

# Clarifications and FAQ

for SmartCap Defence Fund Direct Investments

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## 1. Indicative Terms for Investments

Subject	Term
<b>Requirements for the investee company</b>	<p>The company shall be established as a private or public limited company under the laws of Estonia or similar form in a NATO member country acceptable for SmartCap and according to best industry practices.</p> <p>Team members, investors and related entities of the company shall not be established or operating in, nor shall their shareholders or investors (including the UBOs of such investors in case of legal entities) be the citizens of Russia, Belarus, or citizens of other countries that are on the FATF 'blacklist', UN sanctions list, or any other sanction or exclusion list applicable to the fund.</p>
<b>Investment</b>	<p>Investment shall be in equity or quasi-equity through capital increases (including SAFE agreements, convertible loans and other similar convertible instruments).</p> <p>Investments will be made in:</p> <ul style="list-style-type: none"> <li>• venture capital investment rounds starting from seed stage funding,</li> <li>• private equity investments in expansion capital funding (also called growth capital),</li> <li>• other newly established companies,</li> </ul> <p>with a focus on non-controlling stakes. Other types of deals such as joint ventures might be considered at SmartCap's sole discretion.</p> <p>Investment rounds should be led by an independent private investor(s). The target size of the Investment is EUR 500,000-10,000,000 over one or more financing rounds. SmartCap may selectively lead or co-lead investments.</p> <p>SmartCap may, at its sole discretion, decrease or propose to the company to increase the Investment size, provided that the state aid requirements described below continue to be met.</p> <p>The aggregate holding acquired in the company over one or more investment rounds, either directly or indirectly through other investment funds, may not exceed 49%.</p>
<b>Independent Private Investor Contribution</b>	<p>Preferably at least 50% of the aggregate amount of capital raised in the investment round shall be raised from private investors, whereas this condition is not absolute and shall be evaluated on a case-by-case basis, with final determination subject to the discretion of SmartCap.</p> <p>At least 30% of the aggregate amount of capital raised in the investment round shall be raised from private investors that are considered "independent private investors" within the meaning of the Commission Guidelines on State aid to promote risk finance investments (2021/C 508/01)</p> <p>For the avoidance of doubt, neither SmartCap Defence Fund nor persons or entities directly or indirectly associated with the company shall be considered an 'independent private investor'.</p>
<b>State aid</b>	<p>No state aid, the Investment is made as a <i>pari passu</i> investment (i.e., the Investment is made (i) at the same time and (ii) under the same terms with independent private investors whose (iii) commitments hold real economic significance).</p>

<b>Follow-on investments</b>	Follow-on investments are allowed, provided that the state aid requirement described above is met ( <i>pari passu</i> investment) and the follow-on investment promotes the objectives set out for the Call.
<b>Defence Company</b>	A company that produces or develops products and/or technologies or provides sector-specific services either (i) exclusively for military use, or (ii) for dual-use that can be used for both civilian and military applications.
<b>Deal Flow Management and Prioritization</b>	<p>SmartCap may prioritize in its deal flow management investments to companies that contribute relatively more to the objectives of SmartCap Defence Fund.</p> <p>Notwithstanding the foregoing, SmartCap shall retain sole discretion in its deal flow management and deal prioritization in pipeline, and may use additional considerations when prioritizing its investments.</p>
<b>Investment Terms</b>	<p>The investment shall be made based on the customary economic and commercial terms applicable to venture capital and private equity investments according to the best market practice (e.g., liquidation preference, anti-dilution protection, board seats, reserved matters, founder vesting and other undertakings, etc.).</p> <p>The lead investor or another qualified co-investor participating in the investment round is expected to negotiate and agree on the economic and commercial terms with the company.</p> <p>SmartCap has the right to selectively lead investments or renegotiate any terms with the company and co-lead or other investors, including economic and commercial terms.</p>
<b>Sustainability</b>	The assessment of Defence Companies 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 its activities, to the extent practically possible and relevant.
<b>Reporting</b>	The company who has received an investment shall provide at least quarterly and annual financial and operational reporting and all additional information which may be required by SmartCap 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 investee shall also provide annual financial statements in accordance with the applicable law.

## 2. Indicative Assessment Criteria

#	Assessment Criteria	Descriptive (non-exhaustive list of items to be assessed)
1	<b>Team</b>	<ul style="list-style-type: none"> <li>• Founders, senior management and key persons (position in company, prior professional experience, time commitment and motivation, sector-specific experience)</li> <li>• Operational, technical and financial capability of the team and team cohesion</li> <li>• Need to hire additional team members</li> </ul>
2	<b>Investors and ownership</b>	<ul style="list-style-type: none"> <li>• Current cap table / existing shareholder structure</li> <li>• Governance structure (control of decision making)</li> <li>• Committed and potential investors in current investment round (background info of significant investors, their previous experience and non-financial value for the company)</li> <li>• Lead investor (if any) or qualified co-investor</li> </ul>
3	<b>Business model</b>	<ul style="list-style-type: none"> <li>• Business model description</li> <li>• Product Market Fit (PMF)</li> <li>• Unique Value Proposition (UVP)</li> <li>• Go-to-market strategy</li> <li>• Business partners and relevant external stakeholders (government, universities, suppliers, etc.)</li> <li>• Scalability potential, including export potential</li> <li>• Established or proposed ESG management system</li> </ul>
4	<b>Product/service/technology</b>	<ul style="list-style-type: none"> <li>• Uniqueness of product/service</li> <li>• Competitive advantage of the product/service</li> <li>• IP protection / freedom to operate</li> </ul>
5	<b>Market</b>	<ul style="list-style-type: none"> <li>• Addressable market and market growth potential</li> <li>• Paying and target customers, their reference and diversification</li> <li>• Market structure and competition</li> <li>• Regulatory &amp; political risks</li> </ul>
6	<b>Deal terms</b>	<ul style="list-style-type: none"> <li>• Valuation (pre-money valuation of current investment round and valuation methodology; info about previous valuations if available)</li> <li>• Investment round and target amount</li> <li>• Use of funds</li> <li>• Other investment terms (Term Sheet if available)</li> <li>• Planned timeline</li> </ul>
7	<b>Relevance to SmartCap Defence Fund objectives</b>	<ul style="list-style-type: none"> <li>• Relevance of the product/service/solution in developing Estonian defence industry, contributing to innovation and economic impact in Estonia</li> </ul>
8	<b>Metrics and financials</b>	<ul style="list-style-type: none"> <li>• Current financial data (balance sheet, income statement, cash flow statement)</li> <li>• Financial forecast</li> <li>• Relevant KPIs and metrics</li> </ul>

### 3. Q&A for SmartCap Defence Fund Direct Investments

SmartCap hereby provides answers to the questions (the Q&A) submitted prior to or at the Market Consultation event for the Investment Programme for Defence Direct Investments (the Programme) held on 13 November 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 Market Consultation.

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

No	Question	Answer
1	There is a requirement that the company must be established in a NATO member country. Does it mean that companies from Ukraine, non-NATO and NATO partner countries cannot apply for your investment?	Current investment mandate of SmartCap Defence Fund is geographically limited with NATO member countries.
2	What instruments are included under the term Investment form? Does it cover loans, convertible loans, SAFEs?	Our terms currently foresee investments in equity instruments and quasi-equity instruments, whereas quasi-equity instruments include forms such as SAFEs and convertible notes/loans where there is an equity related element.
3	Private investor contribution - can SmartCap help with finding such investors?	While we always try to support the companies in SmartCap's investment portfolio and pipeline, we see ourselves primarily as co-investors and expect the companies to raise capital mainly by themselves and with the help of their existing investors and network or arrange professional fundraising.
4	You have an option to lead investments but there's no further elaboration on that. What deals will SmartCap lead - what are the considerations?	The core role of the lead investor is to help secure funding for the company, guide its growth and often add strategic value with unique experience and expertise. SmartCap will consider leading investments in case we see an opportunity to add value and help the company to achieve its objectives, by offering industry expertise or access to network etc.
5	How fast can SmartCap make an investment decision? What's the estimated timeline from first contact to signed documents?	Individual progress in the investment process will depend on a number of company specific circumstances like the company's fundraising status, growth stage, robustness of documents, data room readiness, amount being raised etc. Based on our experience, the time to close a funding round often takes 4-7 months and usually takes longer for larger and more established companies or more complex technologies.
6	How big is the investment committee who shall make the final decision whether to invest or not? Who is	Investment decisions will be made by SmartCap's investment committee, which includes both internal team members and external independent PE&VC experts. As of publishing the

	included in the investment committee?	Q&A there are 4 strategy-based investment committee members responsible for Defence Direct Investments. Additionally, the investment committee will consider input from external defence and security experts who will assist SmartCap in defence and security related questions and assess the technologies, their feasibility, and their potential contribution to Estonian defence capabilities.
7	How will the application process look like / Is there an online platform for applying?	The application process will be conducted electronically via email, as there is no dedicated online platform in place.
8	Does the independent private investor contribution clause apply to bridge round investment as well?	A bridge round or extension round, is treated in the same manner as any other funding round. As such, all our standard investment terms will apply to bridge rounds as well.
9	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 company or other entities or persons in its governance structure.
10	Who do you consider as qualifying co-investors or lead investors?	Our preference for a lead investor is guided by alignment of goals and motives. We prioritize partnering with professional investors experienced in similar transactions or strategic investors with deep sector expertise. However, we remain flexible and assess each round structure on a case-by-case basis.
11	Are grants considered as parts of the funding round (and the 30% / 50% limitations)?	Grants and other non-dilutive financing instruments are not considered as parts of the funding round within this context. Therefore, grants would not be considered in the 30% / 50% thresholds.
12	Is it correct that ongoing non-equity direct public sector R&D grants do not interfere SmartCap VC terms and conditions?	Our Investment Programme for Defence Direct Investments terms do not prohibit or exclude the use of non-equity public sector R&D grants. However, these would not be considered as part of the private investor contribution.
13	How is the investment purpose restricted (i.e., can the purpose of the investment be to serve as a self-financing portion for an EIC program)?	We have not imposed limitations on the use of funds. However, please note that investment by SmartCap Defence Fund may not qualify as self-financing for certain programs.
14	What is your policy regarding investments in lethal weapon systems (rockets, ammunition, etc.)?	SmartCap Defence Fund is able to invest in companies developing or producing lethal technologies, provided they fully adhere to international conventions and local regulations applicable to the company or technology.
15	Out of all the assessment criteria written out in the document, could you please explain which will be the critical ones?	We assess each investment opportunity in its entirety whereas the assessment criteria is not weighted. We use the assessment criteria for guidance to analyse every investment opportunity based on specific circumstances of each investment case. Significant shortcomings in any one criteria cannot be compensated by significant advantages in another criteria.
16	What's your approach to evaluating early-stage startups without significant track record?	SmartCap invests on market terms and applies common market practices as we assess all investment opportunities. We analyse every investment opportunity based on specific

		circumstances of each investment case, taking also into account the company development and growth phase or funding stage.
17	Do you consult late pre-seed companies?	While our main focus will be on companies raising funding for their seed round or up, we also engage with companies before raising seed round whenever possible to discuss potential future investment opportunities.
18	How do you decide how much equity you want to take?	Our maximum share in a company can be up to 49%. The size of the equity stake and corresponding share is determined during relevant stages of the investment process when factors such as the type of deal, the development and growth phase of the company, the structure of the funding round, and the commercial terms are being discussed, assessed or agreed.
19	If SmartCap takes a minority equity position, what are the long-term expectations for company performance and potential exit strategies?	SmartCap intends to invest at market terms with long-term expectations guided by standard market practices, focusing on the company's ability to grow and create value over time. Managing performance and exit expectations is part of the discussion with the company during the investment process before the investment decision and subject to shareholder discussions after the investment is made, whereas exit strategies are also addressed with minority shareholder rights in the SHA. Based on specific circumstances of each investment case, SmartCap might act as an investor providing patient capital for companies with high impact to SmartCap Defence Fund strategy and objectives. The need of patient capital is depending on the prevailing market conditions and specific needs of each company, considering also the best interests of all parties involved.
20	Are the criteria around team, IP, and market metrics flexible, or are they hard requirements that startups must fully meet to qualify?	SmartCap does not impose rigid eligibility criteria for prospective investment opportunities and all investment opportunities are evaluated on a case-by-case basis. Please also see answer 15 above.
21	Do you invest in companies working in defence-linked areas, i.e., energy?	SmartCap Defence Fund can only invest in companies that produce or develop products and/or technologies or provide sector-specific services either (i) exclusively for military use; or (ii) dual-use that can be used for both civilian and military applications. Any other types of defence-linked investment opportunities must have an existing or evident potential dual-use application.
22	As per Estonian weapon law, any handling of military weapons or related ammo/explosives need activity license. For that, all relevant people and investors of over 10% equity must be vetted by authorities. How does that apply of SmartCap?	Regulatory requirements apply to SmartCap, SmartCap Defence Fund potential investments or its investment portfolio companies. If a defence company is engaged in activity that requires license under the Weapons Act or its operations are in any other way regulated, there will be no exceptions for SmartCap, SmartCap Defence Fund potential investments or its investment portfolio companies. Any such requirements or regulatory restrictions and limitations applicable to each company are analysed during assessment and due diligence phase of the investment process, and addressed on a case-by-case basis.



23	Can SmartCap help us to get in contact (and contract) with Estonian MoDs or NATO?	While we cannot commit to facilitating specific contacts, experts from the state institutions responsible for internal security and national defence in the area of administration of the Ministry of Defence and Ministry of the Interior will be involved in the investment process. If we can reasonably add value and help companies during the investment process or as a shareholder after the investment is made, we make every effort to do so.
24	Does SmartCap provide any additional value within this fund, like cooperation with the defence forces, testing, experimentation?	Please see answer 23 above.
25	How does SmartCap assess or validate whether the solution/product/service has meaningful value add to Estonian Defence capabilities? Does SmartCap have internal competences, or will you be using external advisors?	We will engage external defence experts from the state institutions responsible for internal security and national defence in the area of administration of the Ministry of Defence and Ministry of the Interior to provide guidance and professional judgement on whether a specific technology or product could be considered as having a "meaningful value-add" to the Estonian defence capabilities.
26	To what extent does SmartCap prioritise companies whose products are exclusively for military use?	As part of deal flow management and prioritizing investment opportunities, SmartCap may prioritize companies in its pipeline based on the fit with SmartCap Defence Fund strategy, including the primary use of products or technologies produced or developed by the company.