counterparty is unable to perform its financial obligations to the Venture Capital Fund. The credit risk of the Venture Capital Fund arises from the cash and cash equivalents held in credit institutions as well as from debt instruments.

The credit risk of the Fund for 2022 was limited to just a few number of well-capitalised credit institutions registered in Estonia and to the national counterparty in the form of the State Treasury.

While in the first half of the year the Venture Capital Fund still held a large part of its liquid assets in the State Treasury, the more favourable interest rate environment led the Fund to move the majority of its funds to an overnight deposit in Swedbank AS by the end of the year.

As at 31 December 2022, the Venture Capital Fund had the following positions exposed to credit risk:

	31.12.2022	31.12.2021
Cash and cash equivalents	40,425,898	15,733,690
Other receivables	24,629	0
Total position exposed to credit risk	**40,450,527**	**15,733,690**

The Venture Capital Fund deposits cash in current accounts and deposits with investment grade rating banks (Moody's rating Aa3 and Moody's rating Baa2) and at the State Treasury. The management board of the Venture Capital Fund is of the opinion that the position of cash and cash equivalents exposed to credit risk, which are held in credit institutions, carries a low credit risk.

	31.12.2022	31.12.2021
Aa3 to Aa1	40,415,898	477,790

A3 to A1	0	10,000,000
Baa1 to Baa3	10,000	5,255,900
Total	**40,425,898**	**15,733,690**

3.3. Liquidity risk

Liquidity risk is the risk that the Venture Capital Fund is unable to perform the investment commitments it has assumed. The liquidity risk of the Venture Capital Fund arises from fund or direct investment commitments.

In accordance with its risk profile, the Venture Capital Fund is required to hold at all times sufficient liquid assets to cover the investment commitments it has assumed. The Fund ensured the compliance of the required liquidity risk position with the risk profile through ongoing monitoring and quarterly reporting to the management board and supervisory board.

As at 31 December 2022, the Venture Capital Fund had assumed investment commitments in the amount of 15.8 mln euros (31 December 2021: 1.44 mln euros) and had liquid assets in the amount of 40.4 mln euros (31 December 2021: 15.7 mln euros).

3.4. Capital risk management

Capital is deemed to be the units of the Venture Capital Fund subscribed by an investor. Units are not redeemed at the request of an investor. Units are only redeemed upon liquidation of the Venture Capital Fund and a corresponding decision can be adopted by unit-holders.

All units of the Venture Capital Fund belong to the Republic of Estonia.

Upon liquidation of the Venture Capital Fund, it must be taken into account that the assets of the Venture Capital Fund are highly illiquid and therefore there is a high risk of maintaining the fair value of the assets in the course of the extraordinary liquidation process. The Venture Capital Fund is not leveraged by a loan.

3.5. Fair value of financial assets and liabilities

The fund manager estimates that the fair values of financial assets and liabilities recognised in the balance sheet at amortised cost do not materially differ from the carrying amounts recognised in the balance sheet. As the financial assets recognised at amortised cost are short-term and bear interest in respect of which no significant changes have occurred on the market between the day when the financial assets were recognised and the balance sheet date, then the carrying amount is estimated to be close to the fair value. As the financial liabilities are short-term, bear no interest and have been paid by the time the financial statements are approved, then their carrying amount is estimated to be close to their fair value.

The Venture Capital Fund divides financial investments into three levels depending on how their fair value is measured:

Level 1: Financial investments measured using unadjusted prices quoted at the stock exchange or another active regulated market;

Level 2: Financial instruments measured using valuation techniques based on observable inputs. This level includes, for instance, financial instruments measured using the prices of similar instruments on an active regulated market or financial instruments measured using the price on a regulated market but whose liquidity on the stock exchange is low.

Level 3: Financial instruments measured using valuation techniques based on non-observable inputs.

	Level 1	Level 2	Level 3	31.12.2022
Fund units	0	0	51,990,789	51,990,789
Total financial assets	**0**	**0**	**51,990,789**	**51,990,789**

	Level 1	Level 2	Level 3	31.12.2021
Fund units	0	0	54,474,597	54,474,597
Total financial assets	**0**	**0**	**54,474,597**	**54,474,597**

In accordance with the internal rules for establishment of the net asset value of the Venture Capital Fund, which have been approved by the management board of SmartCap:

- the value of cash and deposits is determined on the basis of their nominal value;
- the value of the interest on deposits that has been calculated on the accrual basis but has not been received is determined as accrued income;
- the fair value of a non-tradable security is determined in particular on the basis of the valuation techniques provided for in the IFRS and the valuation techniques set out in the International Private Equity and Venture Capital Valuation (IPEV) Guidelines, which may be:
    - the price of the last investment transaction;

- the discounted cash flow method;
- the net assets method;
- valuation based on multiple earnings.

› the value of a share or unit of an investment fond on the basis of its last known net asset value (NAV).

Cash and cash equivalents and term deposits that do not have a list price by a market participant and their value corresponds to the carrying amount are not included in this Note.

Accrued income and trade creditors are short-term, their fair value is close to the carrying amount and the measurement corresponds to level 2.

The Venture Capital Fund determines the fair value of units of non-tradable closed-end funds (level 3) using, above all, the NAV-based valuation and valuation based on multiple earnings. If, in the opinion of SmartCap, these methods do not reveal the fair value of the investment, other methods prescribed by international standards will be used.

Note 4. Significant accounting estimates

The financial statements have been prepared using various accounting estimates and assumptions that have an impact on the assets and liabilities recognised in the financial statements and on the off-balance sheet assets and contingent liabilities disclosed in the notes. Although these estimates have been made to the best knowledge of the management, they need not coincide with the subsequent actual result. Changes in the management estimates are included in the income and expense statement of the period in which the change occurred.

Estimates of the fair value of financial investments have the most significant impact on the financial information disclosed in these financial statements. As at the balance sheet date, long-term financial investments account for 56.2% of the volume of assets of the Venture Capital Fund (31 December 2021: 77.6% of the volume of assets of the Venture Capital Fund).

Note 5. Cash and equivalents

(in euros)

	31.12.2022	**31.12.2021**
Cash at bank	10,120	15,733,690

Funds in overnight deposit	40,415,778	0
Total cash and cash equivalents	**40,425,898**	**15,733,690**

As at 31 December 2022 and 31 December 2021, all the funds in the current account were denominated in euros.

Note 6. Financial investments at fair value with changes through profit or loss

(in euros)

	31.12.2022	**31.12.2021**
Carrying amount of holdings at the beginning of the reporting period	54,474,597	51,631,603
Total investments at fair value at the beginning of the reporting period	**54,474,597**	**51,631,603**
	31.12.2022	**31.12.2021**
Drawdowns	663,654	1,291,501
Revaluations of fair value of holdings/loans	– 2,748,348	1,551,493
Sale of holdings at cost	– 399,114	0
Total investments at fair value at the end of the reporting period	**51,990,789**	**54,474,597**

Note 7. Payables and prepayments

(in euros)

	31.12.2022	**31.12.2021**
Management fee (Notes 8, 10)	196,438	170,361
Other accrued expenses	24,046	10,500

Total payables and prepayments	**220,484**	**180,861**

All payables and prepayments are short-term.

Note 8. Operating expenses

(in euros)

	2022	2021
Management fee expenses of the Venture Capital Fund (Notes 7, 10)	765,004	684,846
Share maintenance fee	1,621	1,500
Other expenses	48,302	41,347
Total other operating expenses	**814,927**	**727,693**

Note 9. Units and statement of comparison of net asset value of Fund

Year	Net asset value of the Venture Capital Fund	Net asset value per unit of the Venture Capital Fund
31.12.2022	€92,220,833	17007.0849
31.12.2021	€70,027,426	17490.3324
31.12.2020	€69,167,818	17275.6335

Note 10. Transactions with related parties

The related parties of the Venture Capital Fund are:

- undertakings who are financial investees and over whom the Venture Capital Fund has a significant influence;

- SmartCap and its executive and senior management;
- close family members of the persons listed above and companies controlled by them or under their significant influence;
- the sole unit-holder of the Venture Capital Fund, i.e. the Republic of Estonia, and entities under the control or significant influence of the State.

In the period from 1 January 2022 to 31 December 2022, the Venture Capital Fund has not made any transactions, except for investment transactions, with the companies that are financial investees. Transactions with investees are disclosed in Note 6.

During the reporting period, 25 million euros (2021: 0 euros) were received from the Ministry of Economic Affairs and Communications for subscribing the fund units.

During the reporting period, the management fee has been calculated to SmartCap in the amount of 765,004 euros (2021: 684,846 euros). In addition, SmartCap was compensated for expenses in the amount of 17,161 euros (2021: 7,500 euros).

As at 31 December 2022: a receivable from the Estonian Business and Innovation Agency concerning the current account interest income not received in the amount of 24,630 euros (31 December 2021: 0 euros) has been recognised under accrued income.

As at 31 December 2022, the management fee payable by the Venture Capital Fund to SmartCap amounted to 196,438 euros (31 December 2021: 170,361 euros). The commission expenses payable to SmartCap amounted to 13,040 euros (31 December 2021: 0 euros).

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Independent Auditors' Report

(Translation of the Estonian original)

To the shareholders and management company of SmartCap Venture Capital Fund

Opinion

We have audited the financial statements of SmartCap Venture Capital (the Company), which comprise the statement of financial position as at 31 December 2022, the income and expense statement, the statements of cash flows and statement of changes in net asset value of Fund, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the financial statements presented on pages from 7 to 29 present fairly, in all material respects, the financial position of the Company as at 31 December 2022, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union.

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing (Estonia). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the Code of Ethics for Professional Accountants (Estonia) (including Independence Standards) and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Other Information

Management is responsible for the other information. The other information comprises the management report, but does not include the financial statements and our auditors' report thereon.

Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact. We have nothing to report in this regard.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditors' Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditors' report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with International Standards on Auditing (Estonia) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Standards on Auditing (Estonia), we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

KPMG Baltics OÜ

Licence No 17

/digitally signed/

Eero Kaup

Certified Public Accountant, Licence No. 459

Tallinn, 19 May 2023

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