

Market Consultation Q&A

Investment programme for selecting defence investments funds

SmartCap hereby provides answers to the questions (the Q&A) submitted prior to or at the Market Consultation event for the investment programme for selecting defence investments funds (the Programme) held on 31 October 2024. The questions may or may not appear in the exact wording that they were received and may have been paraphrased, abbreviated or reworded for simplicity. The questions are not listed in the order that they were received.

Nothing in this document obligates SmartCap to design or change the terms and conditions of the Programme in any way and the final Main Terms of the Programme may differ in whole or in part from the answers provided in this Q&A or from the terms published for the purpose of Market Consultation.

Potential Fund Managers interested in the Programme will have a chance to submit further questions for clarification after the Programme has been officially published.

| No | Question | Answer |
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| 1 | Who are covered under Independent Private Investor definition – does it mean private individuals or also other investors such as corporates, endowments, societies, charities? | The term „Independent Private Investors” includes any non-public investor, including private individual, family office, corporate, endowment, pension fund, society, etc., who is not a direct or indirect associate (including shareholder) to the Fund Manager or other entities or persons in its governance structure. |
| 2 | Would an investment by the Fund sponsor (e.g., shareholder of the General Partner / Fund Manager) be considered an Independent Private Investor Contribution? | We refer to question and answer 1 above, and also „Independent Private Investor Contribution” term highlighted in the Market Consultation document, which states „... 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.” |
| 3 | There are restricted countries mentioned such as Russia, Belarus, Iran, North Korea – however there can be other high-risk countries. What will your approach be regarding such countries? | This is a topic SmartCap expects to touch on in assessment, due diligence, and negotiation phases of the investment process. In any case, all applicable sanctions, embargos, or similar restrictive measures (e.g., as imposed by the EU or the UN) must be fully complied with. Furthermore, we expect that all individuals and entities that are characterized as having heightened risk of money laundering or terrorist financing are thoroughly assessed according to the highest standards and best practices of AML/CTF regulations. Effective KYC and AML measures must be implemented to ensure no such risk exists before engaging in any business with such persons or entities. |
| 4 | What instruments are included under the term Investment form? Does it cover loans, convertible loans, SAFEs, warrants? | Our terms currently foresee investments in pure equity instruments, or quasi-equity instruments. The quasi-equity part includes instruments such as SAFEs and convertible notes/loans where there is an equity related element. Warrants may also be allowed, depending on specific terms |

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| | | and conditions of the warrant. We do not expect to invest in funds that are primarily investing through commercial type loans or solely non-equity related securities. |
| 5 | Why is there requirement for having no restrictions on weapons and munitions? This significantly limits funds, who have defence mandate, but have institutional investors, who might impose such limits. | A restriction on weapons and munitions is significantly limiting to the defence capacity development, which is one of the main objectives of the Defence Fund. In addition, SmartCap is aiming to address the segment on the market, which is significantly underinvested, whereas there are significant amount of investors on the market who are already investing in funds with weapons and munitions restrictions. |
| 6 | Why do you restrict co-investments in SPVs, that can support follow-on strategies? | <p>The term „Co-investments“ within the Market Consultation document does not limit the Fund from making co-investments. However, to avoid any conflicts of interest, the term foresees that 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> <p>The framework for Defence Fund to co-invest with its portfolio funds is not covered within the Market Consultation document.</p> |
| 7 | Can you describe again how many funds you aim to invest in? The document states up to 4 funds, with investments of up to €20m per fund. That brings the total to €80m, assuming maximum investments. But the Defence Fund has a total size of €100m. Can you clarify? | The Market Consultation document at hand covers Defence Fund indirect investments into funds, while part of the Defence Fund allocation is reserved for direct investments. SmartCap has reserved the discretion over the Defence Fund allocation as between fund investments and direct investments, to account for actual deal flow and pipeline that may arise between these different set of investment opportunities. |
| 8 | Would you consider a VC fund which has a 25% focus on defence out of the entire fund capital allocation? | SmartCap has not set any minimum requirement for the allocation by a fund into Defence Companies. However, Defence Fund may prioritize investments into funds that have stronger defence focus. |
| 9 | Can you provide examples of the types of “meaningful value-add” that would justify investments outside Estonia? Are there preferred categories of technologies or industries that might enhance the Estonian defence ecosystem? | SmartCap at this stage has not formally pre-defined the „meaningful value-add“ concept, nor set any preferred categories, technologies or industries. We expect our prospective Fund Managers to be defence industry experts and have relevant expertise and knowledge regarding the Estonian market, including aspects that could constitute meaningful value-add to the Estonian defence industry. Some of the examples might include investments into Estonian Defence Companies, or international companies that are setting up a business unit in Estonia, or who are addressing an identified need in the Estonian defence industry market. SmartCap expects Fund Managers to demonstrate their capacity to add value to Estonian defence industry. |

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| 10 | What percentage of investments (deals/money) should ideally be in Estonia? | SmartCap has not set any percentage limitations for Estonian allocation. We invite Fund Managers to propose their contribution (as well as allocation) to Estonia. In addition we refer to the term „Estonian defence industry value-add“ which states: „... <i>The Fund shall invest at least the Defence Fund Contribution into Defence Companies that are:</i> a) <i>privately held non-listed enterprises,</i> b) <i>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.</i> “ |
| 11 | Are you considering joining a fund as part of its second or later closing? | SmartCap has not set any limitations to which closing it can join and may elect to be admitted at any closing. |
| 12 | How does SmartCap look at accelerator investments as a first tranche? Does SmartCap have any preference regarding accelerator fee model? | SmartCap has not set any preference for accelerator versus other strategies. We invite Fund Managers to make the proposal that best suits their implementation plan, including in relation to appropriate fee structures for accelerator models. |
| 13 | How much capital do you expect a fund to raise from private investors? | We invite Fund Managers to make proposals regarding their targeted private investor fundraising. In addition we refer to the term „State aid“ which states: „ <i>No state aid, pari passu 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.</i> “ |
| 14 | Would SmartCap consider committing to the Fund before private investors? | SmartCap may prioritize investments into funds, that are in more advanced stages of fundraising. However, in suitable investment cases where an anchor or cornerstone ticket is needed, we may be able to give our conditional commitment before required amount of private investors are signed. In any case, further fundraising would be a precondition for our final subscription to the Fund. |
| 15 | Would you consider a more "generalist" fund that is committing to invest at least 1/3 of the investment budget in defence / dual-use companies? | We refer to the question and answer 8 above. |
| 16 | You mentioned the focus needs to be Estonia, development of industry, jobs etc. But you also mention the fund can be from any NATO country? Can you clarify if you think a non-Estonian fund will focus on Estonia? | The Market Consultation document does not state that the overall focus of the Fund must be on Estonia. We refer to the term „Estonian defence industry value-add“ which states: „ <i>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:</i> a) <i>privately held non-listed enterprises,</i> b) <i>established and operating in Estonia, whereas limited investments into Defence Companies</i> |

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| | | <p><i>established and operating in other NATO member countries are possible, if there is a meaningful value-add to the Estonian defence ecosystem.“</i></p> <p>No matter the location of the Fund or Fund Manager, SmartCap will assess the relevant Estonian defence industry development proposition of the Fund Manager.</p> |
| 17 | Will you also be looking into how funds navigate and handle the export control restrictions, IP and other applicable legal and regulatory hurdles with their portfolio companies? Meaning, how they tackle all regulatory angles, including for the portfolio companies, not just the KYC/AML for fund investors? | SmartCap will assess a wide range of processes that a Fund Manager runs in the course of its investment due diligence, including relevant regulation and restriction checks, IP evaluation, and so on. In addition, SmartCap will assess each Fund Manager’s value-add to the portfolio companies, as this can include helping companies with regulations and restrictions, IP etc. |
| 18 | What is your view if there is another national or supernational NATO country fund-of-funds as an LP? Would you be favourable to this? | Other national or supernational LPs are welcome, however we refer to the „State aid“ term within the Market Consultation document. |
| 19 | Assuming you become an LP in the fund, would you be open to direct co-investments as well? Does one preclude the other? | The Market Consultation document does not cover co-investments by Defence Fund, thereby co-investments by Defence Fund are not precluded and shall be subject to negotiations. |
| 20 | What is your policy regarding investments in lethal weapon systems (rockets, ammunition, etc.)? | We expect Funds to be able to invest in such products and technologies. More specifically we refer to the term „Investment focus“ which states: „... <i>The Fund must not be subject to investment restrictions that would limit it from investing in weapons and munitions.</i> “ |