

Market Consultation

on the investment programme for selecting defence
investment funds

SMART
CAP

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› MARKET CONSULTATION

AS SmartCap, a fund management company established under the laws of Estonia with registry code 12071991 (hereinafter **SmartCap**) intends to launch investment programme for selecting defence investment funds (hereinafter the **Programme**) in order to invest in **up to four** already operating or soon to be established **defence investment funds** (hereinafter the **Fund(s)**) managed by private fund managers (hereinafter the **Fund Manager(s)**), to which SmartCap Defence Fund managed by SmartCap (hereinafter the **Defence Fund**) and with total assets at the time of establishment of €100 million, would make an investment of **€5 to €20 million** per Fund (hereinafter the **Investment(s)**). The Programme shall remain open until the end of 2028, subject to availability of unallocated resources.

The principal purpose of the Investments are to develop the Estonian defence industry, contribute to innovation and economic growth, and create economic impact in Estonia, thereby generating market level return from the Investments. For this purpose, Investments shall be made into Funds that invest in enterprises producing or developing products and technologies either exclusively for military use or for dual-use with both civil and military use cases (hereinafter **Defence Companies**).

The intended principal terms for the Fund and the Investment are listed below (hereinafter the **Main Terms**). SmartCap invites interested parties to review and **provide feedback on the draft Main Terms**. The assessment criteria that will be used to evaluate the Funds and Fund Managers are also provided below for informational purposes. Please note that the final version of the Main Terms and the assessment criteria published in the Programme may differ, in part or in whole, from this draft version published for market consultation.

All comments should be sent no later than 8 November 2024 in English via e-mail to investments@smartcap.ee with a subject line “Investment programme for selecting defence investment funds - Market Consultation”

SmartCap will hold a **market consultation presentation on 31 October 2024** for parties potentially interested in participating in the Programme. Please contact SmartCap directly at the e-mail address provided above, if you are a potential fund manager and interested to register for the event. Registered participants will receive details of the event by e-mail.

MAIN TERMS

Subject	Term
Fund structure, composition	<p>The Fund shall be established as a limited partnership fund (<i>usaldusfond</i>) under the laws of Estonia or in a similar form (i.e., alternative investment fund) in another NATO member country, as acceptable for SmartCap, and in accordance with the best industry practices.</p> <p>The Fund Manager and all related entities (e.g., investment advisor, carried interest vehicle) shall be established in a NATO member country.</p> <p>The (a) team members or related entities of the Fund Manager, or (b) the partners or investors of the Fund shall not (i) be established or operating in, or (ii) their shareholders or investors (including the UBOs of such investors in case of legal entities) be the citizens of Russia, Belarus, Iran, or the Democratic People's Republic of Korea.</p>
Defence Fund Contribution	<p>5,000,000 to 20,000,000 euros (per Fund)</p> <p>SmartCap may, at its sole discretion, decrease or propose to the selected Fund Manager to increase the proposed commitment of Defence Fund, provided that the state aid requirements described below continue to be met.</p>
Independent Private Investor Contribution	<p>The expected aggregate amount of finance to be attracted from independent private investors at the level of the Fund shall be indicated by potential Fund Managers in their investment proposals. For the avoidance of doubt, neither the SmartCap Defence Fund, the Fund Manager nor persons or entities directly or indirectly associated with the Fund Manager shall be considered an independent private investor.</p>
Fund size	<p>Fund Managers are invited to propose the minimum, target and maximum Fund size in their investment proposal.</p>
State aid	<p>No state aid, <i>pari passu</i> investment (i.e., at least 30% Independent Private Investor Contribution which is invested at the same time and under the same terms as Defence Fund Contribution) and Distribution Cascade.</p>
Financial Commitment of the Team	<p>At least 2% of the Fund size. Fund Managers should include proposals in their investment proposal in relation to the level of the Financial Commitment of the Team (which must include all Key Executives) to the Fund.</p>
Initial Closing	<p>Initial Closing of the Fund should take place when the proposed minimum Fund size is achieved. Initial Closing of the Fund is expected to take place within 6</p>

	months from signing the Defence Fund Contribution, unless extended with the prior written approval of SmartCap.
Final Closing	Fund Managers are invited to propose the final closing timeline in their investment proposal.
Fund Term	Fund Managers are invited to propose the specific duration of the Fund together with any extensions in their investment proposal.
Investment Period	Fund Managers are invited to propose the specific duration of the Investment Period together with any extension in their investment proposal.
Defence Company	A company that is producing or developing products or technologies for either (i) exclusively for military use, or (ii) for dual-use with both civil and military use cases.
Deal Flow Management and Prioritization	<p>The Defence Fund may prioritize Investments to Funds that:</p> <ul style="list-style-type: none"> a) make investments, among others, in Defence Companies whose products or technologies are exclusively for military use; b) focus their investments on Defence Companies established and operating in NATO member countries; c) contribute directly to the development of the Estonian defence capacity. <p>Notwithstanding the foregoing, SmartCap shall retain sole discretion when allocating Investments to Funds and may use additional considerations when prioritizing its Investments.</p>
Investment focus	The Fund should be a venture capital or private equity fund providing venture or growth capital (also called expansion capital). The Fund must not be subject to investment restrictions that would limit it from investing in weapons and munitions ¹ .
Estonian defence industry value-add	<p>The Fund Managers are invited to specify the contribution and value-add of their investment strategy to the Estonian defence industry. The Fund shall invest at least the Defence Fund Contribution into Defence Companies that are:</p> <ul style="list-style-type: none"> a) privately held non-listed enterprises, b) established and operating in Estonia, whereas limited investments into Defence Companies established and operating in other NATO member counties are possible, if there is a meaningful value-add to the Estonian defence ecosystem.

¹ Other than weapons, munition, and other technologies prohibited under applicable international conventions or regulations.

Stage focus	Fund Managers are invited to specify any target investment development stages for the Fund in their investment proposal. Fund Managers are not required to focus on every allowed development stage and are invited to propose their stage focus in their investment proposal.
Geographic focus	Fund Managers are invited to specify any target geographies for the Fund in their investment proposal, subject to the Investment focus requirement specified above.
Investment form	Equity or quasi-equity.
Follow-on investments	Fund Managers are invited to propose the specific follow-on investment strategy for the Fund in their investment proposal.
Re-investment	Fund Managers are invited to include specific proposals (if any) in relation to permitted re-investment in their investment proposal.
Management Fee	Fund Managers are invited to propose in their investment proposal a Management Fee based on market practice (i.e., amount and structure of the Management Fee including any step-down post-Investment Period). Any separate fee income generated by the Fund Manager or its affiliates related to the Fund's activities must be paid to the Fund or 100% offset against the Management Fee.
Distribution Cascade (together with hurdle rate / catch-up percentage / carried interest)	Fund Managers are invited to propose in their investment proposal a Distribution Cascade based on market practice including any hurdle rate, catch-up percentage (if any) and carried interest percentage.
Borrowing and guarantees	Applicants are invited to specify any caps and limitations on borrowings, guarantees and other indebtedness in their investment proposal.
Fund Manager	The Fund Manager shall be an entity legally entitled to manage the Fund pursuant to the applicable law. The Fund Manager shall have an investment team composed of experienced and reputable professionals with an appropriate skill set and knowledge of the Estonian market. The Fund Manager shall operate in accordance with best industry practices including professional standards issued by Invest Europe and/or other internationally recognised industry bodies acceptable to SmartCap.
Exclusivity	During the Investment Period, the Fund Manager shall for itself, and its directors, officers, employees, Key Executives and any of their affiliates undertake certain exclusivity obligations to be agreed with SmartCap in the Investment Documents, in relation to the management of any other fund, collective investment vehicle or managed account, or the performance of any functions or duties of a similar nature they undertake on behalf of the Fund, for any other person.

	<p>Until the end of the Investment Period, all investment opportunities reasonably falling within the Fund strategy received by the Fund Manager, any of its directors, officers, employees, Key Executives or any of their affiliates, will first be allocated to the Fund. During the Investment Period, none of the Fund Manager, its directors, officers, employees, Key Executives nor any of their affiliates shall invest in investment opportunities reasonably falling within the Fund strategy, other than through the Fund.</p>
Key Executives	<p>The Fund Manager must retain Key Executives who must devote relevant business time and attention to the business and affairs of the Fund. Fund Managers are invited to propose the composition and time devotion of other team members, including additional Key Executives (if any) in their investment proposal. The Key Executives may be replaced according to the procedures foreseen in the Investment Documents.</p>
Investment Committee	<p>The Fund Manager shall form an Investment Committee which shall be independent from investors or other third parties (including any strategic or other sponsor of the Fund Manager) and should wholly or primarily be comprised of the Key Executives.</p>
Advisory Committee	<p>The Fund shall have an Advisory Committee, comprised of representatives of the most significant investors in the Fund (excluding investors representing the Financial Commitment of the Team, the Key Executives, Fund Manager and their affiliates). The Advisory Committee of the Fund shall convene at frequencies to be established in the Investment Documents and shall have functions that include: (i) providing overall guidance to the Fund Manager, (ii) reviewing the activities and governance of the Fund, (iii) reviewing any conflicts of interest, and (iv) such other duties as are specified in the Investment Documents.</p>
Investment Restrictions	<p>The Fund will invest through subscriptions for new shares in portfolio companies and will seek to acquire existing shares in conjunction with subscriptions for new shares only if necessary to strengthen the Fund's existing position in a portfolio company, to incentivise management or where management or earlier stage investors are exiting at the same time as the Fund's subscription for new shares.</p> <p>The Fund will not engage in or make investments which engage in speculative investment activities such as real estate investments when undertaken as a financial investment activity, invest in any financial derivative instruments, including the purchase or sale of options, currency or other futures, crypto currencies, tokens, forward currency contracts, or commodities or commodity futures or options.</p> <p>The Fund shall not make bridging investments (i.e., investments that are in excess of the risk requirements of the Fund whether or not with the view to selling or syndicating such investment to third parties).</p> <p>The Fund will not engage in commercial bank-type, senior or non-equity related lending.</p>

	<p>The Fund will not be involved in hostile bids or investments made where the board of such company has expressed its objection to such investment.</p> <p>The Fund will not operate as a fund of funds and there shall be no investments in other investment funds or collective investment vehicles.</p> <p>The Fund will not invest in enterprises who are established or operating in or whose existing shareholders or new investors (including the UBOs of such investors in case of legal entities) are the citizens of Russia, Belarus, Iran, or the Democratic People’s Republic of Korea.</p> <p>The Fund will not invest into enterprises engaged in the ESG exclusion list of SmartCap.</p> <p>Any changes to the Investment Restrictions will require the prior written approval of SmartCap.</p> <p>Fund Managers are invited to stipulate appropriate diversification limits for the Fund, if considered appropriate, in their investment proposal.</p>
Conflicts of interest	<p>The Fund shall enter into all transactions on an arm's length basis.</p> <p>The Fund Manager shall immediately refer and fully disclose to the Advisory Committee any activities which could create an opportunity for actual or potential conflicts of interest to arise and shall seek the determination of the Advisory Committee as to the course of action to be taken.</p>
Cross-over investments	<p>In order to avoid potential conflicts of interest, the Fund shall not co-invest with, acquire from or sell to another investment fund, managed account or collective investment scheme managed or advised by the Fund Manager, its Key Executives or any of their affiliates, unless with prior written approval of the investors of the Fund.</p>
Co-investments	<p>The Fund Manager, its directors, officers, employees, Key Executives and any of their affiliates shall not co-invest with the Fund, i.e., invest in any target companies, except via the Fund itself through the Financial Commitment of the Team.</p>
Removal of the Fund Manager	<p>The investors may at any time remove and replace the Fund Manager or terminate the Fund without cause by written notice approved by a super-majority of investors unaffiliated to the Fund Manager.</p> <p>Upon the occurrence of a cause event, the investors may remove the Fund Manager or terminate the Fund by written notice approved by a majority of investors unaffiliated to the Fund Manager. The circumstances defining “cause” will be set out in detail in the Investment Documents.</p>
Responsible investing	<p>The assessment of the proposals shall take into consideration the existing or proposed ESG management system that is used to systematically address environmental, social, and governance related risks when carrying out investments from the Fund.</p>

	<p>The description of the Fund Manager’s responsible investment strategy should include the most relevant elements used to address sustainability risks in the Fund’s investment activities (e.g., ESG values, internal policies and processes, risk and opportunity identification, organisational capacity, monitoring and performance management, reporting, etc.).</p>
Reporting	<p>The Fund Manager shall provide quarterly and annual reporting in a standardised form and scope, in compliance with the reporting guidelines published or endorsed by Invest Europe or other internationally recognised industry bodies acceptable to SmartCap from time to time, and provide all additional information which may be required by SmartCap (including impact metrics and ESG reporting) or by the applicable law or other regulations in effect from time to time or which shall otherwise be stipulated in the Investment Documents. The Fund Manager shall also provide annual audited financial statements. The valuation of investments in portfolio companies shall be made in accordance with the valuation principles published or endorsed by Invest Europe from time to time, being currently the International Private Equity and Venture Capital Valuation Guidelines or other similar standard published and endorsed by internationally recognised industry bodies acceptable to SmartCap.</p>

➤ Assessment Criteria

As part of the assessment each Fund and Fund Manager shall be evaluated based on the Assessment Criteria below:

#	Assessment Criteria
1	<p>Team</p> <ol style="list-style-type: none"> 1.1. Prior investment track record of the Fund Manager and its team members 1.2. Team profile including any prior joint working experience, team cohesion, turnover and stability of the team, any need to hire or fill gaps and any succession issues 1.3. Relevant expertise and experience of the proposed Fund Manager’s team members, including experience and competence in the defence investments field 1.4. Ability to demonstrate additional activity in comparison to present activity (if any) for the life of the Fund 1.5. Operational, technical and financial capacity of the proposed Fund Manager, including local presence and market knowledge
2	<p>Investment Strategy</p> <ol style="list-style-type: none"> 2.1. Validity and viability of the Fund strategy including competitive position of the Fund strategy, portfolio composition, Fund size and expected Fund returns 2.2. Consistency of Fund strategy with purpose and objectives of the Programme 2.3. Ability to execute the Fund strategy 2.4. Robustness and credibility of the methodology for sourcing and appraising potential investees, including quality of proposed investment and due diligence processes 2.5. Terms and conditions applied in relation to the financing provided to investees, including expected protective rights and economic terms 2.6. Ability to provide relevant added value to investees 2.7. Pipeline that validates the Fund strategy
3	<p>Terms and Structure</p> <ol style="list-style-type: none"> 3.1. Fund terms and conditions, including management fees, and profit share structure (including hurdle rate) and the proposed methodology for their calculation 3.2. Financial commitment to the Fund by the proposed Fund Manager and the team 3.3. Proposed measures to align interests between the proposed Fund Manager and Defence Fund, and measures to mitigate possible conflicts of interest 3.4. Legal and organisational structure including corporate governance and independence of proposed Fund Manager 3.5. Financial viability and sustainability of Fund Manager 3.6. Ability to raise additional independent private financing for the Fund

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