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ESTONIAN DEVELOPMENT FUND
INVESTMENT STRATEGY

1. Introduction

Estonian Development Fund ("**EDF**") is a public legal entity acting under the Estonian Development Fund Act[1], the "**Act**". From its inception EDF has made venture capital investments with private investors into early stage small and medium sized companies with high growth potential with the main purpose to (a) address market failure in early stage investments and (b) develop local venture capital market.

Pursuant to the Act, the investments shall be made in accordance with the investment strategy approved by EDF Supervisory Board. EDF's initial investment strategy was approved by Supervisory Board on 27 January 2009 (with retroactive effect as of 14 January 2009) and it applies to EDF's direct investments. As of 2012, EDF's direct investments have been carried out through its 100% subsidiary AS SmartCap ("**EDF Manager**") which manages early stage venture capital fund Early Fund II and provides advisory services to EDF with respect to EDF's investments made until 2012.

Since the approval of EDF's initial investment strategy there have been changes and developments in market conditions, state aid rules governing risk finance investments and state strategies in addressing the market failure relating to SME's access to risk finance.

In line with these developments EDF's Supervisory Board has decided to reorganise the management of EDF's direct investments and reorient future investment activities on accelerator funds operating in seed and start-up states.

This document is divided into following Sections: (a) EDF's investment strategy for accelerator funds is set forth in Section 2 (b) EDF's revised investment strategy for direct investments is set forth in Section 3 (c) principles for reorganisation of management of EDF's direct investments are set forth in Section 4 and (d) principles for implementation of the whole investment strategy are set forth in Section 5.

2. Investment Strategy for Accelerator Funds

2.1. *Background*

In this Section 2, the term "Strategy" or "Investment Strategy" refers to the EDF investment strategy for investments into Accelerator Funds.

Although there are different players in Estonian venture capital market, their capital offering opportunities and capabilities are relatively low. It means Estonia lacks smart capital characterized by flow of information and network additional to funding into start-ups. To catch up with the rest of the Europe, Estonia needs new, internationally competitive companies.

Though the number of amounts invested into Estonian start-ups have raised during the years, it is still difficult for start-ups[2] to raise local seed money from Estonia. New, technology-based and high added-value businesses have not developed in the expected numbers. According to the preliminary assessment of the financial instruments[3] the market gap in equity financing is estimated to be between 200 000 and 1 500 000 euros in Estonia.

According to Invest Europe[4] private equity and venture capital investments in Estonia represented 0.204% of GDP in 2014 (2013: 0.147%, 2012: 0.1%, 2011: 0.041%). Total volume of investments in 2014 was 39,9 million euros (2013: 27,6 M€, 2012: 18,6 M€, 2011: 6,6 M€). The venture phase funding (seed, start-up and later venture) has been during the years volatile in between 4,4–6,2 MEUR (2012: 5,9 M€, 2013: 6,2 M€, 2014: 4,4 M€).

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[1] Estonian Development Fund Act: https://www.riigiteataja.ee/en/eli/ee/529062016003/consolide/current
[2] For the purposes of this Strategy, "start-up" means an undertaking meeting the definition of an Eligible SME as defined in Section 2.14 of this Strategy.
[3] Ministry of Finance: "Lõpparuanne. Perioodi 2014-2020 ühtekuuluvus-poliitika vahenditest kavandatavate finantsinstrumentide eelhindamine", 14.11.2014.
[4] Invest Europe (former EVCA): http://www.investeurope.eu

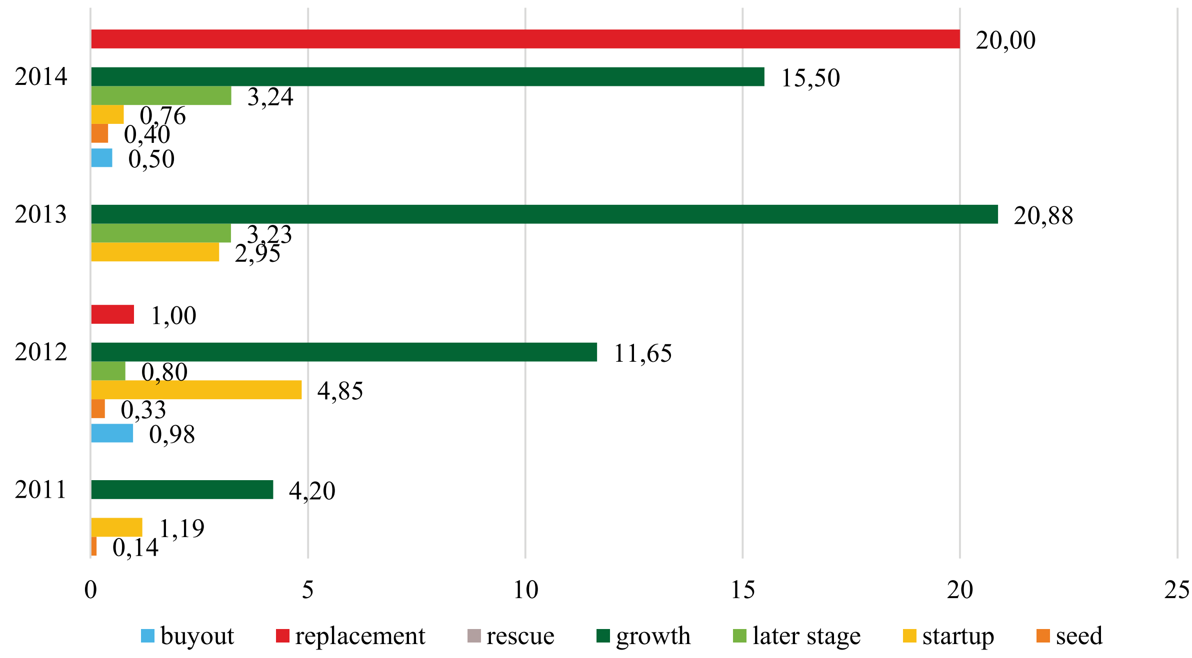

Figure 1. Estonian private equity and venture capital investments 2011–2014. Source: Data from research papers of Invest Europe

In addition to financing bottleneck, several different studies made about entrepreneurship ecosystem in Estonia (Global Entrepreneurship Monitor[5] and Global Entrepreneurship Development Index[6]) point out that the other three bottlenecks that hold back Estonian entrepreneurial performance are:

a) lack of innovation in general but also on terms of products and services and Estonian Foreign Direct Investments policy;
b) attitudes towards entrepreneurship being poor, entrepreneurial career still not enjoying a high status in the minds of Estonians and
c) skills for entrepreneurship being low and Estonia needing to be more supportive of re-orienting human capital towards higher value-added activities.

To overcome these bottlenecks, different activities have been suggested, the most important to launch a program to support start-up teams to grow their ventures from conception into start-up phase.

While many events and seminars address the start-up ideation phase, there are no programs under which start-ups are created and receive in-depth support to go through product, client and team tracks. In Estonia there is also a need for programs that help early teams and prototypes grow into real businesses with concrete focus on vertical niches.

Due to described market gap in Estonia, EDF aims to make investments into accelerator funds (“**Accelerator Funds**” or “**Funds**”) operating in seed and start-up stages[7]. Funds are value-adding small venture capital funds, developing innovative companies with high growth potential in technology intensive sectors in their seed and start-up stages, by providing acceleration services and venture capital investments in the form of equity and quasi-equity. Funds constitute a new incubation model, which has developed into an umbrella term for any program providing structured mentoring, networking opportunities and access to funding.

With this Investment Strategy EDF aims to reach the following targets:

- **Create a viable ecosystem for start-ups aiming for high-growth.**

Target: Estonia is the preferred choice for start-ups when considering the location for establishing their respective companies in Europe.

[5] Global Entrepreneurship Monitor 2013, Estonian Development Fund, 2014: http://www.arengufond.ee/wp-content/uploads/2014/11/GEM_2013_raport.pdf
[6] Global Entrepreneurship Development Index, Estonian Development Fund, 2014: http://www.arengufond.ee/wp-content/uploads/2014/11/GEDI_Estonia.pdf
[7] Based on Invest Europe Investment stages: http://www.investeurope.eu/research/about-research/glossary/

Background: This goal is also voiced in the Strategic plan of the Startup Estonia program[8]. The funds' activities therefore contribute to the ambitious goal in case of Startup Estonia is measured via different indicators used in the Startup Compass. Accelerator Funds' contribution to the goal will be measured by the number of established start-ups in Estonia as a direct result of the activities carried out by the Funds. For 2020 the goal for the number of registered start-ups in Estonia is ≥25.

- **Multiply the number of successful high-growth start-ups.**

Target: Estonian accelerator funds accelerate the highest potential, ensure early-stage funding for the target companies, increase their shareholder value, and make them attractive targets for venture investors. The goal is to increase the annual number of successful start-ups[9] from 25 (in 2015) to 36 by 2018.

- **Increase the average funds raised per start-up in Estonia.**

Target: The average funds raised by an early-stage Estonian start-up in 2014 was 346 thousand EUR. The target for 2018 is 500 thousand EUR.

- **Attract private investments into accelerator fund portfolio companies.**

Target: The target ratio of portfolio companies' between public and private sector funding is after initial investments made by the accelerator fund(s) will be ≥1:2. The achievement of this goal is measured after the end of the Fund Duration (see p 2.19).

- **Enable structural changes in Estonian early-stage VC industry.**

Target: Through a well-functioning accelerator fund(s), the quality of the deal-flow will be improved, attracting more smart capital into the early-stage investment market. The annual volume of Estonia's early-stage investment market in 2014 was 4,402 million EUR[10]. The target for 2018 is 6 million EUR per year.

In addition to this Investment Strategy, EDF shall implement the Startup Estonia program to increase activity in seed stage with the goal of cultivating new ideas into investable start-ups.

2.2. *Terms of the Investment Strategy*

GENERAL		
2.1.	**Aim of Strategy**	The aim of the Strategy is to develop innovative companies with high growth potential in technology intensive sectors in their seed and start-up stage by providing acceleration services and venture capital investments in the form of equity or quasi-equity.
2.2.	**Accelerator Funds**	The Accelerator Funds shall be venture capital funds: a) which are managed by Fund Managers meeting the requirements set out in this Strategy; and b) which in their investment policy target to make equity or quasi-equity investments in Eligible SMEs[11] in their seed and start-up stage; and c) which, in all other aspects, comply with the terms and conditions set out in this Strategy. For the above purposes, a "venture capital fund" is a legal entity or pool of assets that has raised capital from one or several investors with a view to investing it, for the benefit of those investors and in accordance with a defined investment policy, in securities not traded in the regulated market. Fund may, but is not required to be, subject to financial supervision by public authorities.
2.3.	**Fund Managers**	Fund Managers are legal entities established under private law, which principal business is or will be managing one or more Funds and performing Acceleration Services[12].

[8] Startup Estonia program decree: https://www.mkm.ee/sites/default/files/startup_estonia_kaskkiri.pdf
[9] Definition of successful start-up: a starting company which has raised more than 1 million euros funding.
[10] Based on an Invest Europe Special Paper: "Central and Eastern Europe Statistics 2014", August 2015.
[11] Eligible SME definition is provided in 2.14.
[12] Acceleration services definition is provided in 2.4.

		For the above purposes, the management of a Fund shall comprise sourcing, investigating, analyzing, structuring and negotiating potential investments, monitoring the performance of investee companies and effecting the disposition of investments ("**Fund Management**"). Fund Managers may, but are not required to be subject to financial supervision by public authorities. Fund Managers must comprise a team of experienced professionals, operating according to best industry practices, complying with professional standards issued by the Invest Europe or other equivalent organisations. Such teams are expected to act independently and manage the relevant Fund on the basis of commercial principles. During the whole term of the Fund the Fund Manager must retain at least two (2) executives (each a "**Key Executive**") who must devote substantial amount of their time and attention to the affairs and activities of the Fund. The Fund Manager and its Key Executives shall be subject to customary provisions on handling conflicts of interests, including, without limitation, exclusivity terms and other restrictions relating to establishment and management of competing funds. The Key Executives must be nominated by the constitutional or equivalent documents of the Fund. All Key Executives of the Fund Manager must a) have experience as founders or C-level managers (C-level manager meaning a high-ranking executive; typical examples include: CEO, CIO, CTO, CFO, CMO) of high-growth start-ups; and b) be of good repute and experienced in raising funds for growth. The Key Executives must retain the control of the Fund Manager during the whole term of the Fund, unless a change of control is approved by the Advisory Committee with the consent of EDF Advisory Committee member.
2.4.	**Acceleration Services**	The purpose of the Acceleration Services is to create, study, evaluate, approve and develop Eligible SME's product or service, team and business model in order to prepare it for successful raising of next round investments. It is the Fund Manager's responsibility to develop content and form of Acceleration Services and to organize and execute them according to its strategy. In order to provide Acceleration Services, the Fund Managers must have the experience in the expertise area chosen and access to a talent pool of experienced start-up entrepreneurs and advisors. In the course of provision of Acceleration Services, the Fund Managers must: a) offer their proven business expertise, funding and extensive contact networks to the investee companies; b) provide the investee companies with networks and help for market access into target markets. The Acceleration Services must be provided with respect to each portfolio company during the Investment Period of the Fund. Acceleration Services must be performed mainly in the Republic of Estonia[13].
INVESTORS AND INVESTMENTS INTO FUNDS		
2.5.	**Minimum size of Fund**	The minimum size of a Fund managed by one Fund Manager is **six million EUR**.
2.6.	**Investors and Commitments**	Save for EDF, all investors in any Fund (an "**Investor**") must be independent private investors as defined in Commission regulation (EU) No 651/2014 of 17 June 2014 or any subsequent legislation amending or replacing that Regulation in full or in part ("**GBER**").

[13] The location of the Acceleration Services is set according to EU regulations (Article 70 in Regulation 1303/2013) which stipulate that the operations should be located in the programme area (i.e. the Republic of Estonia) or outside the programme area but within the Union provided that certain conditions are satisfied (incl. the operation is for the benefit of the programme area; the monitoring committee has given its agreement, etc).

2.7.	**Commitments**	In relation to an Investor, the amount of money which such Investor has agreed to advance to the Fund (whether or not such amount has been advanced in whole or in part and whether or not it has been repaid to the Investor in whole or in part) is hereinafter referred to as "**Commitment**" and the aggregate of all such amounts by all Investors is hereinafter referred to as "**Total Commitments**".
2.8.	**EDF's minimum and maximum investment into a Fund**	EDF's minimum Commitment into one Fund shall not be defined. EDF's maximum Commitment into one Fund shall be the lowest of (a) 4**,2 million EUR** ("**Maximum Amount**") or (b) 70 per cent of Total Commitments by all Investors. EDF reserves the right to increase its maximum commitment after the first closing of the Fund and before the end of the Investment Period if so approved by the requisite approval[14].
2.9.	**Private investor participation**	The amount of Commitments from independent private Investors into any Fund must constitute, at any time, at least 30 per cent of the Total Commitments of the Fund.
2.10.	**Key Executives participation**	The Key Executives shall commit to invest in the Fund, an amount equal to [x]% of the Total Commitments of the Fund in cash. [x] will be declared by the Fund Manager during the selection process.
2.11.	**Drawdowns**	Commitments will be drawn down by the Fund pro rata from the Investors as needed to make investments and to pay Fund liabilities and expenses.
2.12.	**Shareholdings and Transfers**	The minimum (share)holding of EDF in any Fund is not defined. The maximum (share)holding of EDF in any Fund shall be 70%. Investors may transfer their interest in the Fund only with the Fund Manager's prior consent, except that EDF may transfer its interest in the Fund to any undertaking or other entity ultimately founded, owned or controlled by Estonian state without any restrictions".
INVESTMENTS BY THE FUND		
2.13.	**Investments into Eligible SMEs**	Investments into Eligible SMEs will be made in the form of equity or quasi-equity (as defined in GBER). Each Fund selects Eligible SMEs according to its investment strategy which must set out the criteria and proposed timing of investments. Each Fund is envisaged to invest into 20–40 Eligible SMEs. Fund's investment strategy shall set out the minimum and maximum amount to be invested per each Eligible SME. Fund's investment strategy shall set out the minimum and maximum shareholding in each Eligible SME. The Fund Manager shall be responsible for ensuring that investments are made in accordance with applicable state aid legislation of the European Union and Estonia.
2.14.	**Eligible SMEs**	Eligible SMEs are undertakings which meet the requirements for eligible undertakings pursuant to the provisions of GBER governing risk finance aid. A Fund may also make follow-on investments in such undertakings if conditions for follow-on investments set out in the provisions of GBER governing risk finance aid are fulfilled. At least such percentage of the Total Commitments of the Fund that equals the EDF Participation Percentage must be invested in undertakings that a) are registered in the Republic of Estonia; b) are focused on innovation, are creating or using up-to-date technologies and developing new products, in doing so they have a substantial growth and export potential and a perspective to achieve a considerable position in the international target market, but they are not capable of meeting their capital requirements by other instruments operating in the economy. "EDF Participation Percentage" is the ratio of EDF's Commitment to Total Commitments.

[14] Please see the definition of "requisite approval" in Section 5 below.

2.15.	**Preferred sectors**	Each Fund must have a specific investment and vertical focus. EDF will not invest into a Fund which investment strategy is to invest in sectors or activities that are within the investment focus of any other Fund into which EDF has already invested. Preferred (but not limiting) growth areas for investments are the following[15]: 1. **Information and communications technology** (ICT) horizontally via other sectors[16] emphasizing the following domains: a) Content technologies and information management in means of big, open and linked data, data mining, real-time economy and e-government solutions; b) Cyber security technologies and solutions; c) Smart machines and grids, robotics, IoT and production automation (industry 4.0); d) Tools and methodologies for software development. 2. **Health technologies and services** with a focus on a) biotechnology and e-health – use of IT for the development of medical services and products. 3. **Enhancement of resources** with the objectives of using resources more efficiently and enhancing them, as well as implementing new technologies and technical solutions, which will, among other things, lead to greater energy-efficiency and save costs. Areas of critical importance include: a) Industries working with enhancement of materials (e.g. wood processing industries); b) Development of knowledge-based construction (e.g. smart houses, using word as a construction material, integrating renewable energy solutions); c) Introducing new scalable products and services to the market in green bio-technology (bio-economy, environmental protection and food industry) as well as white biotechnology (bio-fuels, chemical and textile industries); d) Chemical industry.
2.16.	**Excluded sectors and activities**	a) Sectors and operations to which the exemption set forth in Article 21 of GBER does not apply; b) Gambling and betting; c) Production and trade of weapons and ammunition; d) Production and trade of alcoholic beverages and tobacco; e) Production and trade of hazardous substances; f) Activities and operations that do not comply with applicable laws or general ethical or moral standards.
2.17.	**Investment decisions**	The Fund Manager shall make investments into Eligible SMEs based on a viable business plan for each Eligible SME which shall include details of product, sales and profitability development, establishing ex-ante financial viability. The Fund Manager must have a clear and realistic exit strategy for each investment.
2.18.	**Fund duration**	Up to 10 years ("**Initial Term**") with the possibility of extension by up to two additional one-year periods with the Requisite Investor Approval (as defined below).
2.19.	**Fund investment period**	Investment period commences on the first closing date of the Fund. Initial investments into Eligible SMEs are envisaged to be made no later than by the fourth (4th) anniversary of the first closing date of the Fund (the "**Investment Period**"). The Investment Period may be extended by up to two additional one-year periods with the Requisite Investor Approval. After the Investment Period no further investments shall be made other than: a) investments contractually committed prior the end of the Investment Period;

[15] Based on Estonian Smart Specialization reports: http://ns.arengufond.ee/en

[16] It is important to note that the development of this sector around the world has reached a stage where greater opportunities can be found in the application of technology in other sectors.

		b) investment for which exclusivity had been granted during the Investment Period, subject, however, to the approval by the Advisory Board; and c) follow-on investments in existing investee companies during the whole duration of the Fund (in accordance with the state aid group exemption regulation ((EU) No 651/2014 article 21 section 6).
FEES, COSTS AND ALLOCATION OF PROCEEDS		
2.20.	**Management fee**	The management fee (the "**Management Fee**") is not expected to exceed, in any calendar year, 3% of (a) the Total Commitments. The exact amount of the Management Fee and its calculation methodology (both for Investment Period and period thereafter) shall correspond to market terms (to be determined in the process of selection the Fund Manager). The Management Fee applicable after the Initial Term of the Fund until the dissolution of the Fund shall be agreed separately between the Fund Manager and the Investors with the Requisite Investor Approval. All fees (including reasonable fees as the members of the supervisory board or board of directors and reasonable reimbursements for incurred expenses) received by the Fund Manager, or any representative, advisor, employee, officer, member, shareholder or partner of the Fund Manager, from the Fund's investee companies shall be fully deducted from the Management Fee.
2.21.	**Management costs**	The Management Fee shall be deemed to cover any and all fees and costs related to Fund Management (as defined in Section 2.4). In addition to the Management Fee, the Fund shall reimburse only the following third party costs directly related to its operations (to the extent such costs are not reimbursed by the investee companies) ("**Fund Expenses**"): a) fees and costs related to the purchase, holding and sale of investments; b) establishment of the Fund; c) abort costs (but only in respect of those prospective investments which pass preliminary clearance of the Fund's investment committee); d) insurance costs; e) taxes; f) fees and expenses of third party accountants and counsel; g) audit; h) costs of the annual Investor meeting; i) litigation expenses; and j) other extraordinary expenses. The Fund Expenses shall not, however, include any fees or costs of any investment adviser advising the Fund Manager. The aggregate Fund Expenses should follow the market practice and not exceed an aggregate amount equal to 15% of the Total Commitments, whereas the expenses of the establishment of the Fund shall not exceed 75 000 EUR.
2.22.	**Allocations of proceeds**	The allocation of proceeds (distribution waterfall) is expected to follow market practice to be determined in the process of selection of the Fund Manager and terms as outlined in the following example: a) first, to Investors until they have received their Commitments back; b) second, to Investors until a preferred return (hurdle rate) is received; c) third, to Fund Manager as catch-up; d) thereafter, between Fund Manager and Investors according to a split agreed based on market standards. However, EDF may accept asymmetric profit distribution for the benefit of private investors of the Fund, provided that it will be entitled to a certain pre-agreed rate of return. The Fund Manager is expected to propose details for the allocation of proceeds including, if relevant, proposal for any asymmetric profit distribution in the selection process.
FUND GOVERNANCE		
2.23.	**Requisite Investor Approval**	Requisite Investor Approval shall mean approval by Investors that are not related to the Fund Manager that hold more than 50% of the shares or units in the Fund, including, in any event, EDF (the "**Investor Majority**").

2.24.	**Investment Committee and Advisory Committee**	The Fund shall have an investment committee that will make investment and divestment related decisions (the "**Investment Committee**"). The key executives and other personnel of the Fund Manager are expected to hold the majority of the seats in the Investment Committee. Independent members are welcome as a minority group. The Fund shall have an advisory committee comprising at least three (3) members representing the Investors or appointed by the Investors as independent members, including at least one representative appointed by EDF (the "**Advisory Committee**"). The Advisory Committee will meet at least semi-annually and as required, and shall consult with the Fund Manager inter alia as to general policies and guidelines. The Advisory Committee's approval shall be required for changing of auditors, valuation policy or prospective investment sectors and approving actual or potential conflicts of interest. The Fund Manager shall be required to disclose all actual or potential conflicts of interest to the Advisory Committee for the Advisory Committee's prior approval. The Advisory Committee shall not have any authority to take part in the management or control of the business of the Fund Manager.
2.25.	**Valuation and the reporting**	Valuation and reporting will be made in accordance with professional standards issued by the Invest Europe or other equivalent organizations. Among other things, the Fund Manager are expected to provide Investors with the following information: a) annual audited financial statements and impact metrics of the Fund; b) quarterly unaudited financial statements and progress reports on each investee company of the Fund. The Fund Manager is expected to hold annual meetings to provide Investors with the opportunity to review and discuss the Fund's investment activities and portfolio and any general questions that may be raised with respect to the overall strategy and performance of the Fund.
2.26.	**Key-man provisions**	Draw-downs shall be suspended, save for draw-downs required to (a) make investments contractually committed to prior to suspension (b) make follow-on investments in existing portfolio companies (with the approval of the Advisory Committee); or (c) pay the expenses of the Fund, in the event that, at any time any Key Executive ceases to devote substantially his or her business time to the affairs and activities of the Fund (an "**Executive Departure**"). The Fund Manager shall promptly notify the Investors of any Executive Departure. Upon such suspension of the Investment Period, the Advisory Committee shall have 120 days within which to approve, at any time prior to the termination of the Investment Period, the replacement of any such Key Executive, which approval shall lift such suspension. If, after the 120 days period, the suspension has not been lifted, then the Advisory Committee may a) suspend the Investment Period for a further 60-day period pending a decision in accordance with (b) to (d) below; b) elect to terminate the Investment Period (in which event, the Management Fee shall be adjusted accordingly); c) lift the suspension of the Investment Period as if no Executive Departure had occurred; or d) remove the Fund Manager in accordance with the terms of the no cause removal provision, or terminate the Fund.
2.27.	**Removal of Fund Manager**	The Fund Manager may be removed upon any act or omission that the Investors Majority determine to constitute "Cause", in accordance with market standards. The Fund Manager shall immediately notify the Investors of the occurrence of any event constituting Cause. In the event of removal for Cause, the rights of the Fund Manager to receive Management Fees or any other payments shall cease immediately.

		At any time, the Fund Manager may also be removed without Cause upon the decision of Investors representing 75% or more of Total Commitments, including, in any event, EDF, subject to the payment to the Fund Manager of an amount equal to 100% of the Management Fee in respect of the 6-month accounting period immediately prior to the accounting period in which removal occurs.
LEGAL REGIME		
2.28.	**Governing law and language**	The legal documentation of a Fund shall be in the English language and shall be governed by the laws of the country of its incorporation.
2.29.	**References**	a) Commission regulation (EU) No 651/2014 of 17 June 2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty (GBER); b) Estonian Development Fund Act.

Please see more details on the implementation of this Strategy in Section 5 below.

3. Investment strategy for EDF direct investments into SMEs

In this Section 3, the term “Strategy” refers to the EDF investment strategy for direct investments into SMEs. This Strategy is implemented either (a) by EDF or by a fund management company established by EDF (EDF Manager) as described in this Section 3 or, (b) should the current investment activities of EDF related to direct investments into SMEs be reorganised, by private fund management company as described in Section 4 below. Please see further details on implementation of this Strategy from Section 5 below.

GENERAL		
3.1.	**Aim of Strategy**	The aim of the Strategy is to stimulate and support changes in the Estonian economy by providing venture capital investments in the form of equity or quasi-equity in the knowledge and technology intensive Estonian business in the start-up phase.
3.2.	**Investment principles**	Under this Strategy, EDF invests either: a) on normal market conditions; or b) under an exemption set forth in the GBER. If EDF invests under an exemption set forth in the GBER, additional requirements arising from GBER must be adhered to. Further, should the requirements for investments provided below in this Strategy and requirements of GBER for falling under an exemption contradict with each other, the requirements of GBER shall prevail. EDF may invest under an exemption set forth in the GBER only if requirements of GBER for making such investment do not contradict the mandatory requirements for EDF investments provided in the Act.
3.3.	**Investment objects**	Under this Strategy, EDF makes direct investments into SMEs meeting the requirements of § 35 of the Act.
3.4.	**Investment sectors**	All sectors, except sectors prohibited under the Act.
3.5.	**Private investor participation**	Independent private investors shall participate in investments on conditions and at least in the amounts required for the investment to meet either of the investment principles in 3.2 above.
3.6.	**Supervision over investments**	EDF together with other investors shall monitor the performance of investment objects in accordance with normal market practice. In addition to exercising its rights and performing its obligations as a shareholder of the SME, EDF shall appoint representative(s) to the SME’s directing bodies (i.e. supervisory board and/or management board) if it is proportionate to shareholding of EDF in SME, taking into account normal market practice.
3.7.	**Volume of EDF’s single investment**	EDF’s investment per one SME may not exceed 10% of the investment capital. Upon the requisite approval, EDF’s investment per one SME may exceed the above threshold, but not 25% of the investment capital.

[17] Please see the definition of “requisite approval” in Section 5 below.

3.8.	**EDF's minimum and maximum holding in one investment**	As a general rule, EDF's participation in SME's voting capital may not be less than 10% and more than 49%. EDF may acquire a holding exceeding 49% of the share capital of SME only in case a need to gain control in the SME arises. The aforesaid requirement regarding EDF's minimum participation in SME's voting capital shall not apply after EDF's initial investment into the SME.
3.9.	**EDF's investment period per one investment**	The period of EDF's investment in SME shall not, in general, exceed the period of 5 years. The aforesaid shall not apply in case EDF's activities relating to direct investments are reorganised as set forth in Section 4 of the EDF Investment Strategy.
3.10.	**Investment method**	EDF invests into SME to be established or in already established and operating SMEs by acquiring participation in SME in the course of increasing SME's share capital. EDF shall not make investments by acquiring the participation held by other shareholders of SME, except in following cases: a) upon exercising EDF's pre-emptive rights or rights of first refusal to acquire shares transferred by other shareholders of the respective SME; and/or b) upon exercising the right to buy back shares from the founders, employees, directors or consultants of the SME in accordance with the reverse vesting arrangements in cases where the SME itself is not legally permitted to do so; and/or c) if the respective investment is in accordance with the requirements of GBER governing the provision of replacement capital.
3.11.	**Loans and guarantees**	EDF may grant convertible loans, including buy convertible notes, in SMEs. For the purposes of this Strategy, a convertible loan or note shall mean a debt instrument convertible into equity. In addition, EDF may provide interim financing ("**Bridge Investment**") to SMEs with a view to having the SME repay the Bridge Investment or selling the Bridge Investment to a third party within 12 months after EDF has invested into SME. A Bridge Investment not repaid or sold within such period will be, if feasible, converted into share capital of the SME. EDF may also provide guarantees in connection with its investments where it reserves an amount of undrawn commitments equal to the amounts guaranteed.

4. Reorganisation of EDF direct investment activities

4.1. *Direct investments in SMEs in case of reorganisation*

EDF is considering to reorganise its activities relating to direct investments in SMEs (investment strategy described in Section 3 above) which are currently implemented by EDF Manager. Upon such reorganisation, EDF and the venture capital fund managed by EDF Manager into which Republic of Estonia has invested the investment capital in accordance with § 43^2 of the Act ("**Public Fund**") will invest all their assets related to direct investments in SMEs[18] into a venture capital fund managed by a private fund management company in accordance with § 44^1 of the Act in return for shares, units or other equal rights of the respective venture capital fund ("**Private Fund Management**").

If EDF's investment activities will be reorganised as described above, EDF and EDF Manager must respectively procure that the terms, agreements and/or other documents governing the operations of the fund managed by the private fund management company are in line with the principles set out in Section 3 so far as it concerns such part of the assets of such fund that corresponds to the holding of EDF and the Public Fund in the respective fund managed by the private fund management company. For the avoidance of doubt, this EDF Investment Strategy (including strategy in Section 3 above) shall not directly apply to the private fund management company.

4.2. *Requirements to Private Fund Management*

Private fund management company conducting Private Fund Management shall be selected as a result of an open, transparent and non-discriminative process. Private fund management company shall be legal entity established under private law, which principle business is or will be managing one or more venture

[18] Assets related to direct investments in SMEs include shares in SMEs, loans granted to SMEs and uninvested investment capital provided by the Republic of Estonia in accordance with § 43^2 of the Act.

capital funds. The private fund management company may, but is not required to be subject to financial supervision by public authorities.

EDF and EDF Manager respectively must procure that the private fund management company commits to invest in or alongside the fund in accordance with market standards.

In case of Private Fund Management, the representative(s) appointed by EDF (or EDF Manager respectively) shall participate in the Advisory Committee (or its equivalent) of the fund. If a fund has also general meeting of investors or its equivalent, EDF (or fund managed by EDF Manager respectively) as fund investor exercises its rights also in general meetings of investors (or its equivalent).

The management fees payable to the private fund management company shall be according to market practice and are not expected to exceed, in any calendar year, three per cent (3%) of (a) total commitments to the fund during the investment period and (b) the invested capital less the cost of exited and written-off investments after the investment period.

The allocation of fund proceeds (distribution waterfall) shall be as follows: (a) first, to fund investors until they have received back the amount invested by them and (b) thereafter, between the private fund management company as carried interest and investors according to split agreed based on market standards.

EDF investment in the venture capital fund under Private Fund Management shall not be limited in time.

5. Implementation of strategy

5.1. *Implementation of investment strategy for Accelerator Funds*

EDF may implement the investment strategy set out in Section 2 either itself and/or through EDF Manager by investing its investment capital, either alone or together with other public or private investors, into an investment fund managed by EDF Manager, in which case the rights and obligations of EDF set out in Section 2 shall be exercised and performed by, or on the account of, the respective investment fund.

For the purposes of the strategy set out in Section 2, the "requisite approval" shall mean (a) in case the strategy is implemented directly by EDF, the approval of the EDF Supervisory Board (b) in case the strategy is implemented by EDF Manager, the approval of the Supervisory Board (or equivalent body) of EDF Manager.

Investment capital for implementing this strategy for Accelerator Funds comprises of existing and future capital becoming available for reinvestments upon exiting direct investments specified in Section 3 above (whereas implementation of investment strategy in Section 3 is described in 5.2 below) ("**Accelerator Fund Capital**"). Implementation of this strategy for Accelerator Funds from other resources or using Accelerator Fund Capital for other purposes than implementing this strategy for Accelerator Funds shall be allowed only upon respective approval of EDF Supervisory Board.

5.2. *Implementation of investment strategy for direct investments*

The investment strategy in Section 3 may be implemented in the following ways:

a) EDF shall make direct investments on the account of its investment capital and/or EDF Manager shall make investments on the account of the Public Fund (both hereinafter "**Public Fund Management**"); or
b) Upon reorganisation of EDF direct investment activities, the investment strategy shall be implemented as Private Fund Management as described in Section 4 above.

In case of Public Fund Management, investment strategy in Section 3 above shall apply to EDF and/or EDF Manager. To the extent investment strategy in Section 3 above is implemented by EDF Manager, the term "EDF" shall be deemed to refer to EDF Manager.

For the purposes of the strategy set out in Section 3, the "requisite approval" shall mean (a) in case of direct investments by EDF, the approval of the EDF Supervisory Board (b) in case of direct investments by EDF Manager, the approval of the Supervisory Board (or equivalent body) of EDF Manager and (c) in case of Private Fund Management, the approval of the fund Advisory Committee (or its equivalent).

Investment capital for implementing this strategy for direct investments comprises of investment capital allocated according to § 43 of the Act (this part of investment capital has already been invested in full in investment strategy in Section 3) and investment capital which Republic of Estonia has invested in accordance with § 43^2 of the Act (together hereinafter "**Direct Investment Capital**"). Implementation of this strategy for direct investments from other resources or using Direct Investment Capital for other purposes than implementing this strategy for direct investments shall be allowed only upon respective approval of EDF Supervisory Board. For the avoidance of doubt, capital becoming available for reinvestments upon exiting investments made on account of the Direct Investment Capital shall not be considered as part of Direct Investment Capital, but shall be allocated as Accelerator Fund Capital for implementing investment strategy for Accelerator Funds

5.3. *Requirements to Public Fund Management by EDF Manager*

EDF Manager is established and controlled by EDF. In managing the Public Fund, EDF Manager shall adhere to the Act, this EDF Investment Strategy and the rules of the Public Fund. The EDF Manager shall make investments on account of the Public Fund pursuant to investment recommendations of the EDF expert committee.

The Public Fund shall be an evergreen fund and EDF's investment in the Public Fund shall not be limited in time.

The management fees payable to EDF Manager shall be according to market practice and are not expected to exceed, in any calendar year, three per cent (3%) of the fund size.

The allocation of fund proceeds (distribution waterfall) shall be based on market standards.