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CMDAF Baltic SME IPO Fund

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KPMG Baltics AS

March 2021



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CMDAF Baltic SME IPO Fund
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Glossary

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFM Directive	Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010
Altum	National promotional institution of Latvia
AML	Anti-money laundering
AUM	Assets Under Management
BIF I	The Baltic Innovation Fund is a Fund-of-Funds initiative of EUR 130m launched in 2012 by the EIF in close co-operation with the Baltic national promotional institutions – KredEx (Estonia), Altum (Latvia) and Invega (Lithuania). Investment period 2013-2019. Followed by the BIF II.
BIF II	Baltic Innovation Fund 2 (BIF 2) is a EUR 156m Fund-of-Funds initiative launched in 2019 by the EIF in co-operation with the Baltic national promotional institutions – KredEx (Estonia), Altum (Latvia) and Invega (Lithuania). Investment period 2020-2024
BSE Xtend	The Budapest Stock Exchange's alternative market
BVB	Bucharest Stock Exchange
CAPEX	Capital expenditures
CEB	Council of Europe Development Bank
CFT	Combating the Financing of Terrorism
CIT	Corporate Income Tax
CMDAF Baltic SME IPO Fund	Fund being designed under the Assessment and Feasibility Study, with the initial working title of "The Capital Markets Development Accelerator Fund"
CMU	The Capital Markets Union ¹
COC	Cost of Capital
DG REFORM	The Directorate-General for Structural Reform Support
Double Tax Treaty	General reference to any applicable tax treaty for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income that is concluded by Latvia, Estonia or Lithuania

¹ European Commission, A Capital Markets Union for people and businesses-new action, 2020

EBITDA	Earnings Before Interest, Taxes, Depreciation and Amortisation
EBRD	The European Bank for Reconstruction and Development
EDC	European Data Cooperative
EE	The Republic of Estonia
EIF	European Investment Fund
EMS	Environmental Management Standard
ERM 2	The European Exchange Rate Mechanism II
ESG	Environmental, social and corporate governance
ESIF	European Structural and Investment Funds
ESMA	European Securities and Markets Authority
EstFund	EUR 60m Fund-of-Funds initiative launched by EIF in 2016 in close co-operation with KredEx and the Estonian Ministry of Economic Affairs and Communications
ETF	Exchange-Traded Fund
EU	The European Union
EU SME IPO Fund	A European Commission fund-of-funds initiative dedicated to Small and Medium Enterprise Initial Public Offerings, currently in the design and development phase, expected to be part of Invest EU
EU/EEA/CH	All European Union member states, the European Economic Area members and Switzerland
EU-27	27 EU member states
EU-28	27 EU member states plus the United Kingdom when it was a member state
EUR	Euro
FCMC	Latvian and Financial Capital Market Commission
FFFs	Friends, Family and Fools
FPO	Follow on Public Offering
FSA, Estonian	Finantsinspektsioon (Estonian Financial Supervision and Resolution Authority)
FTSE Russell	FTSE International Limited trading as FTSE Russell is a British provider of stock market indices and associated data services
Fund (The Fund)	Capital Markets Development Accelerator Fund, the Baltic SME IPO Fund
GAFMA	Guidelines for SME Access to Finance Market Assessment
GBER	General Block Exemption Regulation
GDP	Gross Domestic Product
GFC	Global Financial Crisis

GIV	Government Investment Vehicle
GP	General Partner
H2	Second half of the year
HNWI	High Net Worth Individuals
HUF	Hungarian Forint
ICT	Information and Communications Technology
IFI	International Financial Institution (EBRD, EIF, NIB etc.)
IFRS	International Financial Reporting Standards
Invega	National promotional institution of Lithuania
Invest Europe	Former European Venture Capital Association
IPO	Initial Public Offering
IRR	Internal Rate of Return
IV	Investment Vehicle
JEREMIE	Joint European Resources for Micro to Medium Enterprises
K-Growth	Korea Growth Investment Corporation
KONEX	The Seoul Stock Exchange's alternative market
KOSDAQ	The Seoul Stock Exchange's main market
KPI	Key Performance Indicators
KredEx	National promotional institution of Estonia
KYC	Know Your Customer
LB	The Bank of Lithuania
LP	Limited Partner
LSE	London Stock Exchange
LT	The Republic of Lithuania
LT CIT Law	Corporate Income Tax Law of the Republic of Lithuania
LT PIT Law	Law on Income Tax of Individuals of the Republic of Lithuania
LV	The Republic of Latvia
LV CIT Law	Corporate Income Tax Law of the Republic of Latvia
LV PIT Law	Law on Personal Income Tax of the Republic of Latvia
M&A	Mergers and Acquisitions
MAR	Market Abuse Regulation
MEIP	The Market Economy Investor Principle
MEOP	The Market Economy Operator Principle
Mid-Cap	Mid-capitalisation
MiFID II	Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU

MS	Member State
MSCI	Morgan Stanley Capital International
MTF	Multilateral Trading Facility
NATO	The North Atlantic Treaty Organisation
NAV	Net Asset Value
NIB	Nordic Investment Bank
NPI	National Promotional Institution
NSEDF	National Stock Exchange Development Fund
OECD	Organisation for Economic Co-operation and Development
Parent – Subsidiary Directive	Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States
PE	Private Equity
PIT	Personal Income Tax
PRI	United Nations Principles for Responsible Investment
RFP	Request For Proposal
Risk Capital Guidelines	Guidelines on State aid to promote risk finance investments (2014/C 19/04)
RON	Romanian Leu
RRF	EU Resilience and Recovery Facility
RTS	Regulatory Technical Standards
SAFE	Survey on the Access to Finance of Enterprises
SMEs	Small and Medium Enterprises
SOE	State Owned Enterprise
SPO	Secondary Public Offering
SRS	State Revenue Service of Latvia
TESI	Finnish Industry Investment Ltd.
UBO	Ultimate Beneficial Owner
UCITS	Undertakings for Collective Investment in Transferable Securities
UCITS Directive	Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities
UHNWI	Ultra-High Net Worth Individuals
USD	United States Dollar
VAT	Value Added Tax
VC	Venture Capital
WHT	Withholding Tax
Y-O-Y	Year-On-Year

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1 Introduction

SMEs play a pivotal role in the economy of the Baltics, where they make up 99.8% of the total number of enterprises in 2018. Across the Baltics SMEs employ 1 620 386 people, which is 77.7% of the people employed in the private and non-public sectors. In terms of value added, SMEs in the Baltics created EUR 33.9 billion in 2018, which is 72% of the total value added (EU-28 average share stands 56.4%).

Compared to large corporations driving the capital markets, technological breakthroughs and large-scale impacts on the societies, SMEs tend to be relatively local and contribute less to these developments and impacts. However, in the broader sense these are enterprises that are the most flexible and able to quickly start new endeavours, experiment with new strategies (products and services) and create grounds for future growth, as well as these are the companies providing employment to most of the economically active population in the Baltics.

At the same time, SMEs have not been very active in capital markets in the Baltic region. Historically they have been predominantly financed by owners' equity, bank debt financing and local and regional SME-focused private equity and venture capital fund equity financing. Lately, banks have become more reluctant to finance "risky" endeavours² (SMEs are risky by definition, as they typically have weaker balance sheets, shorter track-record, are more affected by economy cycles etc.).

Still, on a policy making level officials have been discussing for a long time that SMEs may have a greater potential for growth than they realise. Many SMEs are stuck with a "glass ceiling" in their growth path – to a large extent that is due to the restricted access to finance.³

Taking into account the situation described above, the Baltic countries need to increase and diversify the access to finance for SMEs that have the capabilities to grow and become more significant players in their respective economies and abroad. That requires increased involvement of capital from both institutional and private investors. At the same time, it should be taken into account that each of the Baltic countries is a small market, which often struggles to garner interest from large international investors, thus it is essential to look at the region as a single market able to grow strong economic players – if sufficient financing is available for them. Moreover, raising equity capital for SMEs is also more challenging than for larger public companies (*ceteris paribus*) due to the typical investor preferences for greater absolute size in market capitalisation terms as well as post-listing liquidity on the secondary trading markets on stock exchanges.

The need to diversify and increase the access to finance for SMEs is the reasoning behind the Capital Markets Development Accelerator Fund Baltic SME IPO Fund (the CMDAF Baltic SME IPO Fund or the Fund) initiative⁴. The Fund will act as specialised hands-on investor, guiding Baltic SMEs and mid-caps into public capital market and tapping this previously under-utilised capital market segment funding. This will serve as

² European Commission, SAFE main results 2020

³ European Commission, User guide to the SME Definition, 2016

⁴ EBRD, Regional: Capital Markets Development Accelerator Fund (CMDAF), 2020

a proof-of-concept to wider investor and fund manager community, encouraging private market players to follow if successful.

In international experience, the public capital market (the stock exchange) is one of the three main pillars of an enterprise's access to equity capital for growth, alongside the other two pillars – organised private capital via risk capital funds, and non-organised private capital via business angels, UHNWIs and HNWIs and FFFs.

The primary source of funding in the region has historically come from banks. This creates additional risks due to either the overleveraging of enterprises or lack of access to capital due to insufficient/appropriate collateral being available for smaller and/or earlier stage corporate lifecycle companies. Furthermore, the supply of capital is also limited by the banks' own ability to use their balance sheets for supplying credit.

The last 10 years have seen a notable development and growth of the Baltic private capital market as a result of the BIF I and several national initiatives like the JEREMIEs and the EstFund, whilst the public capital market has stayed mostly stagnant and remains less developed if compared to most other EU countries, be it the market capitalisation to the GDP, the number of IPOs or any other metric.

As a result, the Baltic SMEs and mid-caps were not adequately incentivised to try to access a key source of capital markets funding, which is available to many of their competitors, thus contributing to the creation of a structural problem/market gap. Baltic countries need to increase and diversify the access to finance for enterprises that have the capabilities to grow and become more significant economic players.

The need to reinvigorate the underdeveloped Baltic public capital market, to diversify and increase the access to finance for Baltic SMEs & mid-caps is the reasoning behind the CMDAF Baltic SME IPO Fund initiative.

The CMDAF Baltic SME IPO Fund project has several aims:

1. Market gap – to analyse the Baltic capital market and existing finance providers to identify the market gap, if such to exist, and the parameters for financial instrument that could effectively targeting such a gap;
2. Investment – to facilitate the establishing of a new financial instrument (the Fund, CMDAF Baltic SME IPO Fund), which would operate on a commercial-pricing basis, whilst improving the SME and Small mid-cap access to finance, and to facilitate the development of the Baltic capital markets;
3. Reform – to facilitate the improvement of the Baltic fund operational environment via "Assessing existing legal/tax restrictions or any other impediments" and providing actionable reform recommendations for the improvement on the identified impediments in Lithuania, Latvia and Estonia (to be submitted as a separate document);
4. Regional capital markets development – as reinforced by various Memorandums of Understanding as led and signed by the Ministries of Finance (2017)⁵ as well as the

⁵ EBRD, Baltic states to create a pan-Baltic capital market, 2017, <https://www.ebrd.com/news/2017/baltic-states-to-create-a-panbaltic-capital-market.html>

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Central Banks (2020)⁶ of all Baltic States and benefitting from EC and EBRD support;

5. Sustainable finance – assess the merits of integrating such aspects in the fund design.

⁶ EBRD, EBRD and Baltic states to develop commercial paper market, 2020,
<https://www.ebrd.com/news/2020/ebrd-and-baltic-states-to-develop-commercial-paper-market.html>

2 Executive Summary

On The Project

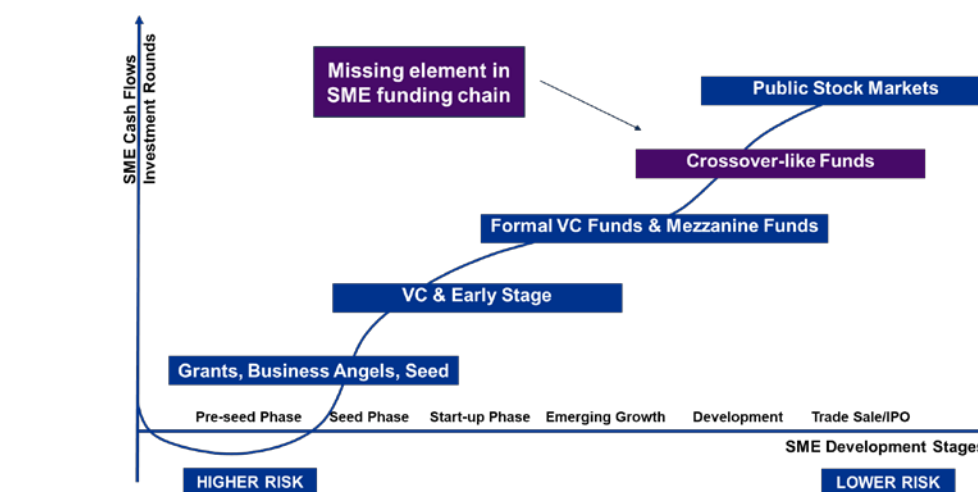
The European Bank for Reconstruction and Development (the EBRD) has commissioned KPMG Baltics AS (KPMG) to implement the consultancy contract number C45109/8347/88106 of 30 June 2020 for Regional: SRSS – LC2 Initiative TC Framework – Capital Markets Development Accelerator Fund (CMDAF Baltic SME IPO Fund) (the project).

The project is funded by the European Commission via the Structural Reform Support Programme and implemented for the benefit of the Ministries of Finance of Estonia, Latvia and Lithuania, in cooperation with the European Commission's DG REFORM and the EBRD.

The CMDAF Baltic SME IPO Fund project is aimed at supporting access to finance for Baltic SMEs and the development of Baltic capital markets in line with the EU Capital Markets Union (CMU) objectives.

It is important to highlight that private equity and public equity sides of capital market cannot be analysed separately, those are two sides of the same coin. The enterprises and/or their owners want to raise new capital or trade existing shares. From an enterprise point of view, new equity is new equity, the technical process and procedure to attract it does not change the colour of the money raised. In theory, public capital markets are typically meant for more mature and stable companies, whilst private equity serves earlier and higher risk stages of enterprise development, but with the development of capital market concept and the introduction of growth markets like the First North this stage distinction has become quite blurred. Also, with enterprises in the Baltics practically not using the public capital market as a funding venue, it can be assumed that all the latent demand for public equity is hiding in private equity demand statistics. Thus this report analyses capital market holistically, looking at the full enterprise funding lifecycle, through private and public. The following figure illustrates the aforementioned lifecycle.

Figure 1 Equity Capital Market Map



Source: KPMG

Supply and Demand of Private and Public Equity

The **supply of private equity** in the Baltics has been significantly bolstered by the availability of financing from and organised by the EIF, which has in turn enabled extra private capital topping up the EIF managed resources. As a result, the growth and development of private equity industry in the Baltics has been strong whilst public capital markets stagnated inter alia without comparable support initiatives. Apart from growing supply of private equity investments, the respective fund managers have also accumulated knowledge about managing private equity investments, which is conducive to any further development of private equity in the Baltic region. Moreover, the information and knowledge about private equity has been widely disseminated among companies and entrepreneurs, helping them better understand when and how to use private equity at the expense of public markets.

According to the analysis performed as part of the project, the total capital in Baltic private equity funds stands at EUR 1.06bn, with capital available for investment at around EUR 800m as of 31 December 2019. This amount of capital, so-called “dry powder”, is to be invested over several years, but clearly points towards the availability of a significant supply of private equity capital in Baltics at the moment of writing of the report.

Applying different methods for calculating **demand for private equity** produce rather different results. Comparing macro level data of private equity to GDP in the Baltics and depending on the statistics used, the gap has been estimated to be between EUR 53.5m and EUR 406.7m. Although this approach in estimating the equity financing gap is of a generalist nature, it still allows seeing the magnitude of the financing gap, especially bearing in mind that the data compiled relates to the period 2015 to 2019 and hence yearly differences should be considered and balanced out. According to the alternative analysis by Fi-compass, the Baltic states have a mid-range equity financing gap to GDP ratio standing at 10.7% (as per 2018 data). That has led Fi-compass researchers to conclude that the equity financing gap in the Baltic states in 2018 stood at EUR 10.77bn.

Public equity contains significant differences between market capitalisations among the Baltic countries. As of year-end 2020, the capitalisations of the Baltic stock exchanges stood at around EUR 4.48bn in Vilnius, EUR 2.84bn in Tallinn and EUR 0.95bn in Riga.

As of 31 December, 2020, there were 69 companies listed on the Nasdaq Baltic stock exchanges. The Baltic Main list is comprised of 33 companies, the Baltic Secondary list of 28 companies and the Baltic Bond list of 56 bond issues. At the same time, the alternative First North market is comprised of 8 share listings and 11 bond issues.

The total equity capital attracted on the Baltic stock exchanges during 2015 to 2020 amounted to EUR 797m, out of which the top 5 deals constituted EUR 690m or around 87% of the total equity capital attracted. This shows the rather big difference between mean (EUR 24.9m) and median (EUR 2.75m) values of capital attracted.

With the three Nasdaq Baltic stock exchanges effectively functioning as a single regional market, the theoretical scope for growth in terms of the **supply of public equity** available for corporates is technically unlimited. There are limiting factors such as the challenge with the indexation issues and scope of absolute sizes of companies indices. However,

solving the deterring aspects have the possibility of capitalising on the significant potential for increase of supply of public equity financing.

The capitalisation of stock exchange to GDP in April 2019 was 4% in Latvia, 11% in Lithuania and 13% in Estonia. At the same time, the median in the EU/EEA/CH stood at 40% and mean at 60%. The median of 40% would yield around EUR 43bn in absolute numbers for the Baltics, it can be seen that with the existing Baltic capitalisation of around EUR 8.3bn, the gap can be estimated at more than 5 times overall. Hence, the potential **demand for public equity** can be estimated at around EUR 35bn for the Baltics.

Regarding peer-group comparison and analysis, Sweden is an example that shows market development that the Baltic stock exchanges could learn from. In Sweden, the biggest Nordic market, there is a relatively similar number of listed companies in both the regulated and First North markets (several hundred in each market sector). Moreover, greater than 20% of the Nasdaq Nordic First North companies (there is a total of around 400, includes Sweden and other Nordic First North locations) have a market capitalisation less than EUR 10m. Nearly 30% had revenues less than EUR 0.5m in the last financial year, out of which more than half had almost non-existent revenue. Furthermore, Sweden has another alternative market as well, the Spotlight Stock Market (previously known as 'Aktietorget'), with around 170 smaller companies admitted to trading. To be noted, there are no existing funds in Baltics (and most of Europe for that matter) with similar investment mandates, also the EU-level EU SME IPO Fund initiative is in a very early stage, thus the proposed Fund will operate largely uncontested.

Market Failure and Assessment of the Market Gap

As described in detail in the report, despite the significant Baltic government efforts during the last 15 years, mainly on the private equity part, there still are demonstrable and quantifiable market gaps both on the private equity and public equity sides of the Baltic capital market.

To recap, the Baltic annual **private equity market gap** can be estimated in the range of EUR 53.5m to EUR 406.7m using the traditional method, or a staggering EUR 10.8bn using the innovative method crafted by Fi-compass team.

The Baltic **public equity market gap** has been analysed using mostly comparative methods due to the lack of existing recognised other, more sophisticated methodologies. The potential demand for public equity is estimated at around EUR 35bn for the Baltics, which is the difference between the potential market capitalisation and the existing one. The theoretical market gap in terms of EUR is a very high amount, but it needs to be taken into account that it includes the potential large-cap company presence/listing, representing a major part of that EUR amount. It is very important to point out that not all SMEs requiring financing are early stage companies in an ICT-related field, hence a broader policy prescription needs to be applied to avoid fallacy of composition aspects whereby only a limited number of industry sectors would be favoured over others.

For the purposes of the project, specifically the SME and mid-cap segment was looked at, using a tailor-made criteria and approach to design an analytical top-down investment

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funnel. Initially screening a broad list of 20 076 companies in the Baltics was sequentially narrowed down to a pool of potential 186 company listings over a several year period.

As a result of the performed analysis, there is a clear and justified need for State intervention.

It is noted that that the potential risk finance measure must be designed in such a way as to address the market failures identified in the ex-ante assessment or an equivalent document such as this report.

The following sections of the report contain details of such a potential risk finance measure - Investment Strategy based on this identified market gap, Fund structure and terms built around the required Investment Strategy, and further legal and tax analysis to help place everything in context.

CMDAF SME IPO Fund Investment Strategy

The CMDAF SME IPO Fund is proposed to operate in the following manner:

- The CMDAF Baltic SME IPO Fund would provide finance for pre-listing stage SMEs and mid-cap companies on the Baltic market;
- The Fund would target established profitable companies with enterprise values between EUR 5m and EUR 100m;
- The Fund would 1) participate in initial public or private offerings related to both the main market and the multilateral trading facility (MTF) alternative market of typically the Nasdaq Baltic stock exchange; and 2) invest in private pre-listing stage Baltic companies with a clear intent to list on the aforementioned venues in a reasonable period of time (indicatively 12-24 months);
- The Fund would operate as a specialist financial intermediary targeting pre-IPO investments, substantially supporting IPO fundraisings and direct listings, by acting as an “cornerstone investor” to take a material allocation (understood as typically at least 25% of the shares or securities issued) of the shares issued, providing a strong signalling effect to other potential investors;
- The Fund would primarily enhance availability of financing for SMEs but as a secondary impact would also contribute to the development of the Baltic capital market;
- Currently it is envisaged that at the fund level the three Baltic Governments would participate at the initial stage, if possible coupled with fund investment and management expertise and/or financing from an IFI or possibly the EU SME IPO Fund (which is a fund-of-funds and hence the CMDAF Baltic SME IPO Fund could become its regional implementing arm);

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- The Fund would invest up to 50% of the total investment cost (gross proceeds per company listing case terminology) in each transaction, with the rest required to come from other investors qualifying as “private investors” under the EU state aid rules;
- The target is to raise a EUR 80m fund with a minimum size of EUR 60m and hard cap of EUR 100m. The proposed Fund should build a balanced and diversified portfolio. With an average initial ticket of EUR 2-3m (expected to be ranging between EUR 0.5–5m) this would allow for 21-24 investments at target fund size, 15-18 at minimum fund size. With investees typically being established growth and late stage companies, a decent portfolio diversification is expected.

Based on the expert team’s practical experience and in line with the Fund’s strategy –**21 companies have been already identified as potential target investments** of the Fund, thereby demonstrating the potential availability of quality investment targets for the Fund also via bottom-up analysis.

The possibility to list the Fund later on (once a track record has been established) is also considered.

Legal Aspects of the Set-up of the CMDAF Baltic SME IPO Fund

The comprehensive assessment undertaken confirms applicability of the EU State aid law to the risk finance scheme under examination. The State aid risk analysis indicates **compatibility of the scheme with the MEOP requirements** on all corresponding levels, namely (i) the level of the IFIs co-investing into the Fund, (ii) the level of the private investors co-investing alongside the Fund into the forthcoming investees; (iii) the level of the Fund accommodating the financial means, (iv) the level of the AIFM managing the financial means of the Fund, as well as (iv) the level of the forthcoming investees constituting final beneficiaries. Therefore, **risk finance scheme under consideration does not constitute State aid** within the meaning of Article 107(1) TFEU.

The currently recommended **legal set-up form** is Limited Partnership. Limited Partnership grants the most freedom of setup and operation. Unlike Public Limited that comes with pre-determined structural setup, the Limited Partnership grants freedom to set up structural, decision-making rules and practices according to the specific circumstances of the Fund. On the downside, this form is less optimal for later listing of the fund.

On the **domicile**, it is feasible to incorporate Fund in either of the three Baltic States . No decisive advantages are identified for establishing the Fund in one Baltic state as opposed to other. While there are differences in all legal systems and they employ different rules for some subject-matters, even those different rules, in general, have similar or comparable effect.

Given the benefit of regulatory clarity and tax transparency as well as the institutional and governance advantages, we recommend that the Fund should pursue an **AIF status**. This means that the manager of the Fund shall be a registered or licenced AIFM or be in the position to obtain a licence or register as an AIFM.

While initial capital injection triggers certain special rules regulating public economic stake-holding in all Baltic states, only some of these rules would pose any material hindrance once operations of the Fund are initiated.

Concluding Remarks

This Assessment and Feasibility Study lays out the logic and practical solutions for the necessity of setting up the Fund. Further discussions will be needed with stakeholders to agree on the most efficient way forward and to progress to the practical implementation aspects of the Fund.

As part of the further work within the project, extensive consultations with the EBRD and the Baltic Ministries of Finance and other stakeholders is envisaged. The Ministries of Finance have to pass the conceptual decision to support and fund the new financial instrument based on the market gap identified in this Report through their respective channels of decision making so as to proceed to the practical set-up of the financial instrument (CMDAF Baltic SME IPO Fund). The proposed financial instrument details are described in this report, but are to be further ironed out in investor (provisionally NPIs) discussions. To facilitate the said process and considering the rather vast array of different stakeholders involved, it may be necessary to draft a CMDAF Baltic SME IPO Fund investor agreement/ letter of intent – so as to proceed in a staged approach.

The expert team will also draft the RFP documents for the selection of the management company for the CMDAF Baltic SME IPO Fund and will reasonably assist the Baltic Ministries of Finance (or NPIs, if applicable) in performing the tender and actual onboarding of the management company.

3 The Market Environment

3.1 Characteristics of the Baltic Economy

The Baltic economy saw constant growth up until 2020. Even though the population was decreasing in size, the gross domestic product (hereinafter, GDP) has been growing at a stable pace. The difference between the GDP's in 2015 and 2019 is almost EUR 25bn in real terms. Alongside that, the real GDP per capita has seen a rise greater than EUR 4 000.

In 2019, on the country level, Lithuania contributed the most to the pan-Baltic GDP, with a share of 45%, Latvia and Estonia contributed 29% and 26%, respectively. Estonia, although the smallest economy in the Baltics, has had the greatest GDP per capita over the five year span peaking in 2019, Lithuania has had the second highest, while Latvia is trailing behind both other countries.

Table 1 Overall GDP and Population of the Baltics (2015-2019)

Baltic Total Population and GDP		2015	2016	2017	2018	2019
Population	Baltics	6 222 228	6 173 459	6 113 655	6 062 413	6 038 972
	EE	1 314 870	1 315 944	1 315 635	1 319 133	1 324 820
	LV	1 986 096	1 968 957	1 950 116	1 934 379	1 919 968
	LT	2 921 262	2 888 558	2 847 904	2 808 901	2 794 184
	Baltics	82.53	85.89	92.93	100.26	107.02
Real GDP, Billions, EUR	EE	20.78	21.93	23.86	25.94	28.11
	LV	24.43	25.07	26.8	29.06	30.48
	LT	37.32	38.89	42.27	45.26	48.43
	Baltics	13 264	13 914	15 200	16 538	17 722
Real GDP per capita, current prices, EUR	EE	15 806	16 666	18 134	19 663	21 220
	LV	12 298	12 734	13 742	15 021	15 873
	LT	12 776	13 465	14 842	16 115	17 333

Source: KPMG compiled data from Eurostat⁷

⁷ Eurostat, Population on 1 January, 2020; Eurostat, GDP and main components, 2020

3.1.1 Macroeconomic Figures

3.1.1.1 GDP Growth Rate

Macroeconomic figures for the respective countries show that GDP growth has been fluctuating across the covered five year period. The average growth rate for the Baltic countries grew from 2.4% in 2015 to 3.5% in 2019. Estonia saw a significant jump in the growth rate in 2016, climbing from 1.8% to 4.4% y-o-y, afterwards the growth stabilised and kept growing steadily at a rate greater than 4%. The GDP growth in Latvia during the five years was instable, peaking in 2018 at a rate of 4.3%, in other years the rate was fluctuating in a range of 1.8% to 4.3%. Lithuania experienced solid growth, it peaked in 2017 at the rate of 4.2%, afterwards it retracted to the range of 3.6% to 3.9%.⁸

3.1.1.2 Inflation

Inflation in the Baltics experienced quite rapid growth up until 2017, going from 0.5% to 3.4%. Afterwards it saw a steady decrease by 0.6% and 0.4% a year through 2018 and 2019 respectively, falling down to 2.4%. On a country level, Estonia and Lithuania both followed the growth pattern of rapid growth through 2015 to 2017, reaching 3.7%, and then a decrease in 2018 and 2019, resulting in 2.3% and 2.2%. Latvia saw a decrease at first in 2016, but grew afterwards in 2017, similar to the other countries, however it did not surpass the 3% level, and in the following years stayed in the range of 2.7% to 2.9%.⁹

3.1.1.3 Unemployment

Employment has seen a positive trend in the Baltics across the five year scope. The unemployment rate decreased every year, dropping from 8.4% in 2015 to 5.7% in 2019. Estonia had the lowest unemployment rate across the five years, ranging from 4.4% in 2019 to 6.2% in 2015. Lithuania and Latvia both had similar ranges for the unemployment rates, from 6.3% in 2019 to 9.1 and 9.9% in 2015, however while Latvia had decrease in its rate across the five years, Lithuania experienced a very slight increase of 0.1% in 2019.¹⁰

3.1.1.4 Government Debt

The average government debt in the Baltics fluctuated over the previous five years, the lowest level was achieved in 2018, when it was 26.5% of GDP. Throughout the other four years the range in which the government debt fell in was from 27.2% to 30.3%. Throughout the five years Estonia had a substantially lower level of government debt, it ranged from 8.3% to 10%. Latvia and Lithuania had more similar paths in that time period, both countries experienced government debt above 30%, up to 40.9% to 42.7%, respectively.¹¹

⁸ Eurostat, Real GDP growth rate, 2020

⁹ Eurostat, HIPC - inflation rate, 2020

¹⁰ Eurostat, Total unemployment rate, 2020

¹¹ Eurostat, Reporting of Government Deficits and Debt Levels of Member States, 2020

3.1.1.5 *Balance of Payments Current Account*

The balance of payments current account fluctuated over the five years in the Baltics. In 2015 it constituted -0.5% of the GDP, whereas in 2019 it reached 2.2%, during the period it increased and decreased as well. Estonia was the only country which had a positive rate throughout all the years, ranging from 1.7% to 2.8%. Latvia experienced a positive rate in 2016 and 2017, however onwards from 2018 it was negative, reaching -0.5% in 2019. Lithuania had a negative rate in 2015 and 2016, however starting from the rate was positive, experiencing a drastic increase in 2019 of 4%, reaching 4.3%.¹²

3.1.1.6 *Budget Deficit*

The average budget deficit rate for Baltics was negative throughout the five years, ranging from -0.5% to -0.03%. The highest level was achieved in 2016. Estonia had a fluctuating level, however it was mostly negative, ranging from -0.8% to 0.1%. Latvia was in a similar situation to Estonia, however the range was wider from -1.4% to 0.2%. Lithuania, in contrast, mostly had a budget surplus. From 2016, it fluctuated, ultimately the balance stayed positive, in 2019 reaching 0.3%, in the other years ranging from -0.3% to 0.6%.¹³

3.1.1.7 *Investment*

The investment rate in the Baltics maintained a solid rate throughout the five years. The rate ranged from 21.1% to 23.3% of GDP. Country wise, the trend was similar, both growth and decline was quite stable, in all countries the rate in 2019 was close to the one in 2015. Estonia experienced a stable rate above 24% throughout the years, peaking in 2019 at 26.2%. For Latvia the rate was ranging from 19.3% to 22.2%, with dips in 2016 and 2017. Lithuania experienced gradual growth from 19.6% in 2015 to 21.4% in 2019, with an increase every year.¹⁴

¹² Eurostat, Balance of payments, 2020

¹³ Eurostat, Reporting of Government Deficits and Debt Levels of Member States, 2020

¹⁴ Eurostat, Investment share of GDP by institutional sectors, 2020

Table 2 Macroeconomic Figures of the Baltic States 2015-2019¹⁵

Baltics Macroeconomic Figures (year on year basis)		2015	2016	2017	2018	2019
GDP growth %	Baltics	2.4	2.9	4.5	4.1	3.5
	EE	1.8	4.4	5.5	4.4	4.3
	LV	3.3	1.8	3.8	4.3	2.2
	LT	2	2.6	4.2	3.6	3.9
Inflation %	Baltics	-0.1	0.5	3.4	2.8	2.4
	EE	0.1	0.8	3.7	3.4	2.3
	LV	0.2	0.1	2.9	2.6	2.7
	LT	-0.7	0.7	3.7	2.5	2.2
Unemployment %	Baltics	8.4	8.1	7.2	6.3	5.7
	EE	6.2	6.8	5.8	5.4	4.4
	LV	9.9	9.6	8.7	7.4	6.3
	LT	9.1	7.9	7.1	6.2	6.3
Government Debt % of GDP	Baltics	29.8	30.3	29.2	26.5	27.2
	EE	10.0	10.2	9.3	8.3	8.4
	LV	36.7	40.9	39.3	37.2	36.9
	LT	42.7	39.7	39.1	33.9	36.3
Balance of payments current account % of GDP	Baltics	-0.5	0.7	1.4	0.5	2.2
	EE	1.8	1.7	2.7	2.0	2.8
	LV	-0.9	1.4	1.0	-0.7	-0.5
	LT	-2.4	-1.1	0.5	0.3	4.3
Budget deficit % of GDP	Baltics	-0.5	-0.03	-0.4	-0.3	-0.1
	EE	0.1	-0.5	-0.8	-0.6	-0.3
	LV	-1.4	0.2	-0.8	-0.8	-0.2
	LT	-0.3	0.2	0.5	0.6	0.3
Investment % of GDP	Baltics	21.9	21.1	21.9	22.5	23.3
	EE	24.3	24.2	24.9	24.6	26.2
	LV	21.9	19.3	20.6	22.1	22.2
	LT	19.6	19.9	20.1	20.9	21.4

Source: Eurostat Database, KPMG analysis and calculations¹⁶
¹⁵ At the time of writing the macroeconomic figures for 2020 were not available

¹⁶ Eurostat, Balance of payments, 2020; Eurostat, Budget deficit, 2020; Eurostat, Real GDP growth rate, 2020; Eurostat, Total unemployment rate, 2020; Eurostat, Reporting of Government Deficits and Debt Levels of Member States, 2020; Eurostat, HIPC - inflation rate, 2020; Eurostat, Investment share of GDP by institutional sectors, 2020

3.1.2 Economic Forecasts

The COVID-19 pandemic has created very challenging conditions for predicting economic growth, as the predictions are very volatile and can change even on monthly basis. In the first half of the year the predictions were pessimistic, however nearing the end of 2020, the predictions were showing more positive signs of mitigating the effects of the crisis in the Baltic region. In this section data from the economic forecast report published by the European Commission on 5 November 2020 is used.¹⁷

Furthermore, with the release of newer economic forecasts by the European Commission the forecasts were updated. The latest release at the time of writing was in February 2021. In the interim Winter 2021 forecast, the GDP growth and inflation forecasts were adjusted.

Overall, the outlook in the years 2021 and 2022 is expected positive and relatively stable in comparison to 2020, for all countries, thus implying solid growth for the whole region.

According to the forecasts, the average GDP growth in the Baltics in 2020 is measured negative at -2.4, however a turnaround is forecasted for the next two years ranging from 2.8 to 3.3 percent. Inflation in the Baltics is set to increase throughout the years increasing from 0.2 in 2020 up to 1.8 in 2022. The Baltics unemployment rate in 2020 is forecasted at 8.2 percent, however it will decrease on a yearly reaching 7 percent in 2022. The government debt percentage of GDP is set to increase from 37.3 percent up to 40.5 percent in 2020. The balance of payments current account percentage of GDP will decrease from 3.2 percent down to 1.4 percent. Lastly, the budget deficit percentage of GDP is set to increase from -7.2 percent up to -3.7 percent.

Table 3 Economic Forecasts by the European Commission Winter 2021 (2020-2022)

Economic forecasts		2020	2021	2022
GDP growth %	Baltics	-2.4	2.8	3.3
	EE	-2.9	2.6	3.8
	LV	-3.5	3.5	3.1
	LT	-0.9	2.2	3.1
	Baltics	0.2	1.4	1.8
Inflation %	EE	-0.6	1.2	2.1
	LV	0.1	1.5	1.9
	LT	1.1	1.4	1.5

Source: European Commission¹⁸

¹⁷ European Commission, Economic forecast for Estonia, 2020; European Commission, Economic forecast for Latvia, 2020; European Commission, Economic forecast for Lithuania, 2020

¹⁸ European Commission, European Economic Forecast Winter 2021, 2021

Table 4 Economic Forecasts by the European Commission Autumn 2020 (2020-2022)

Economic forecasts		2020	2021	2022
Unemployment %	Baltics	8.2	7.9	7
	EE	7.5	7.8	6.7
	LV	8.3	8	7.5
	LT	8.9	8	6.9
Government Debt % of GDP	Baltics	37.3	39.7	40.5
	EE	17.2	22.5	26.4
	LV	47.5	45.9	45.5
	LT	47.2	50.7	49.5
Balance of payments current account % of GDP	Baltics	3.2	2.3	1.4
	EE	2.8	2	1.2
	LV	2.3	1.2	0.1
	LT	4.6	3.7	2.9
Budget deficit % of GDP	Baltics	-7.2	-5.1	-3.7
	EE	-5.9	-5.9	-5.1
	LV	-7.4	-3.5	-3.3
	LT	-8.4	-6	-2.8

Source: European Commission¹⁹

3.2 SME & Mid-Cap Characteristics and Environment

3.2.1 The Baltics

SMEs play a pivotal role in the economy of the Baltics. SMEs make up 99.8% of the total number of enterprises. SMEs across the Baltics employ 1 620 386 people, which is a 77.7% share of the people employed in the private and non-public sectors and is 11.1 % more than the EU-28 average share of 66.6%. In terms value added, SMEs created EUR 33.9bn, which is a 72% share of the whole value added, the EU-28 average share stands 56.4%, which is 15.6 percentage points less than the Baltics.

¹⁹ European Commission, Economic forecast for Estonia, 2020; European Commission, Economic forecast for Latvia, 2020; European Commission, 2020

Table 5 SME Figures in the Baltics and the EU-28 (2018)

Baltics Number of enterprises				Number of people employed			Value added		
Class size	Baltics		EU-28	Baltics		EU-28	Baltics		EU-28
	Number	% share	% share	Number	% share	% share	Billion €	% share	% share
Micro	359 572	92.3	93	658 869	31.6	29.7	10.8	22.9	20.8
Small	24 623	6.3	5.9	499 378	23.9	20.1	10.8	22.9	17.6
Medium	4 580	1.2	0.9	462 139	22.2	16.8	12	25.5	18
SMEs	388 775	99.8	99.8	1 620 386	77.7	66.6	33.9	72.0	56.4
Large	686	0.2	0.2	465 083	22.3	33.4	13.2	28.0	43.6
Total	389 461	100	100	2 085 499	100.0	100	47.1	100	100

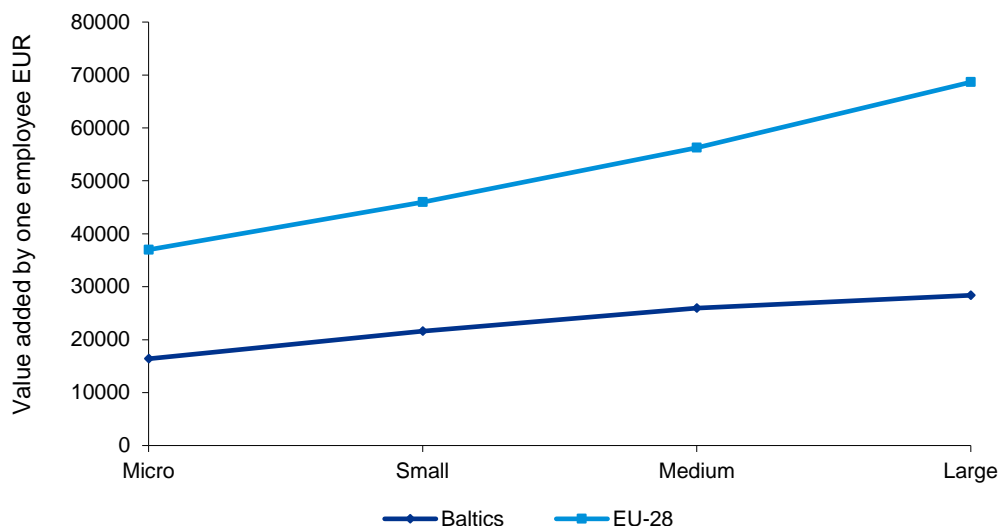
Source: KPMG calculations, data from the European Commission²⁰

In the figure below value added by one employee in the Baltic enterprises has been compared with that of the EU-28 enterprises. There is an evident trend of rising value added per employee as a company grows in terms of number of people it employs. The growth is however much steeper in the EU-28 than in the Baltics, indicating higher overall value added growth that goes together with growing number of employees. Moreover, the absolute numbers are very much different for the Baltics and the EU-28, with ever larger lagging behind of the Baltic enterprises as the number of employees in companies grow.

This productivity growth with size of the company is an aspect to be borne in mind with regard to the CMDAF Baltic SME IPO Fund, since the Fund would aim to contribute to growth of enterprises concerned and hence should be fostering growth of value added.

²⁰ European Commission, Estonia SBA fact sheet, 2019; European Commission, Latvia SBA fact sheet, 2019; European Commission, Lithuania SBA fact sheet, 2019

Figure 2 Value Added by One Employee in the Baltics and EU-28



Source: European Commission²¹

3.2.2 Estonia

SMEs generate 76.7% of the total value added and 79.2% of the total number of people employed, well above the respective EU averages of 56.4% and 66.6%. Estonian SMEs employ 4.5 people on average, which is slightly higher than the EU average of 3.9. Similar to most EU countries, the most significant SME sectors are wholesale and retail trade, and manufacturing. The average productivity of Estonian SMEs, calculated as the value added per person employed, is around EUR 30 600, 31.4% lower than in the EU as a whole.²²

In 2014-2018, SMEs in the 'non-financial business economy' generated a strong increase of 34.5% in SME value added. SME employment grew by 8.8% in the same period. Micro-firm value added and employment rose most strongly, by 48.4% and 15.0% respectively. Most recently, in 2017-2018, SME value added increased strongly by 11.3% and SME employment rose by 1.3%. Again, the highest growth in SME value added and employment was in micro firms, at 15.8% and 3.6% respectively.²³

²¹ European Commission, EU-28 SBA fact sheet, 2019

²² European Commission, Estonia SBA fact sheet, 2019

²³ European Commission, Estonia SBA fact sheet, 2019

Table 6 SME Figures in Estonia and the EU-28 (2018)

Estonia									
Number of enterprises			Number of people employed				Value added		
Class size	Estonia		EU-28	Estonia		EU-28	Estonia		EU-28
	Number	% share	% share	Number	% share	% share	Billion €	% share	% share
Micro	70 344	91.3	93	143 216	32.8	29.7	4	29.3	20.8
Small	5 500	7.1	5.9	106 171	24.3	20.1	3.2	23.1	17.6
Medium	1 012	1.3	0.9	96 144	22	16.8	3.3	24.3	18
SMEs	76 856	99.8	99.8	345 531	79.2	66.6	10.6	76.7	56.4
Large	166	0.2	0.2	90 673	20.8	33.4	3.2	23.3	43.6
Total	77 022	100	100	436 204	100	100	13.8	100	100

Source: European Commission²⁴

3.2.3 Latvia

SMEs generate 71.1% of the total value added and 79.4% of total number of people employed, well above the respective EU averages of 56.4% and 66.6%. However, the average productivity of Latvian SMEs, calculated as value added per person employed, at only EUR 17 900, is less than half the EU average of EUR 44 600. As in most EU countries, the most important sectors in terms of SME value added and SME employment are manufacturing and wholesale and retail trade. On average, SMEs in Latvia employ 4.6 people, above the EU average of 3.9.²⁵

In 2014-2018, the overall value added and employment shares of SMEs and large firms grew at similar rates. However, while value added increased by 29.9% for SMEs and 29.1% for large firms, SME employment growth was significantly lower, with a rise of only 6.3% for SMEs and only 5.0% for large firms. The main drivers of SME value added growth were small firms, with an increase of 36.7% in 2014-2018. In terms of employment growth, micro firms led the way, with a rise of 10.8% in the same period in 2014-2018, the overall value added and employment shares of SMEs and large firms grew at similar rates. However, while value added increased by 29.9% for SMEs and 29.1% for large firms, SME employment growth was significantly lower, with a rise of only 6.3% for SMEs and only 5.0% for large firms. The main drivers of SME value added growth were small firms, with an increase of 36.7% in 2014-2018. In terms of employment growth, micro firms led the way, with a rise of 10.8% in the same period. More recently, in 2017-2018, overall SME value added increased strongly by 14.0%, whereas the rise in overall SME employment was much smaller, at 2.9%.²⁶

²⁴ European Commission, Estonia SBA fact sheet, 2019

²⁵ European Commission, Latvia SBA fact sheet, 2019

²⁶ European Commission, Latvia SBA fact sheet, 2019

Table 7 SME Figures in Latvia and the EU-28 (2018)

Class size	Latvia Number of enterprises			Number of people employed			Value added		
	Latvia		EU-28	Latvia		EU-28	Latvia		EU-28
	Number	% share	% share	Number	% share	% share	Billion €	% share	% share
Micro	104 705	91.5	93	217 364	33.2	29.7	2.7	21	20.8
Small	7 976	7	5.9	158 454	24.2	20.1	3.1	23.9	17.6
Medium	1 450	1.3	0.9	143 879	22	16.8	3.4	26.3	18
SMEs	114 131	99.8	99.8	519 697	79.4	66.6	9.3	71.1	56.4
Large	195	0.2	0.2	135 114	20.6	33.4	3.8	28.9	43.6
Total	114 326	100	100	654 841	100	100	13.1	100	100

Source: European Commission²⁷

3.2.4 Lithuania

SMEs in 2018, generated 69.4% of the economy's value added and 75.9% of the number of people employed, exceeding the respective EU averages of 56.4% and 66.6%. On average, SMEs in Lithuania occupy around 3.8 people, close to the EU average of 3.9. Average SME productivity (calculated as value added per person employed) was approximately EUR 18,500 in the reference period, less than half the EU average of EUR 44 600. Although it has caught up impressively over the past two decades, the fact that productivity is still below the EU average reflects remaining barriers to investment, skills mismatches, relatively low firm dynamics and a large informal sector.²⁸

In 2014-2018, overall SME value added increased by 39.1%, similar to the 38.0% growth of large firms. SME growth rates varied depending on firm size: micro firms generated an increase of 67.8% in value added, whereas the value added of medium-sized firms grew at a lower rate of 25.4%. SMEs created 72,200 jobs, 4.6 times more than large firms (15 700). Overall SME employment surpassed 2008 levels for the first time in 2018, by 1.6%. Overall SME growth accelerated in 2017-2018, with value added and employment up by 12.0% and 3.1% respectively.²⁹

²⁷ European Commission, Latvia SBA fact sheet, 2019

²⁸ European Commission, Lithuania SBA fact sheet, 2019

²⁹ European Commission, Lithuania SBA fact sheet, 2019

Table 8 SME Figures in Lithuania and the EU-28 (2018)

Lithuania Number of enterprises			Number of persons employed				Value added		
Class size	Lithuania		EU-28	Lithuania		EU-28	Lithuania		EU-28
	Number	% share	% share	Number	% share	% share	Billion €	% share	% share
Micro	184 523	93.1	93	298 289	30	29.7	4.1	20.5	20.8
Small	11 147	5.6	5.9	234 753	23.6	20.1	4.5	22.5	17.6
Medium	2 118	1.1	0.9	222 116	22.3	16.8	5.3	26.4	18
SMEs	197 788	99.8	99.8	755 158	75.9	66.6	14	69.4	56.4
Large	325	0.2	0.2	239 296	24.1	33.4	6.2	30.6	43.6
Total	198 113	100	100	994 454	100	100	20.2	100	100

Source: European Commission³⁰

³⁰ European Commission, Lithuania SBA fact sheet, 2019

4 Market Gap Analysis and Findings

4.1 Methodological Framework

4.1.1 Aim of the Gap Analysis

As one of the aims of the CMDAF Baltic SME IPO Fund project, the goal of this market gap analysis is to identify the existing market gaps³¹ in the current offering of equity mid-to-late stage financing available to Baltic SMEs and Small and Innovative mid-caps. A holistic view of the equity financing market is taken by looking at both private equity/venture capital funds and public capital via the listings on the capital markets through an Initial Public Offering (hereinafter, IPO) or other types of listings. A particular emphasis of the analysis is the assessment of the potential need for a new financial instrument that would facilitate the access of mid-to-late stage equity financing to companies, with the eventual goal of transitioning the companies from a private company status to a public (listed) company status with all the positive externalities to both the company itself and the overall development of the Baltic capital market.

4.1.2 Gap Analysis Methodology

To perform the market gap analysis for the CMDAF Baltic SME IPO Fund project needs, the methodological guidelines for an SME access to finance market gap assessment principles recommended by the European Commission and elaborated for practical application by the European Investment Fund in its working paper “Guidelines for SME Access to Finance Market Assessments (GAFMA)”³² (hereinafter, the Guidelines) are applied. The justification of market gaps for any financial instruments is important in light of identifying financial instruments that may be needed to foster SMEs’ access to finance in areas, which are currently not sufficiently served by existing entities and financial instruments. Additionally, the expertise and the experience of the project experts in the design process and the practical application of this and previous iterations of similar EU and EIF methodologies have been used.

According to the Guidelines, they are to be seen as a guidance rather than a prescription of how the market gap assessments are to be conducted. Overall, the following three types of data are to be used when carrying out the gap assessment, although with a possibility of tailoring them to the particular situation at hand:

- Gathering of research and secondary data;
- Performing surveys and stakeholder interviews;
- Doing the peer group analysis.

³¹ Also called „financing gaps”, as in the Communication from the Commission Guidelines on State aid to promote risk finance investments (2014/C 19/04), „Therefore, the existence of a financing gap affecting SMEs, small mid-caps and innovative mid-caps may justify public support measures [...]”.

³² EIF, Working Paper 2014/22 - Guidelines for SME Access to Finance Market Assessments (GAFMA), 2014

As for **gathering of existing research and available secondary data**, the existing, most recent (year 2019) gap analysis reports on access to equity financing for SMEs in Europe, with a particular interest in the said gaps in the Baltic states are to be analysed. Moreover, private equity investment data from Invest Europe with the view to identify the availability of equity finance for SMEs according to the stages of development and financing characteristics is analysed as well. The use of Invest Europe data is also justified by the fact that the data of Invest Europe is available in a uniform format for all three Baltic states, which precludes possible errors due to potential different interpretations of financing definitions across the three Baltic states. Additionally, data from Nasdaq Baltic both in terms of aggregate market data on existing equities as well as from the investment characteristics point of view regarding the deals that took place recently in the Baltics is compiled and analysed.

As for **performing surveys and stakeholder interviews**, only stakeholder interviews as a part of this analysis are performed. Late stage equity financing is a rather sophisticated topic and public equity financing is not a widely embraced topic. Nevertheless interview data from secondary sources for analysing the late stage equity financing gaps in the Baltic market is used. Moreover, because of the specifics of the sophistication of mid-to-late stage equity financing, primary and secondary data from institutions responsible for following the pulse of equity financing, i.e. the venture capital associations of the Baltic states and other relevant institutions has been gathered.

As for doing the **peer group analysis**, carrying out analysis with a group of countries where the public equity markets are as underdeveloped as in the Baltic states would not add value to the analysis. Hence, the analysis is undertaken in markets where the public equity culture is strong, especially as regards to the alternative markets. Hence, Sweden and Finland are chosen as the peer countries for this part of the analysis.

Having performed 1-3 above, it would become possible to identify the existing market gap with the goal to further elaborate the **proposed investment strategy** bearing in mind the conclusions drawn during the performing of the gap analysis. According to the Guidelines, the forming of an investment strategy should not be a part of the gap analysis process, and these Guidelines are being followed.

Building on the mandate of the CMDAF Baltic SME IPO Fund as well as agreed upon during the CMDAF Baltic SME IPO Fund project Steering Committee on 8 August, 2020, the following delimitations regarding the scope of the market gap assessment have been made:

- Standard market gap methodology as explained in the Guidance, identifies seven equity/quasi-equity market segments.
- Business angel financing, technology transfer fund and seed fund segments do not have substantive public capital market equivalents, and hence they are not considered relevant to the primary aim of the CMDAF Baltic SME IPO Fund project and consequently will not be analysed in the gap assessment.
- The following remaining segments are to be covered: venture capital, growth capital, replacement, turnaround and buyout capital, mezzanine financing segments, as those have substantive public capital market equivalents, at least in peer countries.

Additionally, the gap analysis would be provided on an as-of-today basis; no full future projection modelling will be undertaken. Main reason being, the future projections of the Baltic enterprise demand for financing can be expected to grow relatively linearly, in line with inflation plus the real GDP growth, but the equity supply side is dominated by government and IFI supported risk capital funds, thus any future projections need to heavily factor in as-of-today unknowable government market interventions 3-5 years from now, or a lack thereof.

Stemming from the equity-focussed mandate of the CMDAF Baltic SME IPO Fund project, regular debt financing (incl. bank financing) will also not be assessed as a part of the gap analysis. For avoidance of doubt, quasi-equity³³ legally in form of debt, is in the scope of this analysis.

Bearing in mind the methodology described above, the gap analysis is built on the analysis of the following two pillars with two underlying sub-pillars:

- SME & mid-cap equity financing supply
 - Supply of private equity
 - Supply of public equity
- SME & mid-cap equity financing demand
 - Demand for private equity
 - Demand for public equity

4.1.3 Private Equity Definitions

Private equity is a form of professional investment that involves taking an ownership interest in a private company as opposed to taking an ownership stake in a company listed on a public stock exchange (public company). Professional private equity investments typically are made through a fund or other type of pooled investment vehicle/structure, allowing the pooling of investments in an operationally and tax-efficient way as well as pooling investors and giving them investment exposure in an efficient way. Private equity fund managers believe that keeping a company private allows them to focus on making positive and long-lasting changes to the business, as opposed to meeting short-term demands of the stock markets and shareholders driven by quarterly earnings calls. Private equity is characteristically a medium to long-term investment, in which managers are actively involved in the portfolio companies they have invested in over several years. Investment funds are raised by managers from various sources,

³³ GBER definition is applied „‘quasi-equity investment’ means a type of financing that ranks between equity and debt, having a higher risk than senior debt and a lower risk than common equity and whose return for the holder is predominantly based on the profits or losses of the underlying target undertaking and which are unsecured in the event of default. Quasi-equity investments can be structured as debt, unsecured and subordinated, including mezzanine debt, and in some cases convertible into equity, or as preferred equity;”

including institutional investors, such as pension funds, insurance groups and sovereign wealth funds, as well as private high and ultra-high net-worth investors.³⁴

Private equity managers typically screen a large number of companies and only invest in very few of them which have the potential to produce the relatively high rates of return targeted by the fund managers and expected by fund investors. This means, private equity implies a higher-risk and higher-reward operation, companies which would receive the capital, have to possess very specific characteristics. The aim for the manager is to finance a specific operation and exit from the investment when the transformation has been completed. Additionally, private equity occasionally focuses on investments in firms which are facing “turnaround” or “rescue” situations, i.e. facing financial problems, however the companies have the potential to become profitable with change of management, cap table shake-out or restructuring.³⁵

In the following sections the main types of private equity supply and the demand for it in the Baltic region will be examined. In order to proceed with the set analysis it is necessary to explicitly point out the terminology, which will be used, in order to eliminate any potential misunderstandings, which could potentially stem from different terminology used across the world.

In the context of this report terminology recognised by Invest Europe will be utilised. The analysis of the supply of and the demand for will be conducted for some of the private equity categories, namely venture capital; growth capital; replacement, turnaround and buyout capital (as described in the Methodology section above). In addition, analysis will be conducted on the supply and demand of the hybrid debt and equity instrument - mezzanine financing.

Invest Europe defines the aforementioned forms of private equity in the following manner:

Venture capital is a subset of private equity and refers to equity investments made for launch, or early development or expansion business. In other words, seed, start-up and late stage venture phases respectively³⁶. However, in the scope of the report, seed capital is not going to be analysed as the companies in the start-up phases of financing present a high level of risk and are relatively further away from development wise form companies which could be considered ready for listing on a public stock exchange. After the exclusion of seed capital, two forms of venture capital will be examined: the start-up and the late venture stages. During the start-up stage financing is provided to companies, when the product or service is fully developed, in order to start mass production and to cover initial marketing expenses. The company may be in the setting up process or may have been in business for a short while, however have not sold the product commercially yet. The financing mostly would be used to cover capital expenditures and initial working capital. Furthermore, the start-up stage also could contain companies which have initiated commercial manufacturing but require further funds to cover additional capital expenditures and working capital before the break-even point has been reached. The

³⁴ Invest EU, About private equity, 2020

³⁵ Thompson, Boschmans, & Pissareva, Alternative Financing Instruments for SMEs and Entrepreneurs, OECD, 2018

³⁶ Invest EU, Research methodology and definitions, 2020

late venture stage involves financing provided for an operating company, which may or may not be profitable. The stage tends to finance companies which have already attracted investments from other venture capital funds.³⁷

Growth capital is a type of private equity investment, which often is a minority investment, in relatively mature companies that are looking for primary capital to expand and improve operations or enter new markets to accelerate the growth of the business.³⁸

Replacement, Turnaround and Buyout capital are three forms of private equity investments, which are geared towards mature companies. Replacement capital is a minority stake purchase from another private equity investment organisation or from another shareholder. Turnaround capital, as previously mentioned, is financing made to an existing business, which has experienced financial distress, with a possibility of becoming profitable again. Lastly, Buyout capital is financing provided to acquire a company, typically by purchasing majority or controlling stakes and it may use a significant amount of borrowed capital to meet the cost of acquisition.³⁹

Mezzanine finance is a hybrid of debt and equity financing, comprising equity based options and lower-priority debt.⁴⁰ To further elaborate, investors in mezzanine facilities assume more risk than a provider of a senior loans, participating loans, and equity-related mezzanine instruments such as convertible bonds and bonds with warrants. A mezzanine facility usually contains more than one of the aforementioned instruments. Mezzanine finance is often used as expansion capital.⁴¹

4.1.3.1 *Private Equity Data Methodology*

Previously data regarding private equity activities in the Baltics was very hard to come by as there was no harmonised data acquisition across the three countries. As the private equity eco-system has grown, data has become more accessible.

Two main sources, which provide comprehensive data regarding private equity investments, fund raising and divestments are a survey conducted in 2020 by the Baltic private equity and venture capital associations in collaboration with Deloitte⁴² and the European Data Cooperative (hereinafter, EDC), which was created by Invest Europe and its partner associations, including the Baltic private equity and venture capital associations.

In both of the sources, data relevant to the report is available, i.e. quantified information showcasing private equity activity in the Baltic region from 2015 to 2019. However, the sources differ in their scope. The survey data covers industry data, i.e. investments, fund raisings and divestments made by private equity firms based in the region. In contrast, data from the EDC, also compiles data about private equity investments made by non-

³⁷ Invest EU, Research methodology and definitions, 2020

³⁸ Invest EU, Research methodology and definitions, 2020

³⁹ Invest EU, Research methodology and definitions, 2020

⁴⁰ Invest EU, Research methodology and definitions, 2020

⁴¹ Thompson, Alternative Financing Instruments for SMEs and Entrepreneurs: the Case of Mezzanine Finance, OECD, 2013

⁴² Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

European private equity firms in the Baltic region, thus allowing for a profounder representation of the whole private equity eco-system in the region.

The data used for the estimation of the private equity supply of and demand for it in the Baltics, was obtained directly from Invest EU. The methodology behind the collection of data are outlined in the following section⁴³.

The database is made up of firms managing investment vehicles or funds investing primarily equity capital in companies, which are not listed on the public stock exchanges. The inclusion of firms is decided at a fund level, meaning no individual firms are found in the statistics, only funds. Only firms which meet certain criteria are included in the database. The firms have to work in accordance with the classical PE/VC models, by having a fund structure or other form of a pool of capital, portfolio companies, a medium to a long period of holding a company in the portfolio and an exit strategy.

The categories of private equity entities, which are omitted from the database are: fund-of-funds, hedge funds, real estate funds, project financing/infrastructure funds, secondary funds, distress debt, venture credit, participative loans, accelerators, business angels and holding companies.

For **fundraising** direct private equity investment funds primarily invest in Europe are monitored and the funds raised are recorded in the country where the management team is located in.

Investments in the respective country's/region's companies are an aggregation of the figures according to the domicile in which the investee company or the company being exited is registered, regardless of the private equity fund firm's domicile. The same region and country benchmarks apply to this type of data as with the aforementioned type mentioned in the paragraph before.

Investments by the respective country's/region's funds are an aggregation of the figures according to the country in which the private equity firm making an investment is based and not related to the investee companies' domicile. Divestments are aggregated in the same manner as investments. In the report three regions are looked at – the Baltics, Europe and the Nordic Countries. On the country level this entails the analysis on data from Estonia, Latvia and Lithuania for the estimation of the Baltic equity financing market gap and benchmarking it in depth it with data from Sweden, Norway, Denmark, Finland and generally with the European countries.

The number of companies represent a list of companies receiving investments throughout the reporting year. If a company receives more than one investment during the year the number of companies will not change.

⁴³ Invest EU, Research methodology and definitions, 2020

4.1.4 Public Equity

4.1.4.1 Stock Exchange Descriptions and Characteristics

Securities in the Baltics are traded on the Nasdaq Baltic exchange. All of the three stock exchanges in the Baltic states are operated by Nasdaq⁴⁴.

According to Nasdaq, the essential elements of a single Baltic marketplace like shared global technology, one market model, joint membership, common information distribution and other have been put in place, making the region easier accessible and more attractive to local and international investors, as well as companies seeking to list their shares on the stock exchange.⁴⁵

All of the exchanges are licensed and supervised by state institutions in their respective countries.

Table 9 Baltic Stock Exchange Licensing and Supervising Authorities

Stock exchange	Licensing and supervising authority
Nasdaq Tallinn	Estonian Financial Supervision Authority (FSA) ⁴⁶
Nasdaq Riga	Financial Capital Market Commission (FCMC) ⁴⁷
Nasdaq Vilnius	Bank of Lithuania (LB) ⁴⁸

Source: Compiled by KPMG, based on data from Nasdaq Baltic⁴⁹

There are two markets across the Baltics, the regulated Main market and the alternative First North market, managed by Nasdaq.

The regulated market is made up of four lists⁵⁰:

The Baltic Main List

Includes the most respected companies across the three Baltic stock exchanges, in order to be considered eligible a company must have:

- A history of at least 3 years of operations;
- A sound financial position;

⁴⁴ Nasdaq Baltic, About Us, 2020

⁴⁵ Nasdaq Baltic, About Us, 2020

⁴⁶ FSA, Main page, 2020

⁴⁷ FCMC, Main page, 2020

⁴⁸ LB, Main page, 2020

⁴⁹ Nasdaq Baltic, Market regulation, 2020

⁵⁰ Nasdaq Baltic, About the markets, 2020

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- Market capitalization of at least EUR 4m;
- Reporting according to IFRS (International Financial Reporting Standards);
- A sufficient free float.

The Baltic Secondary List

The special requirements for inclusion on the Main list do not apply for the Secondary List. Most of the companies on the list have been relegated from the Main list because the requirements were not fulfilled.

The Baltic Bond List

Baltic fixed-income securities are presented in a joint list, government bonds of Latvia and Lithuania are included in the list as well as corporate bonds with varying maturities.

The Baltic Fund List

The list presents the investment fund units that are listed and traded on the Baltic exchanges.

The alternative market consists of two lists: the **First North Baltic share list** and the **First North Baltic bond list**.

The Main market is regulated under the EU directives and supervised in each country by the national financial supervisory authority. Listing requirements follow EU standards and are intended for well-established companies. Therefore, the regulatory requirements are more gruelling than those on the First North market.⁵¹

The alternative market is geared towards companies in their earlier stages of the corporate lifecycle. There are no minimum requirements for companies regarding size, market value or amount of shares required to belong to small investors.

As both markets are tailored for different type of companies, the requirements vary significantly, as mentioned before. The following table compiles the different requirements.

⁵¹ Nasdaq Baltic, About the markets, 2020

Table 10 Comparison of the Alternative First North and the Regulated Main Market

Parameters	The First North Market	The Main Market
Company's minimum operating experience	No minimum period of company's operation	Company's operating experience: Bonds: 2 years Shares: 3 years
Minimum market value of the company	No minimum market value of the company	Bonds: minimum amount of issue EUR 1m (EUR 200 000 on Nasdaq Riga and Nasdaq Vilnius) Shares: Company's minimum value EUR 4m
Shares required to belong to small investors	No minimum number of shares required to belong to small investors	At least 25% or EUR 10m shares in the hands of small investors (applies to share listing)
Prospectus	Unless a public offering, a simplified company description can be prepared	Approved prospectus
Reporting frequency	Annual and semi-annual financial reports	Annual report and semi-annual or quarterly financial reports
Accounting standards	Financial accounting standards of choice	Financial reports to be prepared according to International Financial Reporting Standards
Languages of information disclosure	Information disclosure in either local or English language	Information disclosure in local and English language
Certified Advisers	Agreement with a Certified Adviser	-
Non-financial reporting	-	Non-financial reporting – reports on corporate governance and sustainability

Source: Nasdaq Baltic⁵²

Furthermore, the fees for admission of shares and bonds differ between the both markets. The one-time fee for listing shares is more than three times smaller on the alternative market than on the regulated market. Additionally the admission fees for the regulated market depend on the size of the company looking to list on it. The annual shares fees for both markets are influenced by aspects such as the company's market value for the alternative market and the size and chosen list for the regulated market. The comparison of fees for equity listing is compiled in the following table.

⁵² Nasdaq Baltic, Raise Capital, 2020

Table 11 Comparison of Fees for Equity Listing of the Alternative First North and the Regulated Main market

Fees	First North market	Main market
Equity listing admission fees	€3000 One-time fee for getting listed on Nasdaq First North	Equity listing Admission fee from €9200* * Depending on company's size and chosen listing market One-time fee for getting listed on Main market
Equity listing annual fees	from €3000* * Depending on the capitalization of the issuer's shares $\leq €5m \rightarrow €3000$ $\leq €20m \rightarrow €3000 + 0.02\%^*$ $\leq €50m \rightarrow €6000 + 0.01\%^*$ $\leq €100m \rightarrow €9000 + 0.006\%^*$ $\leq €200m \rightarrow €12000 + 0.003\%^*$ $> €200m \rightarrow €15000 + 0.002\%^*$ Company's market value * From company's market value exceeding the threshold	Equity listing Annual fee from €5000* * Depending on company's size and chosen listing market

Source: Nasdaq Baltic⁵³

Similarly to shares fees there are annual and one-time fees for bonds as well. For both markets the admission fees are one-time fees, however the fee amounts differ significantly. The admission fee for the main market is double the fee of the alternative market, however there is a possibility for an issue program where there are certain discounts if there are up to three bond issues, starting from the fourth issue, the fees are significantly smaller. For both markets the annual fees are dependent on the issue's total nominal value, however the fee starting points differ, on the regulated market the fees are more than two time limes larger than on the alternative market. The fees and their determining factors are compiled in the following table.

⁵³ Nasdaq Baltic, Raise Capital, 2020

Table 12 Comparison of Fees for Listing of Bonds on the Alternative First North and the Regulated Main market

Fees	First North market	Main market
Bonds Admission fees	€1500 One-time fee for getting listed on Nasdaq First North	Bonds Admission fee €3000 per bond issue or €6500 per issue program (up to 3 bond issues. From 4th – €1000 each)
		Onetime fee for getting listed on Main market
Bonds Annual fees	Bonds Annual fee from €1000* * Depending on the issue's total nominal value ≤ €10m → €1000 ≤ €50m → €1000 + 0.005%* ≤ €100m → €3000 + 0.001%* > €100m → €3500 + 0.0001%* Total nominal value * From the total nominal value exceeding the threshold	Bonds Annual fee from €2200* * Depending on the issue's total nominal value ≤ €10m → €2200 ≤ €50m → €2200 + 0.005%* ≤ €100m → €4200 + 0.001%* > €100m → €4700 + 0.0001%* Total nominal value * From the total nominal value exceeding the threshold

Source: Nasdaq Baltic⁵⁴

It must be noted that the aforementioned fees charged directly by the stock market itself are representing relatively small part of the total listing costs, especially from the one-off initial costs happening before and during listing process. The vast majority of one-off costs relate to various specialised external services needed. The summary of listing costs can be seen in the following table.

⁵⁴ Nasdaq Baltic, Raise Capital, 2020

Table 13 Summary of Listing Costs

Type of costs	Short description	Cost estimate/range ⁵⁵
Stock market operator fees	As described above	As described above
Investment banker	Builds the sector/story/valuation expectations etc. Prepares various investor materials, advises on steps needed to prepare company for public status.	Depends on whether retainer + success fee or success fee only. Typically 3-8% of the monies raised (the smaller the deal the more expensive due to fixed costs of servicing the client, as also the difficulty of the project itself)
Legal costs	Depending on the type of offering to be taken (public is more expensive), the complexity and international diversity of operations and amount of 'corporate actions and clean up' necessary to prepare the company to be public (including change to JSC from LLC etc). Due diligence plus documentation plus corporate actions.	Can be anything from EUR 25k (simple case) to EUR 125k or more (complex and large public offer with restructuring etc and meaningful changes effected post due diligence process completion)
Accountant	Moving company accounting from local accounting standards to IFRS, if applicable (IFRS is not required for the alternative market)	Depends of whether external help needed, otherwise just internal staff time-cost
Auditors	For SMEs this will mainly relate to the conversion from private to public company status.	Can vary significantly depending on the work to be done.
PR/marketing	Very much depends on the public / private aspects of the transaction and geography of offering.	Can be from EUR 5k to 50k to EUR 100k or more depending on the package chosen and geography covered.

Source: KPMG

⁵⁵ These cost estimates/ranges are based on Baltic listing examples comparable with the planned Fund, mainly on the First North market. It is important to highlight that there is no single cost formula for these cost items, each item is agreed upon case by case with the relevant service provider based on the specific investment case details. The actual numbers can be higher/lower than described here, based on the particular case.

4.2 SME & Mid-Cap Equity Financing Supply

4.2.1 Supply of Private Equity

The statistics used in the following sections are divided in two, previously mentioned categories: investments by the country's/region's funds and investments in the country's/region's companies. The first, represent private equity firms based in or primarily operating in the region/country, however the second also include investments made by other European, non-European private equity firms into companies from the Baltic region. Even though global private equity firms occasionally make investments in the region, it is not systematic, thus when estimating the supply of private equity finance only private equity firms in the Baltics will be accounted for. Having said that, investments in the country's/region's companies are important to show the complete landscape of the private capital which is present in the region.

4.2.1.1 Fundraising

The amount new of capital attracted to the region varied quite significantly throughout the years. In 2019 a record amount of capital was attracted by Baltic private equity funds, upwards of EUR 300m. Most of the capital was attracted in the buyout segment, followed by the growth segment and lastly made up of venture capital segment funds.

Table 14 Funds Raised by stage of Venture Capital and Private Equity Funds in the Baltics (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Early-stage	0	45 002	44 200	89 075	7 633
Later stage venture	0	0	0	0	0
Venture (all stages)	0	0	0	7 000	0
Total venture	0	45 002	44 200	96 075	7 633
Growth capital	0	0	40 750	25 000	25 000
Mezzanine	70 000	0	0	0	0
Generalist	74 950	12 917	0	0	0
Buyout	0	0	0	5 400	268 232
Total funds raised	144 950	57 919	84 950	126 475	300 865

Source: Invest Europe⁵⁶

Most of the capital attracted came from government or quasi-government institutions, including the EIF investing BIF I and BIF II funding provided mostly by the national development agencies, followed by private individuals and pension funds. The rest is made up of various sources of capital. In the following table the funds raised by investor type in the time period 2015-2019 can be observed.

⁵⁶ Invest Europe, EDC Baltic Countries, 2020

Table 15 Funds Raised by Investor Types in the Baltics (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Academic institutions	0	0	0	0	0
Banks	0	0	0	0	0
Capital markets	0	0	0	0	0
Corporate investors	3 000	0	0	3 850	31 289
Endowments and foundations	0	0	0	0	0
Family offices	0	14 000	3 000	12 350	3 750
Fund of funds	0	2 000	0	5 000	25 000
Government agencies	73 900	32 075	47 200	64 229	115 000
Insurance companies	0	0	0	1 000	0
Other asset managers including PE houses other than fund of funds)	27 500	2 274	0	500	0
Pension funds	31 000	6 500	29 000	19 790	57 251
Private individuals	4 300	1 060	2 250	8 366	68 575
Sovereign wealth funds	0	0	3 500	0	0
Unclassified	5 250	10	0	10 490	0
New funds raised	144 950	57 919	84 950	125 575	300 865

Source: Invest Europe⁵⁷

In the record year of 2019, all of the funds came from European sources. In the following table the geographical breakdown of the attracted capital in 2015-2019 is depicted. In almost all of the covered years most of the funds were raised domestically, meaning in the Baltics, with the remainder coming from other European countries. To be noted, it seems that in the database BIF I and BIF II funding is categorised as non-domestic to the Baltics due to the use of EIF's allocation key (Luxembourg). So in reality the vast majority of raised funding is in effect Baltic in origin. In some years a smaller amount of capital was attracted from sources outside of Europe or unclassified.

⁵⁷ Invest Europe, EDC Baltic Countries, 2020

Table 16 Geographical Breakdown of the Funds Attracted in the Baltics (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Within Europe	139 700	57 909	80 950	112 885	300 865
Domestic	59 800	22 832	59 950	93 659	160 865
Non-domestic	79 900	35 077	21 000	19 226	140 000
Outside Europe	0	0	4 000	2 200	0
Unclassified	5 250	10	0	10 490	0
New funds raised	144 950	57 919	84 950	125 575	300 865

Source: Invest Europe⁵⁸

Investments in Baltic companies The statistics show that the total presence of private equity is far greater than just the Baltic private equity funds. In 2019 more than an EUR billion was invested in the region. In this section the investment amounts made by foreign, European and Non-European as well as local private equity firms will be explored.

Table 17 Venture Capital and Private Equity Investments in Baltic companies by Stage Focus (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Seed	2 463	4 076	1 549	6 142	7 790
Start-up	16 572	12 323	4 705	4 960	18 509
Later Stage Venture	1 603	1 805	300	10 000	16 974
Total venture	20 639	18 203	6 555	21 102	43 273
Growth capital	64 270	64 123	161 415	57 779	127 098
Rescue/Turnaround	0	0	0	0	0
Replacement capital	0	5 000	0	11 069	350
Buyout	10 768	175 520	20 124	147 699	848 343
Total investment	95 677	262 846	188 093	237 649	1 019 064

Source: Invest Europe⁵⁹

It can be seen that the bulk of the investment has gone into finance and insurance activities, consumer goods and services and ICT. If not for the large numbers in the finance and insurance activities in 2019, the category would not have made the top listing over the five years under consideration. It appears that the record 2019 numbers were skewed by widely reported EUR 1bn Luminor acquisition by Blackstone⁶⁰. The transaction was publicly announced in 2018, and completed in 2019, but apparently a part of the payment was milestone-based or routed via structures which do not report

⁵⁸ Invest Europe, EDC Baltic Countries, 2020

⁵⁹ Invest Europe, EDC Baltic Countries, 2020

⁶⁰ Luminor, Blackstone completes the acquisition of €1 billion majority stake in Luminor 2019

information to Invest Europe, hence only EUR 600m+ was reported in 2019 under “financial and insurance activities” in the table below.

Table 18 Sector Breakdown of Venture Capital and Private Equity Investments in Baltic companies (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Agriculture	4 700	11 548	0	19 880	1 400
Business products and services	13 968	23 914	12 900	14 009	24 437
Chemicals and materials	96	5 088	12	0	10 000
ICT (Communications, computer and electronics)	25 827	161 799	5 551	43 258	123 647
Construction	0	1 495	150	0	0
Consumer goods and services	25 462	47 174	166 220	141 672	217 746
Energy and environment	4 034	440	600	1 511	551
Financial and insurance activities	8 950	5 407	0	767	618 287
Real estate	7 269	0	1 750	994	3 107
Biotech and healthcare	1 155	5 582	911	100	9 138
Transportation	4 216	400	0	15 458	10 750
Other	0	0	0	0	0
Total investment	95 677	262 846	188 093	237 649	1 019 064

Source: Invest Europe⁶¹

Baltic private equity firms in the Baltic region activity wise are dwarfed by foreign private equity firms. The amounts which foreign private equity firms invest in the Baltics grew tremendously throughout the time period being covered. The amount in 2015 is more than EUR 900m smaller than the one observable in 2019. Of course, it is not possible to assume that this data shows maintainable growth, because the large investment amounts often represent one or a few very large buyout transactions, which come sporadically on a deal by deal basis and have small impact on availability of funding to the vast majority of much smaller typical Baltic companies. But the trend that the foreign investment amount is increasing is noticeable and a good sign of the Baltics being able to build companies that attract interest of foreign corporate giants. In the case of, investments made by local private equity firms, the investment amounts were growing, albeit slowly with a noticeable drop in 2017. Foreign investments by Baltic private equity firms saw exponential growth in the covered period, albeit from a very low base. Partially these foreign investments could be explained by the Baltic fund follow-up participation in larger rounds of formerly Baltic companies now registered outside of the Baltics or companies set up by Baltic founders but registered outside of the region due to commercial considerations. A notable example of such a case are the multiple rounds raised by TransferWise⁶². The investments categorised by the origin of the capital are outlined in the following table.

⁶¹ Invest Europe, EDC Baltic Countries, 2020

⁶² Crunchbase, TransferWise, 2021

Table 19 Investments in Baltic Companies Categorised by Origin of Capital (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Investments by local private equity firms	42 273	78 686	37 846	50 218	87 287
(-) Foreign investments by local private equity firms	1 786	5 188	12 944	14 242	28 077
(+) Local investments by foreign private equity firms	55 189	189 348	163 191	201 674	959 854
Total investment in the region	95 677	262 846	188 093	237 649	1 019 064

Source: Invest Europe⁶³

Investments by the Region's Funds The investments by Baltic private equity firms reached record numbers in 2019 within the covered time period. In the following section a breakdown of the investments will be demonstrated.

In the Baltics the most active investment stages in the covered period were in the more mature financing stages. In 2015 the gap was comparatively narrower; however, more and more capital was invested in the very late stages, like the buyout stage, widening the gap. This is in line with underlying market mechanics, earlier stage companies typically require smaller investment amounts, whilst later stage companies are larger and thus require greater investment tickets. The trend shows that the private equity industry is maturing.

The Baltic private equity market development flagship initiatives - the Baltic Innovation Fund I and II have had a massive effect on the industry by injecting large amounts of capital in it, especially in later stage equity financing by supporting private equity firms, such as Livonia Partners, BaltCap later stage funds and Invalda. On a smaller scale, the Baltic Innovation Fund I also supports the large ticket early stage with investments in funds such as Karma Ventures. The BIF I and BIF II impact on the number of deals is minor, but still noticeable.

In the venture capital stages, a very noticeable change is that start-up financing ultimately has become relatively less popular, mainly explained by the later stage BIF I funds starting to trickle down to the real economy – investee companies. From being the most popular financing stage in 2015 it has fallen behind the three other stages. The late stage venture, has seen drastic growth in 2019 reaching investments upwards of EUR 26m. The stage focus categorisation of investments made by local private equity firms is compiled in the following table.

⁶³ Invest Europe, EDC Baltic Countries, 2020

Table 20 Venture Capital and Private Equity Investments By Baltic Funds by Stage Focus (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Seed	2 463	2 976	1 041	2 916	3 060
Start-up	13 469	12 239	7 986	3 333	4 870
Later Stage Venture	3 139	5 493	3 600	7 660	26 312
Total venture	19 071	20 708	12 627	13 909	34 242
Growth capital	12 434	28 458	1 037	5 139	13 423
Rescue/Turnaround	0	0	0	0	0
Replacement capital	0	5 000	0	11 069	350
Buyout	10 768	24 520	24 182	20 100	39 272
Total investment	42 273	78 686	37 846	50 218	87 287

Source: Invest Europe⁶⁴

Even though the investment amount is growing, the number of investee companies is decreasing. The difference between the total number of investee companies between 2015 and 2019 is quite significant, measurable at 31. Meaning the average deal amount has increased substantially. The average deal amount in 2015 was around EUR 600 thousand, but in 2019 it reached approximately EUR 2m.

Table 21 Number of Companies Invested in by Baltic Venture Capital and Private Equity Funds by Stage Focus (2015-2019)

Number of companies	2015	2016	2017	2018	2019
Seed	20	18	5	12	10
Start-up	35	35	8	6	9
Later Stage Venture	9	6	4	1	3
Total venture	62	56	17	19	21
Growth capital	10	12	4	4	11
Rescue/Turnaround	0	0	0	0	0
Replacement capital	0	1	0	4	1
Buyout	2	5	8	10	10
Total number of companies	74	74	29	36	43

Source: Invest Europe⁶⁵

The most popular sectors in which investments were made varied substantially year by year. There were certain sectors, such as business products and services, ICT, consumer goods and services which attracted noteworthy investments in all of the

⁶⁴ Invest Europe, EDC Baltic Countries, 2020

⁶⁵ Invest Europe, EDC Baltic Countries, 2020

covered years. The in the following table investments are categorised by their respective sectors, regardless of the stage in which the investment as made.

Table 22 Sector Breakdown of Venture Capital and Private Equity Investments by Baltic Funds (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Agriculture	3 000	548	0	0	0
Business products and services	3 956	2 865	12 900	13 649	24 437
Chemicals and materials	96	5 088	12	0	0
ICT (Communications, computer and electronics)	8 046	14 888	13 273	14 397	8 825
Construction	0	1 495	4 208	0	0
Consumer goods and services	14 067	46 874	4 792	11 772	14 542
Energy and environment	3 734	240	0	1 111	350
Financial and insurance activities	950	707	0	5 566	200
Real estate	7 269	0	1 750	994	12 198
Biotech and healthcare	1 155	5 582	911	0	8 838
Transportation	0	400	0	2 729	17 896
Other	0	0	0	0	0
Total investment	42 273	78 686	37 846	50 218	87 287

Source: Invest Europe⁶⁶

A significant aspect of growth in the last year of the covered period, 2019 is the capital outflow to Non-European countries, which previously was almost non-existent. Capital export has become a larger driving force in the growth of the local private equity industry in the years between 2017 and 2019. The following table outlines the geographical flow of capital.

Table 23 Geographic Distributions of Baltic Venture Capital and Private Equity Fund Investments (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Domestic	40 487	73 498	24 902	35 975	59 210
Other European countries	1 786	5 188	12 944	13 899	10 706
Non-European countries	0	0	0	344	17 371
Total investment	42 273	78 686	37 846	50 218	87 287

Source: Invest Europe⁶⁷

Throughout all the covered years independent private equity funds were the main actors in the industry distantly followed by public sector private equity funds. There is a

⁶⁶ Invest Europe, EDC Baltic Countries, 2020

⁶⁷ Invest Europe, EDC Baltic Countries, 2020

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significant difference between independent private equity funds and public sector funds with no captive funds at all. The table below demonstrates the dominance of independent private equity funds.

Table 24 Investor Type of Venture Capital and Private Equity Funds in the Baltics (2015-2019)

Amounts in EUR thousands	2015	2016	2017	2018	2019
Independent	37 957	61 654	37 060	43 957	82 039
Captive	0	0	0	0	0
Public sector	4 316	17 032	786	6 261	5 248
Total investment	42 273	78 686	37 846	50 218	87 287

Source: Invest Europe⁶⁸

4.2.1.2 Venture Capital

The venture capital private equity market segment has the most active players in it. Currently there are 11 Baltic VC funds in their investment period. To be noted, further regional funds, mostly Nordic and CEE-based, also have the Baltics as part of their geographic mandates, but invest only opportunistically here. The following table lists all the Baltic funds:

Table 25 Baltic Venture Capital Funds Currently Investing in the Region

Fund	Strategy	Region	Vintage year	Status	Size	Cornerstone investor	Investment ticket
Nordic Ninja	VC	Nordics	2019	Investing	€100m	JBIC and EIF	€2-4m
Karma Ventures Fund I	VC	Baltics	2016	Investing	€70m	BIF (EIF)	€≤3m
Practica Venture Capital II	VC	Lithuania	2018	Investing	€25m	Invega	€0.2-2m
Tera Ventures Fund II	VC	Estonia	2018	Investing	€21m	EstFund	N/A
Trind Ventures Fund I	VC	Baltics	2018	Investing	€21m	BIF (EIF)	€0.1-3m
Change Ventures Fund II	VC	Lithuania	2019	Investing	€21m	BIF (EIF)	€0.2-1.5m
Open Circle Capital	VC	Lithuania	2017	Investing	€20m	Invega	€0.1-3m
United Angels Fund I	VC	Estonia	2017	Investing	€18m	EstFund	€≤1.5m
INEC 1	VC	Latvia	2019	Investing	€18m	Altum	€0.6-2.7m
Iron Wolf Capital	VC	Lithuania	2018	Investing	€17m	Invega	€0.25-2m
Superangel Fund I	VC	Europe	2018	Investing	€12m	SmartCap	€0.05-0.5m

Source: Data from fund websites and ESTVCA compiled by KPMG⁶⁹

⁶⁸ Invest Europe, EDC Baltic Countries, 2020

⁶⁹ ESTVCA, 2019; Iron Wolf capital, 2020; Practica Capital, New venture capital fund, 2018; Change Ventures, 2020; Nordic Ninja, 2020; Trind, 2020; Superangel, 2020; United Angels, 2020; Karma Ventures, 2020; Expansion Capital, 2020; Open Circle Capital, 2021

The funds on average are smaller than later stage funds, however there are notable funds like the Nordic Ninja and the Karma Venture Fund I, whose capital commitments are greater than EUR 50m, which are on par with very late stage private equity funds. The investment tickets range quite significantly throughout the funds, however they are only indicative because investments are evaluated on case by case basis with many factors influencing the final decision on the investment amount. Several funds, for example, those whose cornerstone investors are the BIF I and EstFund are the beneficiaries of the EIF's activity in the region.

The size of the venture capital funds in their investment stage is estimated at around EUR 343m, however this number does not take into account the already invested amounts, as generally the information on the deals is confidential or undisclosed.

According to research performed by Deloitte⁷⁰, as of 31 December 2019 there was capital available equalling EUR 150m for early venture investment and EUR 147m for late venture investment.

4.2.1.3 Growth Capital

The growth capital stage financing funds previously were more represented in the region however currently there are five active funds in their investment stage. The following table compiles the funds:

Table 26 Baltic Growth Capital Funds Currently Investing in the Region

Fund	Strategy	Region	Vintage year	Status	Size	Cornerstone investor	Investment ticket
BaltCap Growth Fund	PE/Growth	Baltics	2018	Investing	€45m	BIF (EIF)	€1-4m
LcX Opportunity Fund	PE/Growth	Lithuania	2020	Investing	€35m	Invega	€2-4m
ZGI-4	PE/Growth	Latvia	2018	Investing	€32.5m	Altum	€0.5-5m
Equity United PE I	PE/Growth	Estonia	2019	Investing	€25m	EstFund	€1-4m
Orion Private Equity Fund	PE/Growth	Baltics	2018	Investing	€15m	N/A	€0.13m

Source: Data from Fund websites compiled by KPMG⁷¹

The overall size of growth capital funds in their investment stage in the Baltics measures around EUR 152.5m.

According to research performed by Deloitte⁷², as of 31 December 2019 there was capital available equalling EUR 148m for growth investments.

⁷⁰ Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

⁷¹ ZGI, 2020; Altum, ZGI, 2020; LitCapital, 2020; LitCapital, LcX Opportunity, 2020; ESTVCA, 2019; BaltCap, Growth, 2020; Verslo Žinios, Orion Asset Management, 2018; Equity United, 2020

⁷² Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

4.2.1.4 Replacement, Turnaround and Buyout Capital

The late to very late financing stages have the largest funds when it comes to capital commitments. The stage is dominated by buyout funds, however in response to the Covid-19 crisis Invega (Lithuania) and Altum (Latvia), launched to large turnaround capital funds. No distinct Baltic replacement capital funds are currently investing in the region. The Baltic funds currently investing in the region are compiled in the following table.

Table 27 Baltic Replacement, Turnaround and Buyout Capital Funds Currently Investing in the Region

Fund	Strategy	Region	Vintage year	Status	Size	Cornerstone investor	Investment ticket
INVL Baltic Sea Growth Fund	PE/Buyout	Baltics	2019	Investing	€164.7m	Invega	€10-30m
BaltCap Private Equity Fund III	PE/Buyout	Baltics	2019	Investing	€126m	BIF2 (EIF)	€5-10m
Investment Fund Covid-19	PE/Turnaround	Latvia	2020	Investing	€100m	Altum	<€10m
Livonia Partners Fund I	PE/Buyout	Baltics	2015	Investing	€82.5m	BIF (EIF)	N/A

Source: Data from fund websites compiled by KPMG⁷³

The overall size of replacement, turnaround and buyout capital funds in their investment stage in the Baltics is around EUR 473m.

According to research performed by Deloitte⁷⁴, as of 31 December 2019 there was capital available equalling EUR 343m for buyout investments.

4.2.1.5 Mezzanine Financing

Mezzanine financing if compared to other private capital forms is the least prevalent form across the Baltic states. Mezzanine financing is relatively new to the region, thus it still is gaining traction, however the deal amount is growing and financial institutions recognise that there is an explicit market gap. In the Baltics there are a couple of large players, on the fund level in the mezzanine financing market, combined with several

⁷³ Baltic Course, 2020; Invalda, Fund overview, 2020; BaltCap, Buyout, 2020; Altum, Investment fund Covid-19, 2020; Livonia Partners, 2020

⁷⁴ Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

small private players which provide financing on a lesser scale. The following table shows the two main funds which are currently investing in the region:

Table 28 Baltic Mezzanine Financing Funds Investing in the Region

Fund	Strategy	Region	Vintage year	Status	Size	Cornerstone investor	Investment ticket
BPM Mezzanine Fund I	Mezzanine	Baltics & Poland	2015	Investing	€70m	BIF (EIF)	N/A
FlyCap Mezzanine Fund II	Mezzanine	Latvia & EU	2020	Investing	€21m	Altum	€1-3m

Source: Data from fund websites compiled by KPMG⁷⁵

The overall size of mezzanine funds in the Baltics is EUR 91m.

According to research performed by Deloitte⁷⁶, as of 31 December 2019 there was capital available equalling EUR 14m for mezzanine investments.

4.2.2 Supply of Public Equity

As at 31 December 2020, there were 69 listed companies listed on the Nasdaq Baltic stock exchange. On the regulated side of the market, the Baltic Main list is comprised of 33 companies, the Baltic Secondary list of 28 companies and the Baltic Bond list of 56 issues. At the same time, the alternative First North market was comprised of 8 share listings and 11 bond issues.⁷⁷

The following table shows the overall Baltic stock market capitalisation on December 31st, 2020. The capitalisation is dynamic and the one mentioned in this report is not representative of the current market situation.

Table 29 Market Capitalisation of the Baltic Stock Exchanges on 31 December 2020.

Market	Number of companies	Capitalisation on 31 December 2020
Baltic Regulated market	61	€8,269,745,516
First North Alternative market	8	€125,201,000
Total	69	€8,269,746,516

Source: Nasdaq Baltic⁷⁸

⁷⁵ BPM Capital, Company, 2020; FlyCap, About, 2020

⁷⁶ Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

⁷⁷ Nasdaq Baltic, Capitalisation by home markets, 2021

⁷⁸ Nasdaq Baltic, Capitalisation by home markets, 2021

In the table below, the breakdown of the local markets capitalisation is shown. Lithuania leads the other Baltic countries when it comes to the market capitalisation by quite some margin. The difference between Estonia and Lithuania is around EUR 1.6bn but with Latvia the difference is enormous, coming in at almost EUR 3.5bn, considering that the number of companies listed on the markets is not radically smaller. The difference in this case is the quality of the listed companies. While Latvia has 21 listed companies, most of them have been relegated from the main share list to the secondary list and their capitalisations are very small and the requirements to climb back up to the main list are becoming ever more so distant to reach a time goes on. The main difference maker between Estonia and Lithuania is the listing of Ignitis Grupė which was listed recently and has a market cap upwards of EUR 1.5bn, without it the capitalisations would be relatively similar.

Table 30 Market Capitalisation of the Baltic Stock Exchanges by Home Market on 31 December 2020

Home Market	Number of companies	Capitalisation on 31 December 2020
Tallinn, Estonia	20	€2,840,878,633
Riga, Latvia	21	€948,892,264
Vilnius, Lithuania	28	€4,479,974,618

Source: Nasdaq Baltic⁷⁹

Out of the 69 listed companies there are two that have market capitalisation greater than a EUR billion. However, between the leading the companies and the rest there is a very large gap, as the third largest market capitalisation is around EUR 500m. The following table highlights the capitalisation and the aforementioned gap.

Table 31 Top 5 Companies by Market Capitalisation on the Baltic Stock Exchanges

Company	Market Capitalisation on 31 December 2020
Ignitis Grupė	€1,548,816,333
Telia Lietuva	€1,063,268,977
LHV Group	€561,972,294
Tallink Grupp	€494,372,945
Tallinna Sadam	€473,400,000

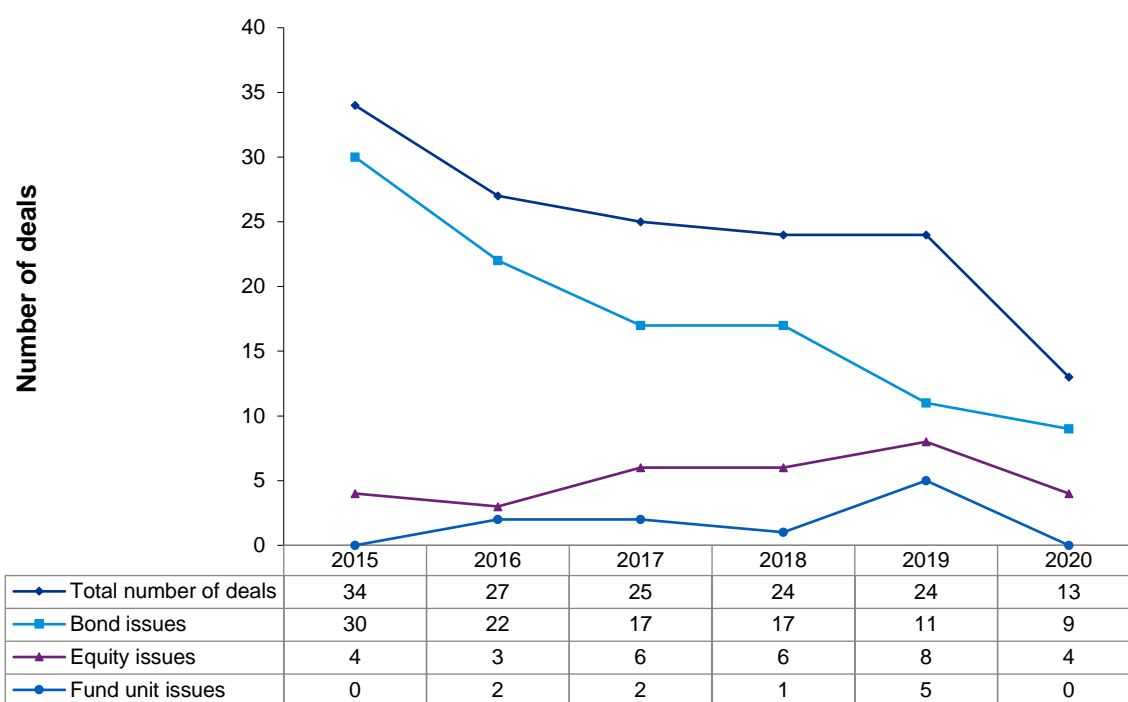
Source: Nasdaq Baltic⁸⁰

⁷⁹ Nasdaq Baltic, Capitalisation by home markets, 2021

⁸⁰ Nasdaq, Capitalisation, 2020

During the time period between 2015 and 2020 there has been a downward trend for the number of total equity, bond and fund unit listings on the stock exchanges. The trend can be observed in the following figure:

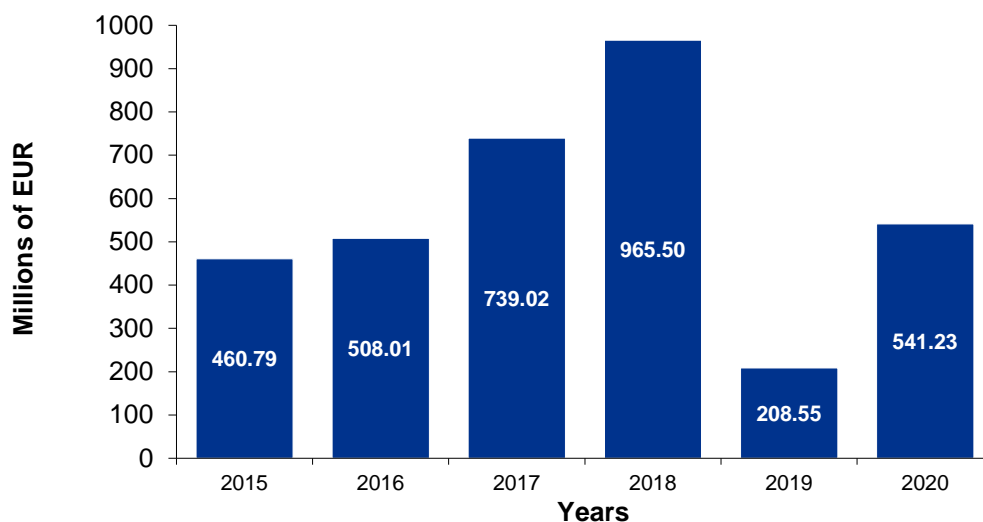
Figure 3 Number of Deals on the Baltic Stock Exchanges (2015-2020)



Source: Nasdaq Baltic, New listings, 2020

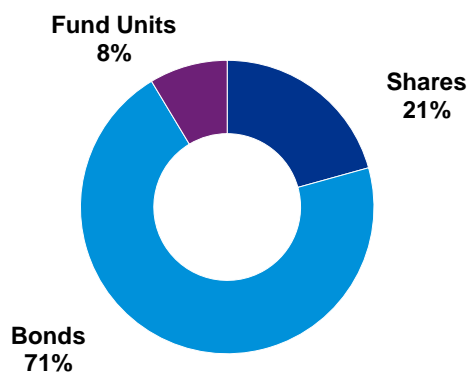
However, the decrease in the number of listings does not imply a lower amount of capital attracted in all the years. From 2015 up until 2019, the capital attracted was experiencing linear growth. The peak was reached in 2018 when the capital attracted was close to one billion euros, coming in at EUR 965m. After 2018, there was a great dip and the amount of capital attracted plummeted to EUR 208m in 2019. In 2020, despite the turbulent business conditions, which the global markets experienced, the capital attracted in the Baltics managed to reach a level of greater than EUR 500m, in only 13 deals. The main IPO of the year and the greatest contributor to the capital attracted in the markets, by attracting EUR 450m, was the equity listing of Ignitis Grupe. The following figure shows the total capital attracted in all deals: shares; bonds and fund units.

Figure 4 Capital Attracted on the Baltic Stock Exchanges in Millions of EUR (2015-2020)



Source: Nasdaq Baltic, New listings, 2020

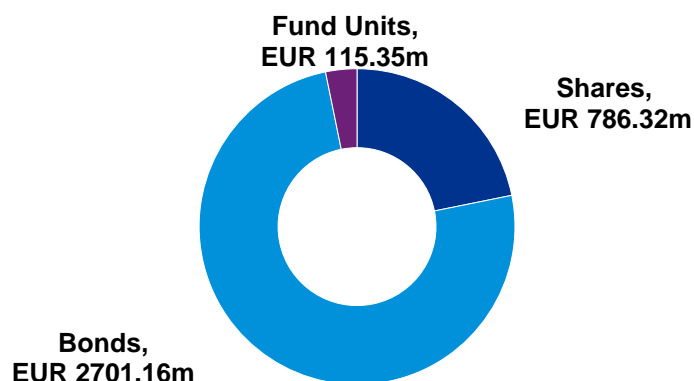
Figure 5 Number of Deals (Percent) on the Regulated Baltic Market by Category (2015-2020)



Source: Nasdaq Baltic, New listings, 2020

The figure above shows the distribution of the three types of deals, which have been made in the time period of 2015 up to 2020. Bond listings are distinctly the most common type of deals observable across the Baltic stock exchanges, followed by equity listings and fund unit listings. It is possible that the ratio could change, as for example a large amount of capital in bond listings was attracted, by the now defunct Latvian bank ABLV Bank. The market is dynamic and could shift towards more equity listings.

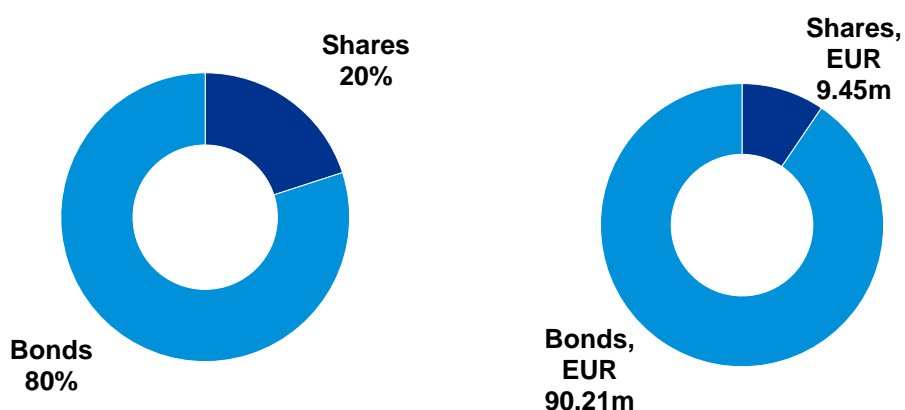
Figure 6 Capital Attracted on the Regulated Baltic Market by Category in Millions of EUR (2015-2020)



Source: Nasdaq Baltic, New listings, 2020

The figure above further reiterates the bond listing dominance in the Baltics. Bond listings have attracted more than EUR 2.7bn, while equity listings have attracted EUR 786m and fund unit listings have attracted EUR 115m.

Figure 7 Number of Deals (Percent) and Capital Attracted in Millions on the Alternative First North Market by Category (2015-2020)



Source: Nasdaq Baltic, New listings, 2020

Similarly to the regulated market, the alternative market also is dominated by bond listings. There are no fund units listed on the alternative market. In the covered time period bond listings attracted almost 10 times more capital than equity listings.

In the table below, all equity listings (2015-2020) arranged by capital attracted have been identified to show the geography of listing, type of listing as well as capital attracted. The total equity capital attracted on the Baltic stock exchanges during 2015 to 2020 amounts to EUR 796.8m, out of which top 5 deals constitute EUR 690m or around 87% of the total equity capital attracted. This shows the rather big difference between mean (EUR 24.9m) and median (EUR 2.75m) values of capital attracted.

Table 32 Equity Listings on the Baltic Stock Exchanges as of 31 December 2020 (2015-2020)

Market	List	Type	Issuer	Sector	Capital attracted, EUR million
VLN	Baltic Main list	IPO	Ignitis Grupē	Utilities	450.0
TLN	Baltic Share list	IPO	Tallinna Sadam	Maritime transportation	147.4
VLN	Baltic Main list	SPO	AUGA Group	Farming	36.0
TLN	Baltic Main list	IPO	Coop Pank	Commercial bank	31.3
TLN	Baltic Main list	SPO	LHV Group	Commercial bank	25.3
VLN	Baltic Main list	IPO	Novaturas	Tour operator	22.1
TLN	Baltic Main list	SPO	EfTEN Real Estate Fund III	Real estate investments (real estate fund)	16.0
TLN	Baltic Main list	IPO	LHV Group	Commercial bank	13.9
VLN	Baltic Secondary list	SPO	INVL Technology	Computer Services	10.0
VLN	Baltic Secondary list	SPO	INVL Baltic Real Estate	Real Estate	9.0
VLN	Baltic Main list	Private placement	Rokiškio sūris	Dairy products	7.1
TLN	Baltic Share list	IPO	EfTEN Real Estate Fund III	Real estate investments (real estate fund)	4.7
TLN	Baltic Share list	Public Offer	Pro Kapital Grupp	Real estate development	4.3
TLN	Baltic Share list	SPO	Arco Vara	Real estate development	3.7
RIG	First North Share list	Public Offer	MADARA Cosmetics	Consumer Goods	3.3

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VLN	First North Share list	IPO	East West Agro	Distributor of agricultural machinery	3.0
RIG	Baltic Main list	Private placement	HansaMatrix	Technology, R&D	2.5
VLN	First North Share list	Private placement	K2 LT	Crematorium services	1.2
TLN	First North Share list	IPO	Saunum Group	Development of a sauna heating solution	1
VLN	Baltic Main list	SPO	Šiaulių bankas	Banking	0.8
TLN	First North Share list	Private placement	Linda Nektar	Distillers & Vintners	0.8
VLN	First North Share list	IPO	NEO Finance	Mutual lending	0.6
VLN	First North Share list	SPO	K2 LT	Crematorium services	0.5
TLN	Baltic Share list	Private placement (options programme to staff)	LHV Group	Commercial bank	0.5
TLN	Baltic Share list	Private placement (options programme to staff)	LHV Group	Commercial bank	0.4
TLN	Baltic share list	Private placement (options programme to staff)	LHV Group	Commercial bank	0.4
TLN	Baltic share list	Private placement (options programme to staff)	LHV Group	Commercial bank	0.4
TLN	Baltic Main list	SPO	Harju Elekter	Production of electrotechnical devices	0.2
VLN	Baltic Main list	Public Offer	Klaipėdos nafta	Operation of oil products	0.2
VLN	Baltic Secondary list	SPO	INVL Baltic Real Estate	Investment in Real Estate	0.1

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VLN	Baltic Secondary list	Public Offer	INVL Invalda	Investments	0.1
RIG	First North Share list	Technical listing	Frigate	Financial services	-

Source: Nasdaq Baltic⁸¹

4.2.2.1 Available Information About Public Offerings (2015-2020) Regarding Shareholder Structures, Oversubscriptions and the Geography of Investors⁸²

To shed more light on the interested parties in Baltic public offerings, information (as far as available) on the shareholder structure before and after the public offering is provided, the subscription multiple as well as the geography of investors. It can be seen that Baltic public offerings have the potential and ability to attract institutional investors from outside the region. Moreover, the offerings also tend to be attractive to retail investors from the region, thereby not only enlarging the potential investment targets for the said investor group, but also proliferating the capital markets as an alternative source for growing wealth and proliferation of financial education as a result of all of the aforementioned.

Auga Group SPO

Capital attracted:

- Attracted capital to the company: EUR 18m
- Shares sold by the Company's owner: EUR 18m
- Total EUR 36m

Public offering share price:

- EUR 0.45

Shareholder structure before and after the public offering:

- Shareholder structure before SPO: 88% Baltic Champs Group; 6% Multi Asset Selection Fund; 6% Other
- Shareholder structure after SPO: 55% Baltic Champs Group; 9% EBRD; 8% UAB Me Investicija; 21% other investors; 7% retail investors

Ignitis Grupė IPO

Capital attracted:

- EUR 450m

Public offering share price:

- EUR 22.50

Shareholder structure after the public offering:

- 73.08% Ministry of Finance;
- 24.42% Institutional investors;

⁸¹ Nasdaq Baltic, New listings, 2020

⁸² Nasdaq Baltic, IPO Case studies, 2020

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- 2.5% Retail investors (LT, LV, EE).

Investor breakdown by type:

- 1/3 Hedge funds;
- ~2/3 Long term only investors;
- 6827 Retail investors

Geography of the investors:

- ~1/3 United Kingdom;
- ~1/2 Baltics and Scandinavia;
- <1/3 Other

Tallinn Sadam IPO:

Capital attracted:

- EUR 147.4m

Public offering share price:

- EUR 1.70

Shareholder structure after the public offering:

- 67.03% Ministry of Economic Affairs and Communications;
- 32.72% Retail investors;
- 0.25% institutional investors

Oversubscription:

- 3 times in tranche for retail investors
- 13 723 Estonian retail investors and 102 institutional investors from 22 countries participated in the offering

Coop Pank IPO:

Capital attracted:

- EUR 31.3m

Public offering share price:

- EUR 1.15

Investor breakdown by type:

- 83% retail;
- 17% institutional.

LHV SPO:

Capital attracted:

- EUR 25.3m

Public offering share price:

- EUR 11.50

Oversubscription:

- 1.5x

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Novaturas IPO:

The public offer was made in Estonia, Lithuania and Poland.

Capital attracted:

— EUR 22.1m

Public offering share price:

— EUR 10.50

Shareholder structure before and after the public offering:

- Before the IPO: 71% institutional; 29% private
- After the IPO: 49% institutional; 24% private; 27% new (of which 94.2% institutional and 5.8% retail).
- Total number of shareholders after IPO: 645

LHV IPO:**Capital attracted:**

— EUR 13.9m

Public offering share price:

— EUR 6.95

Investor breakdown by type:

- 99.6% retail;
- 0.4% institutional.

MADARA Cosmetics IPO:**Capital attracted:**

— EUR 3.3m

Public offering share price:

— EUR 6.25

Investor breakdown by type:

- 42% strategic investors;
- 34% institutional investors;
- 24% private investors.

Geography of the investors:

- 40.7% Finland;
- 40.5% Estonia;
- 8.5% Latvia;
- 10.3% other.

East West Agro IPO:**Capital attracted:**

— EUR 3m

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Public offering share price:

- EUR 24

Shareholder structure after the public offering:

- Before the IPO: 50% Gediminas Kvietkauskas; 50% Danas Šidlauskas.
- After the IPO: 20% (together 107 new investors); 40% Gediminas Kvietkauskas; 40% Danas Šidlauskas.

Oversubscription:

- 22%

HansaMatrix Private Placement:**Capital attracted:**

- EUR 2.46m

Offering share price:

- EUR 6.53

Shareholder structure before and after the offering:

- 87% existing investors; 13% new investors

K2 LT Private Placement:**Capital attracted:**

- EUR 1.2m

Offering share price:

- EUR 23.00

Shareholder structure before and after the offering:

- Before the offering: 77% private individuals, 18% Cayenne investment fund (private holding); 5% other private holdings.
- After the offering: 47% private individuals, 39% existing shareholders (private); 11% Cayenne investment fund; 3% other private holdings

Linda Nektar Private Placement:**Capital attracted:**

- EUR 0.8m

Offering share price:

- EUR 6.53

Shareholder structure before and after the offering:

- 16% new investors; 84% existing investors

4.2.2.2 *Evolution of Institutional Investor Business Model*

Broadly speaking, the classical institutional investor business model in recent years would appear to have moved more and more into a focus on larger and more liquid companies. This has had negative implications for both smaller companies (including SMEs) as well as smaller markets. The Baltics are therefore heavily implicated on both counts. Moreover, indexation of such portfolios has meant that smaller markets, such as those in the Baltics have been receiving very little flow of such portfolio investments due to the very limited number of benchmarked companies in indices related to the MSCI and/or FTSE Russell universes. The capital markets status of Latvia is not even represented in the MSCI indices while Estonia and Lithuania are relegated to 'frontier market' status (with a couple of companies included) despite EU, Eurozone, OECD and NATO memberships having been achieved. This situation is not expected to markedly change in coming years.

Anecdotal evidence from the team's experts would suggest that fund managers in most buy side firms are typically looking for at least EUR 0.5-1m or more in secondary daily turnover for a particular listed company in order to consider investing in it. For a region such as the Baltics, this starts to approach total regional market trading volume across all companies on a single trading day. Therefore, it is unrealistic, without having larger companies joining the Nasdaq Baltic exchanges to expect the situation to change. Even if such companies were to be listed, the lion's share of this portfolio-related flow would be largely restricted to such enterprises, rather than smaller companies (the latter would apply to the investment cases for the Fund).

Part of the reasoning for this is that the institutional investor community is facing significant fee pressure from passive, index-tracking alternatives. Therefore, in order to be able to reduce management fees (in many cases), less focus is placed on smaller companies, where active tactical re-positioning of stock decisions can result in material slippage from entry and exit-related trades, further negatively impacting the overall performance.

This further raises the argument for having initial public sector support for the Fund, as the available investor pool to consider such companies (SMEs), has dwindled further in recent years. Greater Baltic regional institutional investor support may be developed over time, however, as the 'small end' (from a market capitalisation perspective) is also underdeveloped here, such investors also need time to become more comfortable to invest in smaller capitalisation companies.

Retail investor activity not only in the Baltics but elsewhere in Europe is at relatively low levels. Investing into an ETF does not also guarantee that the ETF will then invest into smaller companies as their themes are more typically focused only on larger markets and indices. In other cases, the ETF uses indirect methods to gain exposure (derivatives etc.) in order to gain the desired exposure to a particular benchmark, further limiting the actual money entering primary-based deals. Furthermore, Baltic investor financial literacy also needs considerable development. This is being addressed with various initiatives, however, will also take time to trickle down into meaningful changes in terms of demand for SME-related equity instruments.

Further to the challenges in terms of achieving greater investor activity in smaller companies, EU legislation up until recently made the environment even more challenging by virtue of applying similar standards to large market capitalisation companies. This relates to the research-related work undertaken by banks, brokers and other investment analytical parties when servicing larger institutional investors. MiFID II a few years ago determined that equity research on listed companies to many European institutional investors could no longer be paid for by compensating for this service via market transactions, a process known as 'bundling' (combining an execution component and also separate fee for the provision of research services). This led to the reduction of smaller companies being covered by analysts, as affected institutional investors did not want to pay for a service they were not going to use (particularly due to their own pressures on expenses).

This is highly relevant because one of the fundamental ways any investor will learn more about a company prior to considering investing into it will be to read analytical material available to them. With decreasing attention given to SMEs, the ability to garner attention to this sector of the market was further challenged. Fortunately, some of this impact will be reversed by forthcoming changes in MiFID II regulation where the market capitalisation is less than EUR 1 bn.

The experts of the project therefore believe that it is very important that research is available on any company the Fund decides to invest in during the post-listing environment in order to not only maintain visibility for existing investors (shareholders) but also broaden the shareholder base over time. This generally leads to greater secondary liquidity which in turn generates a positive feedback mechanism encouraging a wider group of investors to consider investing in smaller companies as well.

4.2.2.3 *Potential for Supply of Public Equity*

With the three Nasdaq Baltic stock exchanges effectively functioning as a single regional market the theoretical scope for growth in terms of the supply of public equity available for corporates is technically unlimited. The perceived quality stamp of a leading market infrastructure operator provides confidence to both local and international investors that both the regulated market as well as First North (alternative market, MTF) that it is realistically only the specific risk of corporates to invest into which require the decision making.

Some of the challenges artificially limiting the supply include the absence of larger companies. Specifically, despite the Baltics representing EU member countries, Eurozone, OECD and NATO memberships (and without external capital controls seen in other markets) the region is currently delegated as 'frontier' capital market status by major index providers such as MSCI and FTSE Russell. Due to the large role played by international institutional investors and index tracking funds, this means that only a few companies from the Baltic region are represented in the aforementioned index provider products. In turn, this heavily restricts the activity of such larger investors which would automatically be expected to increase should larger (particularly >EUR 1bn market capitalisation with adequate free float) companies be listed on the Nasdaq Baltic exchanges. The same can be said for the Nasdaq Baltic Index: most local and

international investments would appear to be focusing on specific companies rather than overall country or regional weightings.

The project experts believe that for emerging market status alone to be reached there would need to be several companies with multi-EUR billion market capitalisations and sufficient free float to trigger enough liquidity for the expectations of such investors, where EUR 1m of daily secondary turnover in a company may be deemed a starting point. For reference, the Baltic market (up until 2020) may have only reached such a level when accumulating turnover generated by all companies listed on the region's 3 exchanges during the course of a trading day. From 2020 this has markedly improved due to the discontinuation of a few leading market operators from charging trading commissions to retail customers. However, in absolute terms trading volumes are still very low (coming to around EUR 400m in 2020).

This has had the effect of generating greater willingness to make speculative shorter-term investments because the associated transaction costs do not have to be taken into account.

At the same time, without the creation of broader indices (incorporating smaller market capitalisations) the demand for new issues is more likely to be absorbed by the Baltic region's various institutional and retail investors. An example of this could be the creation of an EU-wide index using a formulation more similar to the US Wilshire 5000 Index, which represents a market-capitalization-weighted index of the market value of all American-stocks actively traded in the United States⁸³. While tracking such an index would be unlikely to be a popular strategy due to liquidity constraints it could help to raise a greater focus on SMEs on an EU basis. The key for such an index is to be investable, tradeable and replicable. The MSCI ACWI ESG Index is a good template as it covers both Developed and Emerging markets while there can be a cap in place in terms of index allocation to a certain jurisdiction/firm. This would allow the Baltics to be represented in such EU-wide [SME] indices.

However, with estimated retail cash available alone estimated to be around EUR 44bn⁸⁴ there is plenty of scope for new companies to be listed, together with other institutional investors including increasing pension fund assets. A significant number of such investors are believed to actively trade other larger markets in Europe and the US, which could then in theory be also traded locally were liquidity levels more suitable for speculative investments. One of the key reasons for this is shortage of perceived investments to make (quality and liquidity). This would then improve the alignment of applying longer-term domestic equity capital into local enterprises, rather than be typically exported into foreign markets.

Therefore the CMDAF Baltic SME IPO Fund would serve as a helpful source of satisfying the supply side with new opportunities for investment in carefully selected corporates,

⁸³ Wikipedia, Wilshire 5000, 2020

⁸⁴ ERR, Bank of Estonia: Estonians' savings increased during coronavirus crisis, 2021; Bank of Latvia, MFI balance sheet and monetary statistics, 2021, Lietuvos Bankas, With rapidly growing deposits, household investment in equity is decreasing, 2021

which would help to garner greater trust in both SMEs and also the First North alternative market where there are only a few listed entities at present.

4.2.3 Supply Consolidated

4.2.3.1 Supply of private equity

The supply of private equity in the Baltics has been significantly bolstered by the availability of financing from and organised by the EIF⁸⁵, which has in turn enabled extra private capital topping up the EIF managed resources. As a result, the development of private equity industry in the Baltics is notable. Apart from growing supply of private equity investments, the respective fund managers have also accumulated wealth of knowledge about managing private equity investments, which is conducive to any further development of private equity in the Baltic region. Also, the information and knowledge has been widely disseminated among companies and entrepreneurs, helping them better understand when and how to use the private equity.

In line with the analysis above, the existing supply of private equity investments in the Baltic region is significant. The following numbers characterise the cumulative size of various segments of private equity funds based in the Baltic region and currently in the investment stage, with the caveat that the already invested portion of these funds have not been deducted due to their typically confidential nature:

- Venture capital stage financing: EUR 343m;
- Growth capital stage financing: EUR 152.5m;
- Replacement, turnaround and buyout capital: EUR 473m;
- Mezzanine financing: EUR 91m.

Aggregating the above numbers, it can be seen that the total Baltic supply of private equity stands at EUR 1.06bn less the already invested part, as described above⁸⁶.

According to research performed by Deloitte⁸⁷, as of 31 December 2019 the total capital available for investment stood at EUR 802m in the following categories – early ventures (EUR 150m), late ventures (EUR 147m), growth investments (148m), buyout capital (EUR 343m) and mezzanine capital (EUR 14m).

⁸⁵ Primarily through JEREMIE, Baltic Innovation Fund I, Baltic Innovation Fund II and EstFund initiatives

⁸⁶ It is possible that additional up to EUR 1bn could potentially be available from the Lithuanian Business Support Fund, when established. Due to insufficient visibility on this potential financing instrument as well as its specific niche investment strategy, it has not been included in calculating the total private equity financing supply.

⁸⁷ Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

4.2.3.2 *Supply of public equity*

As of 31 December, 2020, there were 69 listed companies listed on the Nasdaq Baltic stock exchange. The Baltic Main list is comprised of 33 companies, the Baltic Secondary list of 28 companies and the Baltic Bond list of 56 bond issues. At the same time, the alternative First North market is comprised of 8 share listings and 11 bond issues.

There are significant differences between market capitalisations among the Baltic countries. As of year-end 2020, the capitalisations of the Baltic stock exchanges stood at around EUR 4.48bn in Vilnius, EUR 2.84bn in Tallinn and EUR 0.95bn in Riga. These differences cannot be attributed either to sizes of respective countries or number of listed entities. They rather show the varying development stage of the respective national stock markets. This is also confirmed by the fact that out of top 5 companies by capitalisation two first are from Vilnius Stock Exchange and the remaining three – from Tallinn Stock Exchange.

The total equity capital attracted on the Baltic stock exchanges during 2015 to 2020 amounts to EUR 796.8m, out of which top 5 deals constitute EUR 690m or around 87% of the total equity capital attracted. This shows the rather big difference between mean (EUR 24.9m) and median (EUR 2.75m) values of capital attracted.

On the investor side, Baltic and non-Baltic investors of all types can be observed, incl. institutional investors, IFIs and retail investors. Interest of retail investors has been significant in some of the IPOs (such as those of Tallinna Sadam or MADARA Cosmetics), which shows not only interest of retail investors in placing their savings, but also in rising investment culture and knowledge overall.

With the three Nasdaq Baltic stock exchanges effectively functioning as a single regional market the theoretical scope for growth in terms of the supply of public equity available for corporates is technically unlimited. There are limiting factors such as the challenge with the indexation issues analysed above. However, solving the deterring aspects have the possibility of capitalising on the significant potential for increase of supply of public equity financing.

4.3 SME & Mid-Cap Equity Finance Demand

4.3.1 Demand for Private Equity

EU/EIF methodology⁸⁸ and similar market gap analysis conducted previously in the Baltics⁸⁹ used EU statistics on risk capital investments as a % of the country's GDP as the main method for estimating the theoretical size of equity investments in a well-functioning capital market, and used any differential below the EU average to connote the potential market gap in the particular country. Recently however, the Fi-compass⁹⁰ platform published an EU wide market gap assessment with country gap data derived using an alternative approach. Firstly, the recent secondary data from the Fi-compass financing gap analysis is examined, followed by the use of the abovementioned more established methodology. Finally, available secondary data on survey of SMEs covering equity financing matters is presented with the view to show European and Baltic similarities and differences as regards to the equity financing landscape.

4.3.1.1 Secondary Data for the Gap Analysis

In this part of the report available secondary data that is relevant for the CMDAF Baltic SME IPO Fund project is elaborated on in terms of understanding the market gap and the need for the specific financial instrument to be developed.

Fi-compass Market Gap Analysis

In December 2019 a market gap assessment ("Gap analysis for small and medium-sized enterprises financing in the European Union") was published by Fi-compass, funded by the EU. The main aim of the study was to provide DG REGIO with insights on financing gaps and market failures related to SME financing at the member states' level and to highlight the potential of financial instruments for SME financing. Two forms of financing were covered in the study: debt financing and equity financing.⁹¹

As the scope of the gap analysis of the CMDAF Baltic SME IPO Fund project does not include debt financing instruments, the findings of the study conducted by Fi-compass regarding the debt financing market gap in the Baltics are not relevant for this report, and thus the findings will not be further elaborated on.

The methodology behind the study consists of analysing both quantitative and qualitative data. The quantitative data analysis consisted of the use of available data on SME financing from various sources in order to compute the financing gaps. In addition, to conduct a more comprehensive analysis, the quantitative data was supported by a

⁸⁸ EIF, Working Paper 2014/22 - Guidelines for SME Access to Finance Market Assessments (GAFMA), 2014

⁸⁹ The Ministry of Economics of the Republic of Latvia, Access to Finance ex ante assesment, 2015

⁹⁰ Fi-compass is a platform for advisory services on financial instruments under the European Structural and Investment Funds (ESIF), provided by the European Commission in partnership with the European Investment Bank

⁹¹ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

literature review of works on European SMEs' access to finance and a number of interviews with EIB Group experts in SME financing.⁹²

In order to compute the financing gaps, information was gathered from Eurostat, the Survey on Access to Finance of Enterprises (SAFE) by the European Central Bank and Invest Europe. The formula was the multiplication of the number of SMEs (Eurostat) times the number of unsuccessful SMEs (ECB SAFE), times the average SME equity size (Invest EU).⁹³

According to the study, it is a well-known fact that SMEs face greater financing obstacles than larger enterprises. In general SMEs enjoy less favourable conditions of finance and if financing is offered at all, often the financing is offered at unreasonable conditions in terms of interest rates, maturities, repayment terms and collateral required. In some of its publications, the European Commission acknowledges the fact that market failures, common in the whole EU, hinder the start-up and growth of SMEs. Rarely SMEs have the internal funds required for growth expenditures and seek external financing for them. Moreover, the lack of financing provided by the market, could have negative externalities that delay economic growth, job creation, innovation, the pursuit of long-term objectives, the emergence of sustainable economic models, and the resilience of the financial systems.⁹⁴

The main objective of financial instruments is to address the market failures and the suboptimal investment situations related to the supply of financing to SMEs that the private sector financiers are not addressing. Financial instruments with investments in various segments of SMEs have the potential to foster competitiveness and increase the contribution to the EU's economic growth and innovation. Carefully designed financial instruments have positive macroeconomic effects, meaning that the positive stimulating effects on the economy outweigh the possible defaults.⁹⁵

According to the Fi-compass research, the Baltic states have a mid-range equity financing gap to GDP ratio (10.7%) as compared to their EU peers, but a relatively high percentage of SMEs have been unsuccessful in obtaining external equity funding (4.4%). Partially the high unsuccessful Baltic SME percentage could be explained by the wide publicity created around equity funding in last 10 years, causing many SMEs to try and get rejected, thus potentially overestimating the needs from the SMEs in comparison to the actual investable projects that equity funds would be keen to invest in.⁹⁶ This observation is supported by only 0.05% of Italian SMEs having difficulties in receiving equity finance, as opposed to the staggering 10.45% of Swedish SMEs failing to get equity finance.

⁹² Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹³ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹⁴ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹⁵ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹⁶ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

Table 33 Equity Financing Gaps in the Baltic States in 2018

Number of SMEs (2017)	Percentage of SMEs with difficulties in seeking equity finance (2018)	Number of SMEs with difficulties (2018)	Average equity financing size in EUR million (2018)	Equity gap in EUR million
391 177	4.36%	17 055	632	10 771

Source: Fi-compass⁹⁷

The equity financing gap relative to the respective GDP of the time amounts to 10.7%.

Table 34 Equity Financing Gaps in Comparison to Gross Domestic Product for the Baltic States in 2018

Equity Gap in EUR million	Gross Domestic Product (current prices, EUR million, 2018)	Equity gap/GDP ratio (2018)
10 771	100 824	10.7%

Source: Fi-compass⁹⁸

Macro Level Analysis

In addition to the above-mentioned secondary data, macro level data on the differences of private equity investment as percentage of GDP in the Baltics and in Europe is analysed. To avoid observable outliers in the dataset that is used for the project, the five year averages are taken for comparison. Having seen the calculated differences the range of the equity financing market gap is estimated under these assumptions. Additionally, a point of caution for this type of analysis is that the investment destination regions and countries within them are rather different and hence the pure macroeconomic approach cannot be considered as very precise. Furthermore, several of the large de facto Baltic funds (for example BPM Mezzanine, Baltcap Private Equity Fund II) are registered outside of the Baltics (in Luxembourg, Guernsey, etc) thus their investments in companies are not included by Invest Europe in „Baltic fund” statistics. This explains part of the gap between „Baltic fund investments” and „investments in Baltic companies”. Yet, the approach provides another range of underserved demand to be considered in the final estimation of the equity financing gap in the Baltics.

From the table below, it can be observed that the annual gap between private equity investment as percentage of GDP in the Baltics and Europe ranges from 0.05% of GDP (under the investments in the region’s companies data) to 0.38% of GDP (under investments by the region’s funds data). Using the same Baltic GDP number from the economic section of this report⁹⁹ (EUR 107.02bn), the said annual market gap can be estimated in the range of EUR 53.5m to EUR 406.7m.

⁹⁷ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹⁸ Fi-compass, Gap analysis for small and medium-sized enterprises financing in the European Union, 2019

⁹⁹ Table 1 Overall GDP and Population of the Baltics (2015-2019)

CMDAF Baltic SME IPO Fund
March 2021

Table 35 5 year Average (2015-2019) Private Equity Investment as % of GDP in the Baltics and Europe

5 year average (2015- 2019) private equity investment as % of GDP	Investments in the country's/region's companies	Investments by the country's/region's funds
<i>Baltics total</i>	0.39%	0.07%
<i>Estonia</i>	0.71%	0.11%
<i>Latvia</i>	0.19%	0.08%
<i>Lithuania</i>	0.27%	0.03%
<i>Europe</i>	0.44%	0.45%

Source: Invest Europe¹⁰⁰

The table below provides detailed numbers for calculation of private equity investment as % of GDP for the Baltic states.

Table 36 Private Equity Investment as % of GDP in the Baltics (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Baltic companies</i>	0.12%	0.31%	0.20%	0.24%	0.95%
<i>Investments by Baltic funds</i>	0.05%	0.09%	0.04%	0.05%	0.08%

Source: Invest Europe¹⁰¹

The following tables below provide detailed numbers for calculation of private equity investment as % of GDP for the Baltic states individually.

Table 37 Private Equity Investment as % of GDP in Estonia (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Estonian companies</i>	0.10%	0.37%	0.03%	0.62%	2.43%
<i>Investments by Estonian funds</i>	0.08%	0.24%	0.07%	0.04%	0.10%

Source: Invest Europe¹⁰²

¹⁰⁰ Invest Europe, EDC Baltic Countries, 2020

¹⁰¹ Invest Europe, EDC, 2020

¹⁰² Invest Europe, EDC, 2020

Table 38 Private Equity Investment as % of GDP in Latvia (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Latvian companies</i>	0.06%	0.09%	0.06%	0.07%	0.11%
<i>Investments by Latvian funds</i>	0.11%	0.10%	0.65%	0.04%	0.03%

Source: Invest Europe¹⁰³

Table 39 Private Equity Investment as % of GDP in Lithuania (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Lithuanian companies</i>	0.13%	0.40%	0.01%	0.15%	0.68%
<i>Investments by Lithuanian funds</i>	0.03%	0.01%	0.01%	0.04%	0.05%

Source: Invest Europe¹⁰⁴

The table below provides detailed numbers for calculation of private equity investment as % of GDP for Europe.

Table 40 Private Equity Investment as % of GDP in Europe (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in European companies</i>	0.35%	0.36%	0.46%	0.50%	0.53%
<i>Investments by European funds</i>	0.36%	0.38%	0.46%	0.50%	0.54%

Source: Invest Europe¹⁰⁵

Survey on the Access to Finance of Enterprises (SAFE)

The SAFE survey shows how SME financing conditions were affected by the spread of the COVID-19 pandemic across Europe and indicates the associated disruption in the business activity of many companies. The survey provides some key insights into the sources and the magnitude of the inflationary pressures perceived by EU SMEs.¹⁰⁶

The survey results reflect the opinions of SMEs, based on their experiences over the last six months (April to September, 2020). They were asked about the importance of various issues affecting access to finance: uses and relevant sources of funding, application and outcome, needs and availability, purpose and expectations.¹⁰⁷

Although SAFE data does not directly provide numeric information on available market gaps, it is a good point of reference for comparing the claimed need for finance by SMEs in the Baltics as compared to the overall European numbers.

¹⁰³ Invest Europe, EDC, 2020

¹⁰⁴ Invest Europe, EDC, 2020

¹⁰⁵ Invest Europe, EDC, 2020

¹⁰⁶ European Commission, SAFE main results, 2020

¹⁰⁷ European Commission, SAFE main results, 2020

Baltic enterprises (Latvian – in particular) state that equity capital financing is very relevant to them and has been used lately. The said Baltic numbers (except for Lithuania) are well above the EU27 numbers showing a clear interest in the instrument.

Table 41 Is equity capital financing relevant to the enterprise and has it been used in the past or is considered for use in the future?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Yes, this source is relevant to my enterprise</i>	10%	27%	21%	49%	10%
<i>No, this source is not relevant to my enterprise</i>	85%	69%	74%	46%	88%
<i>Does not know/answer not available</i>	5%	4%	5%	5%	3%
<i>Unweighted number of observations</i>	14055	558	95	185	278
<i>Source: SAFE survey EC¹⁰⁸</i>					

The Baltic states of Estonia and Latvia have similar levels to those of the EU27 in terms of the need for equity financing trends with around 15% saying the need for equity financing has lately increased. Very few companies (less than 10% in all cases) both from the EU27 and the Baltics state that the need for equity financing has actually decreased lately. Hence, the topicality of equity financing is clearly underlined here.

Table 42 Has the need for equity financing changed (increased, remained unchanged or decreased) over the past 6 months and if has then how?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Increased</i>	15%	12%	15%	17%	3%
<i>Remained unchanged</i>	78%	79%	72%	74%	91%
<i>Decreased</i>	6%	7%	8%	7%	6%
<i>Does not know</i>	1%	2%	5%	2%	0%
<i>Unweighted number of observations</i>	1586	133	16	90	27
<i>Source: SAFE survey EC¹⁰⁹</i>					

At the same time, willingness of banks to provide credit in the Baltic countries has significantly more deteriorated than improved. This is an indication supporting the need to diversify access to finance and to diversify financial instruments that can foster the aforementioned.

¹⁰⁹ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

Table 43 How has the willingness of banks to provide credit to your enterprise changed (improved, remained unchanged, deteriorated) over the past 6 months?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Improved</i>	21%	11%	6%	13%	14%
<i>Remained unchanged</i>	54%	41%	44%	44%	34%
<i>Deteriorated</i>	15%	26%	30%	23%	24%
<i>Not applicable</i>	7%	12%	13%	9%	15%
<i>Does not know</i>	3%	9%	6%	11%	12%
<i>Unweighted number of observations</i>	10149	311	58	95	158

Source: SAFE survey EC¹¹⁰

As for equity capital financing availability lately, it has deteriorated more than it has increased in the eyes of Baltic SMEs, as opposed to the overall EU27 where the number of improvement observations is rather close to those of deterioration, with a fraction of more weight on the improvement side. Although not very strongly, this also speaks in favour of the need to increase the availability of equity financing.

Table 44 How has equity capital financing availability changed (improved, remained unchanged, deteriorated) for the enterprise over the past 6 months?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Improved</i>	10%	9%	8%	15%	3%
<i>Remained unchanged</i>	72%	65%	65%	55%	74%
<i>Deteriorated</i>	9%	16%	22%	18%	7%
<i>Not applicable</i>	7%	11%	6%	10%	17%
<i>Does not know</i>	2%	0%	0%	1%	0%
<i>Unweighted number of observations</i>	709	53	6	27	20

Source: SAFE survey EC¹¹¹

The Baltics overall are very much aligned with the EU27 as relate to the foreseen changes of the availability of equity capital financing over the coming half year, with somewhat more claiming that deterioration will prevail over the improvements.

¹¹⁰ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

¹¹¹ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

Table 45 How do you think the availability of equity capital financing for the enterprise will change (improve, remain unchanged or deteriorate) over the next 6 months?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Will improve</i>	13%	12%	15%	16%	5%
<i>Will remain unchanged</i>	67%	62%	52%	64%	69%
<i>Will deteriorate</i>	14%	18%	28%	11%	16%
<i>Not applicable</i>	4%	3%	0%	4%	4%
<i>Does not know</i>	3%	5%	5%	4%	5%
<i>Unweighted number of observations</i>	1586	133	16	90	27

Source: SAFE survey EC¹¹²

Both the EU27 SMEs as well as the Baltic SMEs overall and on a country level clearly prefer bank loans and loans from other sources of financing for growth. Although equity comes in third, this is with clear lagging behind the bank loans and loans from other sources that cumulatively stand closer to 70-75% of the responses.

Table 46 If you needed external financing to realise your growth ambitions, what type of external financing would you prefer most?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Bank loan</i>	65%	50%	48%	48%	55%
<i>Loan from other sources</i>	15%	22%	15%	26%	25%
<i>Equity investment</i>	6%	12%	12%	18%	6%
<i>Other</i>	6%	9%	15%	4%	9%
<i>Does not know/answer not available</i>	8%	7%	11%	4%	6%
<i>Unweighted number of observations</i>	7300	317	47	116	154

Source: SAFE survey EC¹¹³

The vast majority of surveyed SMEs both in the EU27 and the Baltics overall require external growth financing of below EUR 1m, which is the case in 85% of the observations.

¹¹² European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

¹¹³ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

Table 47 If you needed external financing to realise your growth ambitions, what amount of financing would you aim to obtain?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
< € 25 000	12%	14%	8%	20%	12%
€ 25 000 – 100 000	24%	24%	20%	23%	31%
€ 100 000 – 250 000	17%	16%	14%	16%	19%
€ 250 000 – 1 000 000	18%	17%	20%	13%	19%
> € 1 000 000	15%	15%	20%	17%	8%
<i>Does not know/answer not available</i>	14%	13%	19%	10%	11%
<i>Unweighted number of observations</i>	7300	317	47	116	154

Source: SAFE survey EC¹¹⁴

The two most typical difficulties for the obtainment of an external financing deal are insufficient collateral or guarantee and the interest rates or the price being too high. The latter is especially important in the case of the Baltic countries, although the former is also more prevalent in the Baltics as compared to the EU27. Insufficient collateral for obtaining financing can also be considered as an indication in favour of developing the capital markets.

Table 48 What do you see as the most important limiting factor to get financing?

Answer	EU27	Baltics	Estonia	Latvia	Lithuania
<i>Insufficient collateral or guarantee</i>	13%	17%	15%	15%	23%
<i>Interest rates or price too high</i>	11%	24%	29%	25%	18%
<i>Reduced control over the enterprise</i>	3%	3%	5%	3%	1%
<i>Financing not available at all</i>	5%	5%	5%	8%	2%
<i>Too much paperwork is involved</i>	8%	10%	1%	19%	11%
<i>There are no obstacles</i>	45%	28%	37%	20%	26%
<i>Other</i>	11%	6%	0%	7%	11%
<i>Does not know/answer not available</i>	5%	7%	10%	4%	8%
<i>Unweighted number of observations</i>	6254	275	35	108	132

Source: SAFE survey EC¹¹⁵

¹¹⁴ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

¹¹⁵ European Commission, Survey on the Access to Finance of Enterprises (SAFE), 2020

4.3.2 Demand for Public Equity

The demand for public equity consists of two distinct segments.

First, it is enterprises willing to raise new capital. This segment significantly overlaps with the demand for private equity described in the previous section. From an enterprise point of view, new equity is new equity, the technical process and procedure to attract it does not change the colour of the money raised. In theory, public capital markets are typically meant for more mature and stable companies, whilst private equity serves earlier and higher risk stages of enterprise development, but with the development of capital market concept and the introduction of growth markets like the First North this stage distinction has become quite blurred. Another, more stable difference is that private equity, except mezzanine, targets controlling or quasi-controlling positions, to be able to control and implement the company value-add strategy, whilst IPOs and other listings typically are for non-controlling stakes (and there is no external value-add strategy anyway). In practice, this difference is often more a result of negotiations, not enterprise intentions. Additionally, the planned Fund is expected to take on a more active role than a typical minority public market investor, for example by often taking a council position. This is both to protect the minority shareholder value and to help investee better transition to and settle in the new, public company status.

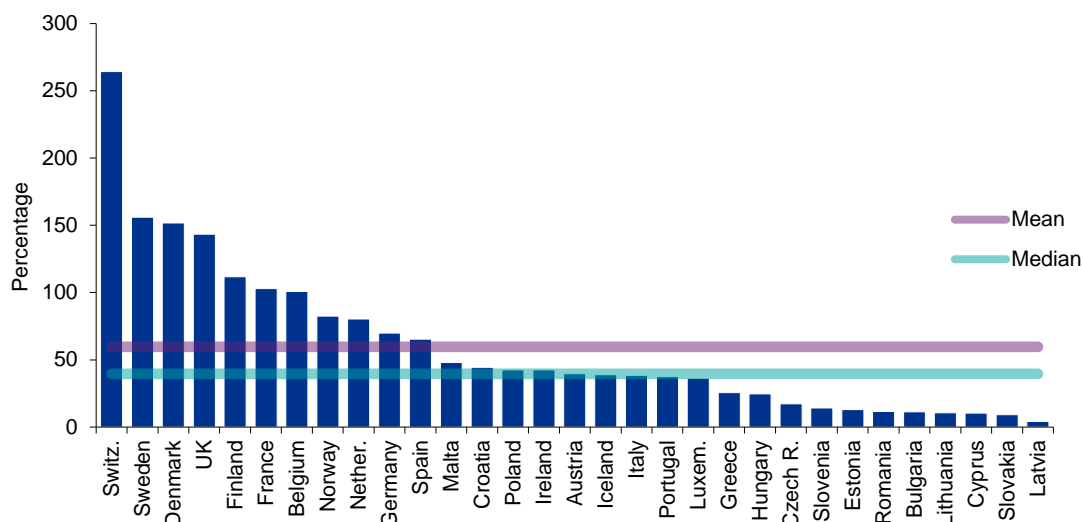
Also, with enterprises in the Baltics practically not using the public capital market as a funding venue, it can be said that all the latent demand for public equity is hiding in private equity demand statistics.

Second, it is trading activity. Either longer term investors buying existing shares from current investors to hold, or speculative investors buying existing shares in hope of hitting the next hot stock in a few months, it is so called “replacement capital”. Existing shares changing owners, enterprises not getting new capital, but trading activity is important for the market functioning and liquidity.

To give a quantification to the potential scope of the public capital market activity in the Baltics, below can be seen a comparison of market capitalisation to GDP in selected countries¹¹⁶. As can be seen, all three Baltic states lag significantly behind both the mean and median values of the EU/EEA/CH in terms of market capitalisation to GDP, with Latvia being the last on the list, followed by Lithuania and then by Estonia. The capitalisation to GDP in April 2019 was 4% in Latvia, 11% in Lithuania and 13% in Estonia. At the same time, the median stood at 40% and mean at 60%.

¹¹⁶ Bloomberg, Market Capitalisation to GDP, 2019

Figure 8 Market Capitalisation to GDP in the EU/EEA/CH in April 2019

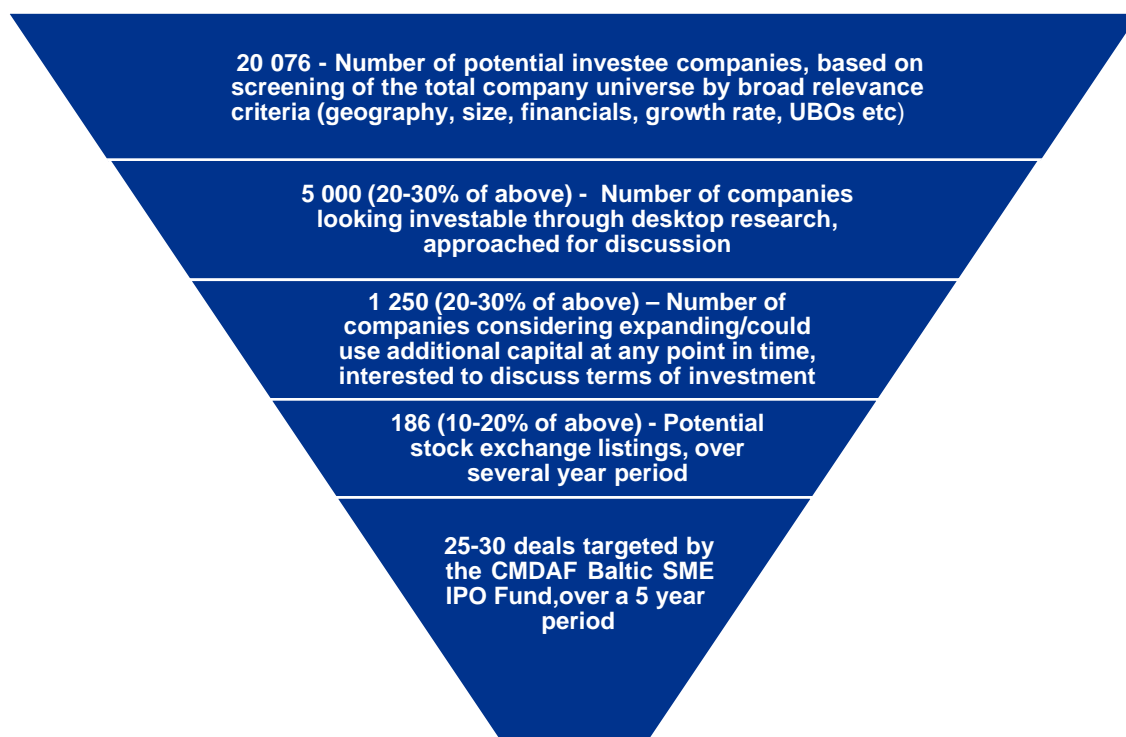


Source: Bloomberg, 2019¹¹⁷

Another quantification is the number of companies in the Baltics that would pass the broad initial top-down screening by the Fund, resulting in a sample size of potential investment targets across the Baltics. It was calculated against the criteria elaborated by project experts (please see detailed criteria and approach in section 7). The initial broad list is comprised of 20 076 companies relatively evenly spread throughout the Baltics. Below, the project experts have designed an investment funnel that shows the sequence and logic of progressively narrowing down the initial pool of potential investees (as described within funnel) to a smaller pool, from which the Fund will source the few deals planned each year.

¹¹⁷ Bloomberg, Market Capitalisation to GDP, 2019

Figure 9 CMDAF Baltic IPO SME Fund Investment Funnel



Source: KPMG

To put this in perspective, the CMDAF Baltic SME IPO Fund plans to invest in 5-6 companies per year, whilst, according to the report by Deloitte¹¹⁸, in 2019 a total of 182 private equity investments were made in Baltic companies, when aggregating the number of investments in all investment stages. This 192 actual investments number is in the same ballpark as the 186 potential listings number estimated in the funnel above, fitting well with the earlier argument that to some extent private and public equity is interchangeable, as a result the theoretical demand could be somewhat similar.

The scope for additional companies to come to the market is materially increased. This is supported by various factors, including:

- Low absolute market capitalisation levels to GDP relative to other EU/EEA/CH markets;
- High historical dependence on bank loans for capital requirements;
- Selectivity together with 'lessons learned' aspect when it comes to risk capital;
- Growing scope of local companies looking to take on international markets rather than only serve the local economy;

¹¹⁸ Deloitte, ESTVCA, LVCA, & LTVCA, Baltic Private Equity survey Capital Market overview 2010-2019, 2020

— Listing support programmes.

The low absolute ratio of market capitalisation to GDP relative to other markets suggests that this funding route has very significant growth potential without moving down into the individual company analysis. The reasoning here is that if the mean and median levels applicable in the EU/EEA/CH region are used and it is assumable that this to be to the order of approximately 40-60% of GDP and assume this to be a feasible medium to longer term target, then the ca. EUR 8.3bn total market capitalisation should have the possibility to grow up to around 10x in Latvia, 5x in Lithuania and 4x in Estonia on this metric alone based on current ratios.

Historically there has been very high dependence on bank supplied debt for external financing purposes (more than 80%). The direct ramifications of this were highly visible during the Global Financial Crisis (GFC), when many Baltic corporates had overleveraged themselves, which is also partially a direct consequence of aggressive lending policies and cheap financing at the time (supplied in EUR terms due to the ERM 2 status of the Baltic countries and disbursed despite local currencies still prevailing). Bank appetite for lending since then has been far more tempered and this has led many companies to look for alternative sources of capital. Initially this appears to have helped hasten the development of the Baltic corporate bond market. However, in more recent years, the preparedness to improve corporate transparency and governance has also heightened the interest in sharing the profits generated with minority investors and together with the appearance that the First North can be successfully used for attracting equity capital in the Baltics has led to more corporates contemplating this. It should be noted that the region is dominated by SMEs and they are therefore naturally more attracted to the less stringent requirements of the alternative market (MTF) First North rather than the regulated market.

Furthermore, although private equity (PE) has made major inroads into the Baltic corporate investing environment, when it comes to equity-related financing, the number of companies selected for investment is deemed to be very low. In other words, a few companies out of an initial broad pipeline. This leaves open many more corporates looking for funding in a similar way and together with the growing understanding that higher internal rates of return (IRR) are expected for PE (implying lower valuations), then for public markets this is deemed to be lower and at the same time entrepreneurs generally have greater freedom to continue running their enterprises (without drag-along/tag-along requirements), sell minor stakes from time to time, as well as timing capital increases with greater flexibility.

Equity capital potential for international expansion indirectly has a greater need for equity capital for the reason that borrowing for international expansion related projects will also be more difficult for typical SMEs. Banks in the Baltics will typically only focus on their domestic market and do not usually have international networks allowing better collateral management of international business (overseas subsidiaries, M&A etc.).

All three Baltic countries have undertaken listing support programmes by projects managed by the EBRD. This involves a rebate to be paid out upon successful raising of a minimum amount of new capital and listed status being achieved on the regulated or

alternative market. Latvia is presently the only Baltic country to have implemented this and the first application period drew in 8 candidates for equity-related support.

Together with increasing engagement of equity culture in the private sector, Baltic governments in recent years have also looked to increase the presence state-owned enterprises (SOE) on the Baltic region's exchanges. This helps to increase awareness of the capital markets as a source of financing in the relevant country to the private sector.

A recent working paper by the EIF¹¹⁹ analyses in a comprehensive manner responses from 2020 surveys of EIF Venture Capital, Private Equity Mid-Market and Business Angels on matters *inter alia* related to investment exit opportunities. All three of the aforementioned respondent groups consider exit environment a top investment challenge. None of the categories use IPOs as primary exit route, although IPOs are used more often as exit routes by VCs than PE respondents. It is not only that IPOs are almost not at all reported as the existing exit route, they are also not part of the future fund strategies. Among those VC and PE managers that invest around IPOs, they mainly report participating in pre-IPO investments (investments in companies with anticipated listing in the next 12 months). Holding periods for these investments are 2-3 years typically. The main reasons for not considering IPO as part of exit strategy are (apart from IPO not being an exit strategy per se) insufficient liquidity in the IPO market and IPOs being too expensive and burdensome.

The aforementioned analysis of the EIF can be considered an additional proof of the necessity of state support of access to finance for SMEs thereby also developing the respective capital markets and raising of general awareness of IPOs as investment/investment exit routes. It also reinforces the public need for EIF to be more actively involved in public markets.

4.3.3 Empirical Analysis of SME & Mid-Cap Equity Finance Demand

During the market analysis and the interviews/meetings carried out during the course of the project¹²⁰ a list of less quantifiable insights and observations about the nature of the demand of enterprises for equity finance was identified. There was a clearly identifiable market gap observable with several sub-segments – companies in need of capital, but not fitting private equity funds' business model well. The main reasons why some growth companies are either not using private equity for growth, or are using it in sub-optimal ways, whilst complaining about its complicated impact on a company, are listed below.

4.3.3.1 First Distinct Sub-Segment

This sub-segment consists of growth companies whose owners are (not all of these characteristics need to be present collectively in any specific company):

- Not willing to share the control over the company, including both strategy and operations;

¹¹⁹ EIF, Scale-Up Financing and IPOs: Evidence From Three Surveys, Working Paper 2021/69, 2021

¹²⁰ See the interview/meeting list attached in Annex B

- Not ready to accept a forced sale of their shares together with a fund in the future (the so called “*drag along, tag along clause*”);
- Fearing inherent instability associated with a private equity fund’s need to exit and find a new owner after a few years, potentially a new investment fund which would mean the process will repeat itself;
- Not satisfied with private equity valuations.

These concerns are interrelated, but it is worth exploring each one of them in more detail.

The “*sharing control*” issue originates from the private equity funds’ business model. Private equity by its nature is a high-risk activity with relatively high administration costs, requiring a significant growth in value of underlying assets (investee companies) to make the investment commercially feasible. Assuming that a fund invests at a fair value and exits at a fair value, the company’s valuation must grow significantly in between. To achieve this, fund managers are professionals with high-expertise and knowledge in helping companies to grow value at a fast pace (there is a list of standardised techniques for achieving this). However, such growth often means taking on more risk (as costs often grow ahead of revenues) as well as decreasing the professional life-quality for the owners of the company (together with other stakeholders). The additional risk aspect is important, because the original owner/founder of the company typically possesses this single company as their key source of wealth. Therefore, if it fails, this particular owner loses everything. Each fund typically has 10-15 companies, so it actually expects to take losses on several, as long as the remaining ones sufficiently grow in value. That puts extra growth expectations and pressure on the investee companies.

The “*forced sale*” issue again stems from the private equity funds’ business model. The fund wants to earn maximum returns on investments. Earning more can be achieved by selling higher. Private companies often sell higher as a whole (not only achieving a controlling stake). Thus a fund, at the moment of investment in a company, requires other company owners to sign a shareholder agreement stating that if the fund finds a buyer, other shareholders have to automatically sell their shares together with the fund, or alternatively to buy the fund’s shares themselves at the same price as the buyer has offered. This is sometimes psychologically difficult for existing company owners to accept. If a person has spent say, 15 years of his/her life building a company from scratch, it often becomes his/her second family, and the sentimental attachment may become a hard to overcome hurdle when it is time to sell the company. Moreover, there may be several groups of shareholders in a company without one of them dominating and with each having different views on the desired timing of their particular shareholding exit from the enterprise.

The “*instability*” issue is two-fold. Firstly, there often is frantic activity when a fund invests, with the company business strategy being reviewed, the cutting of costs, non-core assets being disposed of, the management team being reviewed for improvements (i.e. the firing of underperformers, the hiring of overperformers) et cetera. Secondly, when the fund enters its divestment period, it starts to showcase the investee company around looking for a buyer, whilst putting a short-term upward pressure on financials and postponing capital expenditures to lift the EBITDA, in anticipation of the EBITDA multiple (to enterprise value) being the main valuation method in exit negotiations. This also

suggests why increased financial leverage would be typically preferred – so that the maximum possible return on equity can be generated.

The “*valuation*” issue boils down to mathematics. Private equity funds have an implicit annual cost of capital (COC) in the 15-20% range, with mezzanine funds going as low as 12% and VC funds up to 25% COC. This is caused by it being a high-risk activity with relatively high administration costs. Public capital via the stock-exchange has an implicit COC in the 5-10% range. Private equity funds typically use 6% as a proxy for public capital COC.¹²¹

If plugging these different COCs into a valuation model, it could mean that the same company could easily be valued 50-100% higher¹²² on the stock exchange than by a private equity fund over the course of an expected investment holding period. The case study of MADARA Cosmetics serves as a perfect example of this.

4.3.3.2 *Second Distinct Sub-Segment*

This sub-segment consists of companies with a slower, but still decent growth trajectory.

To make a company interesting for a private equity fund, that company has to show a value growth potential in line with the estimates indicated in section 4.3.3.1. Typically value growth can be equalled to the company revenue or the EBITDA growth as proxies. If a company's prospective EBITDA growth can realistically be projected only in the 5-10% range (a mature company in a stagnant industry, declining market, competitive environment et cetera), then such a company simply does not justify the cost of capital amounting to 12-20% per annum. At the same time, it may still be a rather good company for the cost of capital of 6% per annum.

Such companies may also qualify as those in a ‘cash cow’ status. This is where market growth may be minimal, however they have an established leading position without requiring significant additional capital to be invested and can reap above average distributions to their shareholders. Simple application of financial leverage to boost return on equity would probably not justify the entry of a private equity fund. Moreover, the original founders/owners may also have a conservative view towards banks/debt. In such a situation it would potentially create an attractive dividend stock, particularly considering the low global interest rate environment currently being experienced.

4.3.3.3 *Additional Considerations*

Not strictly distinct sub-segments, but there are features of public capital via the stock exchange that are not at all or at least less efficiently provided by private equity funds:

- Situations where a company's need for capital is gradual and less certain in the amount required. With private equity investments it might be difficult to obtain top up financing on various occasions, i.e. if the fund is close to the end of its investment phase, if the fund has a shortage of investable capital (‘dry powder’) etc.;

¹²¹ Project lead expert proprietary data and analysis

¹²² Assuming that a private equity fund uses a 4-5 year holding period assumption in that model. Shorter holding period reduces impact, a longer one increases it.

- Raising equity capital (selling shares) in batches allows more efficient deployment of capital, since only the capital actually needed is deployed;
- Listing as a top-up/partial exit for companies already having a private equity as a shareholder;
- There are some industries that private equity funds, which have been partly funded by public funds (which is largely the case all over the Baltics), cannot invest in. Public equity is less restrictive in this aspect.

In the first situation, there is a further twist that could occur. This is that while the fund may be prepared (in principle) to support CAPEX by the firm it has invested in, the specific CAPEX preferences may be for shorter term value-boosting purposes. In other words, decisions are taken with the motive to increase the shorter-term value of the enterprise rather than necessarily boosting certain investments, which may take more than 2-3 years to reap additional shareholder value increases (by which time the fund may have already planned to have exited the investment).

If an enterprise has an efficient way of raising equity capital in batches (second scenario) as the key shareholders are liquid enough to participate in rights issues or other similar mechanisms, this increases the ultimate return generated. As alluded to earlier, private equity funds are typically challenged to undertake such an approach.

There are several hundred companies presently sitting in various private equity portfolios in the Baltic region. Some of these may not quite be ready for a change of control to industry players or, selling to another private equity fund may already be a moot point for the original founders who are resisting subsequent co-investors on existing terms. In such a situation a direct listing (not raising capital nor selling existing shares) can be the first step towards creating a longer-term exit plan. However, it may also be argued that due to the limited development of the Baltic capital market, it would be encouraged that any initial appearance in these circumstances would initially raise some new capital rather be wholly focused on selling existing shares. Once listed, the company may create a track record with the view to undertaking block-based transactions for the exit of the private equity (and other) shareholders over time, most likely under the structure of a lock-up agreement so that immediate perceptions of a share overhang are better managed in the eyes of potential new shareholders.

One of the recent trends in the Baltics and elsewhere in the world has been the active development of fintech companies. Other sectors such as defence may also gradually become more capital starved over time, requiring further equity-based funding. Financial intermediation and defence have frequently been considered complicated or impossible sectors for private equity to gain exposure to, limiting the supply of capital to such areas. This is due to boilerplate investment strategy restrictions imposed by the EIF and Baltic NPIs, which restrict any funds, in which they have invested, from investing in industries like arms, alcohol, tobacco, financial intermediation and several others.

4.3.4 Demand Consolidated

4.3.4.1 Demand for Private Equity

Comparing macro level data of private equity to GDP in the Baltics, yields much lower potential equity financing gap. Depending on the statistics used, the gap has been estimated to be between EUR 53.5m and EUR 406.7m. Even on the higher end, the gap is more than 20 times lower than that estimated by the Fi-compass researchers. Although this approach in estimating the equity financing gap is of a generalist nature, it still allows seeing the magnitude of the financing gap, especially bearing in mind that the data compiled accounts for the period 2015 to 2019 and hence yearly differences should be balanced out.

According to the Fi-compass analysis, the Baltic states have a mid-range equity financing gap to GDP ratio standing at 10.7% (as per 2018 data). That has led Fi-compass researchers to conclude that the equity financing gap in the Baltic states in 2018 stood at EUR 10.77bn, which is a strikingly high number if compared with the numbers seen in the supply side analysis. One must take precautions when it comes to the assumptions used by the researchers and if the applied absolute financing gaps can be taken for granted. Nevertheless, the identified gap, even if adjusted, still accounts for significant amount.

According to the SAFE survey, the Baltic (especially Latvian) enterprises state that equity capital financing is very relevant to them and has been used lately. The Baltic numbers (except for Lithuania) are well above the EU27 numbers showing a clear interest in the type of investment. At the same time, willingness of banks to provide credit in the Baltic countries has significantly more deteriorated than improved. The aforementioned results indicate support of the need to diversify access to financing (incl. equity financing) and to diversify financial instruments that can foster financing of SMEs in the region. A matter worth noting is that the vast majority of surveyed SMEs both in the EU27 and in the Baltics overall require external growth financing of below EUR 1m, which is the case in 85% of the observations. This can serve also as an indication for the possible deal sizes to be taken into account in the CMDAF Baltic SME IPO Fund strategy.

4.3.4.2 Demand for Public Equity

Public equity is a partial substitute to private equity, since both private equity and public equity is an equity, if looking how it is accounted for on a company balance sheet. Hence, from this angle, the demand for public equity could be analysed by looking, inter alia, at the demand for private equity. Amongst other matters, such analysis needs to consider the rather different parameters associated with public equity and private equity financing. In theory, public capital markets are typically meant for more mature and stable companies, whilst private equity serves earlier and higher risk stages of enterprise development, but with the development of capital market concept and the introduction of growth markets like the First North this stage distinction has become quite blurred.

The low absolute ratio of market capitalisation to GDP relative to other markets suggests that this funding route has very significant growth potential. When comparing the

EU/EEA/CH region average market capitalisation to GDP (around 40%), which would yield around EUR 43bn in absolute numbers for the Baltics, it can be seen that with the existing Baltic capitalisation of around EUR 8.3bn, the gap can be estimated at more than 5 times overall. Hence, the potential demand for public equity can be estimated at around EUR 35bn for the Baltics.

The project experts have done a broad top-down screening of Baltic companies potentially qualifying for investment by the CMDAF Baltic SME IPO Fund. As can be seen in Figure 9 CMDAF Baltic IPO SME Fund Investment Funnel , the initial broad screening resulted in 20 076 companies, which has subsequently in several steps been narrowed down to the estimated number of potential listings over several year period as 186 companies.

The Baltic governments have engaged in numerous activities targeting the public equity market gap, including support programmes for listing, initiatives related to inclusion of Baltic market in international indices and lastly but not least important, the work undertaken on the CMDAF Baltic SME IPO Fund initiative.

4.4 Peer Group Analysis

4.4.1 Private Equity

In terms of private equity, it is worthwhile comparing the Nordic Countries (Denmark, Finland, Norway and Sweden) to the Baltics, since these are countries that are mentally similar, geographically close, yet different in terms of economic development to the Baltics.

Private equity investment in the selected Nordic countries overall stands strongly above the average numbers in the Baltics on aggregated level. On disaggregated level, Estonia has a higher five year average in the investments in the country's/region's companies (standing at 0.71% of GDP). The selected Nordic Countries' aggregated GDP is around 13x larger than the aggregated GDP of the Baltics.

The Baltics clearly lag behind in investments by the their private equity funds, which shows for the alleged difference in strength of development of the private equity investment sector.

Table 49 Private Equity Investment as % of GDP in the Nordic Countries (Denmark, Finland, Norway and Sweden), not Including Iceland (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Nordic Country companies</i>	0.50%	0.41%	0.50%	0.66%	0.66%
<i>Investments by Nordic Country funds</i>	0.38%	0.47%	0.38%	0.44%	0.44%
<i>GDP (EUR billion)</i>	1284	1297	1347	1369	1397
<i>Source: Invest Europe¹²³</i>					

The numbers for Denmark are above those of the Baltics aggregated under both statistics. Stability of investments under both statistics can be observed, which is not the case in the Baltics.

Table 50 Private Equity Investment as % of GDP in Denmark (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Danish companies</i>	0.67%	0.52%	0.58%	1.06%	0.67%
<i>Investments by Danish funds</i>	0.49%	0.71%	0.47%	0.54%	0.36%
<i>GDP (EUR billion)</i>	273	282	292	298	310
<i>Source: Invest Europe¹²⁴</i>					

¹²³ Invest Europe, EDC, 2020

¹²⁴ Invest Europe, EDC, 2020

Sweden has comparable numbers under investments in the country's companies with those of Denmark, but stands out on investments by the country's funds, which signifies the level of development of private equity in Sweden. Baltics (both on aggregate and disaggregated level) clearly lag behind Sweden.

Table 51 Private Equity Investment as % of GDP in Sweden (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Swedish companies</i>	0.39%	0.42%	0.56%	0.66%	0.82%
<i>Investments by Swedish funds</i>	0.40%	0.61%	0.58%	0.80%	0.72%
<i>GDP (EUR billion)</i>	454	466	479	471	473
<i>Source: Invest Europe¹²⁵</i>					

The numbers of Norway have been fluctuating quite significantly over the years. The investments under the investments in the country's companies are comparable to those of the Baltics aggregated, with Estonia exceeding Norway on an individual level. Numbers of investments by country's funds are significantly higher in Norway than in the Baltics showcasing also the development of private equity investment sector in Norway.

Table 52 Private Equity Investment as % of GDP in Norway (2015-2019)

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Norwegian companies</i>	0.46%	0.29%	0.55%	0.24%	0.75%
<i>Investments by Norwegian funds</i>	0.34%	0.28%	0.32%	0.19%	0.46%
<i>GDP (EUR billion)</i>	348	333	353	368	373
<i>Source: Invest Europe¹²⁶</i>					

On an aggregated level, Finland has higher numbers under both statistics. On an individual level, under investments in the country's companies the Estonian numbers are above those of Finland. Finnish numbers are also the lowest in this peer group, although still significantly above those of the Baltics.

¹²⁵ Invest Europe, EDC, 2020

¹²⁶ Invest Europe, EDC, 2020

Table 53 Private Equity Investment as % of GDP in Finland

Private equity investment as % of GDP	2015	2016	2017	2018	2019
<i>Investments in Finnish companies</i>	0.50%	0.41%	0.30%	0.66%	0.41%
<i>Investments by Finnish funds</i>	0.29%	0.30%	0.16%	0.26%	0.22%
<i>GDP (EUR billion)</i>	210	216	224	232	241
<i>Source: Invest Europe¹²⁷</i>					

Overall, it can be noticed that on aggregate level the Nordic countries significantly outperform the Baltics under both statistics. Individually, Estonia stands out on the Baltic level, including having higher investments in the country's companies than those of Norway and Finland. This showcases the level of private equity investments in Estonia and alleged attractiveness of Estonia as a private equity investment destination, as well as a recipient of several large investment rounds pushing up the average statistics, like the Luminor transaction by Blackstone. In terms of investments in Estonian companies, the Baltics is clearly lagging behind the peer group countries on aggregate and individual level.

4.4.2 Public Equity

4.4.2.1 Market Descriptions

Nordic Main Market¹²⁸

The Main Market is the Nordic regulated market suited to companies that can adhere to the highest standards. More than 650 companies are traded across the Main Markets in Stockholm, Copenhagen, Helsinki and Iceland, including some of the most innovative companies in the Nordic region. By listing on the Main Market, companies benefit from increased visibility and investor exposure, and Nasdaq's efficient and independent surveillance of issuers, members and trading. More than 170 trading member firms engage in the daily trading, with most trades made by international banks and brokerage houses.

The benefits the market provides to the listee companies:

- A listing on the Main Market generally serves as evidence of a company adhering to the highest standards and as such provides a quality stamp. Many companies which list on the Main Market experience greater public exposure, credibility and interest in the company and its business.

¹²⁷ Invest Europe, EDC, 2020

¹²⁸ Nasdaq, Nordic main market, 2020

- One of the main drivers behind a listing on the Main Market is to make the company's shares more eligible to institutional investors, such as investment funds. Interest by international investors is generally greater for companies listed on the Main Market.

Nasdaq First North Premier Growth Market¹²⁹

Nasdaq First North Premier is a European growth market designed to further assist companies in raising investor visibility and to prepare them for a Main Market listing. The segment targets companies that make a conscious decision to comply with higher disclosure and accounting standards than those imposed on Nasdaq First North.

The benefits the market provides to the listee companies:

- The Premier segment offers companies an opportunity to make its higher ambition visible towards investors by choosing to list on Nasdaq's senior growth market segment.
- The stricter listing requirements serve as a quality stamp for the Premier segment, as the company's transparency to the market increases.
- Higher institutional investor interest in the Premier segment indicated by shareholder data.

Nasdaq First North Growth Market¹³⁰

Nasdaq First North is a European growth market for small- and medium sized companies. A company can join Nasdaq First North regardless of the country of origin or industry sector. A key factor for success is that there is investor interest for the company's share. The Nordic region boasts the largest retail presence in the world per capita, with small private investors and professional investors taking an active role in the market.

The benefits the market provides to the listee companies:

- More than 75 Nasdaq First North Growth Market listed companies have grown and migrated to the Main Market.
- A Strong investor demand for growth companies, both among retail investors as well as domestic and international institutional investors.
- The Nasdaq brand brings visibility and credibility, and can potentially help listed companies as they expand internationally, and in talent acquisition.

¹²⁹ Nasdaq, First North Premier growth market, 2020

¹³⁰ Nasdaq, First North growth market, 2020

Table 54 Equity Listing Requirement Comparison Between Nasdaq Nordic Markets

Requirement	Nasdaq First North Growth Market	Nasdaq First North Premier Growth Market	Nasdaq Main Market
<i>Free Float</i>	10%	25%	25%
<i>Market Value</i>	N/A	> EUR 10m	> EUR 1m
<i>Listing Document</i>	Prospectus or Company Description	Prospectus or Company Description	Prospectus
<i>Financial Reporting</i>	Local Accounting Standard	IFRS	IFRS
<i>Disclosure and Information</i>	MAR and First North Rules	MAR and Main Market Rules	MAR and Main Market Rules
<i>Corporate Governance Code</i>	N/A	Yes	Yes
<i>Certified Adviser</i>	Yes	Yes	N/A

Source: Nasdaq¹³¹

Table 55 Number of Companies on the First North Growth Market Including the Premier Growth Market on 17 December 2020

Stock exchanges	Number of companies					Of which
	XSTO	XHEL	XCPH	XICE	Total	First North Premier
Technology	52	8	13	1	72	11
Telecommunications	14	-	-	-	14	3
Health Care	79	5	5	-	84	10
Financials	8	3	1	-	12	3
Real Estate	24	-	1	1	27	7
Consumer Discretionary	41	5	4	1	54	9
Consumer Staples	10	1	1	1	13	-
Industrials	57	9	9	-	75	10
Basic Materials	24	-	-	-	24	5
Energy	14	-	-	-	15	4
Utilities	4	-	-	-	3	-
Total	327	31	34	4	396	62

Source: Nasdaq¹³²

Nasdaq First North in the Baltics is a relatively new market structure (ca. 2007) compared to its regulated infrastructure sibling, which has been around since the earlier part of the

¹³¹ Nasdaq, First North Premier growth market fact sheet, 2020

¹³² Nasdaq, The Nordic list, 2020

1990's. Its description in short, is that of a multilateral trading facility (MTF), which is focusing more on smaller companies (with less demanding listing requirements). Intuitively, as the Baltic region is dominated by SMEs, it would be expected that such a market structure would be the dominating one. However, the exact opposite is the situation today, as their representation on public capital markets is virtually non-existent (representing around one tenth of the number of regulated market companies). Moreover, many of these First North enterprises are not start-ups but well established business which have been around for years rather than only early stages of the corporate lifecycle.

It is believed that a key reason that the listing of smaller companies in the region has taken longer is due to the earlier view by market participants that such a task (in an already illiquid regulated market) would not be possible. Indeed, it is really only during the past five or so years that around half a dozen issuers have appeared. A historical dearth of equity and investment culture development plays a key role in this, particularly when comparing this to the Nasdaq First North Nordic region. Therefore, much effort needs to be put into this, as the First North platform would appear to be more (at least initially) suitable for many of the potential candidate companies for the Fund due to the relative listing costs and ongoing compliance aspects.

To compare, in Sweden, which is the main Nordic market, there is a relatively similar number of listed companies in both the regulated and First North markets (several hundred in each market sector). Moreover, greater than 20% of the Nasdaq Nordic First North companies (there is a total of around 400) have a market capitalisation less than EUR 10m. Nearly 30% had revenues less than EUR 0.5m in the last financial year, out of which more than half had almost non-existent revenue. Furthermore, Sweden has another alternative market as well, the Spotlight Stock Market (previously known as 'Aktietorget'), with around 170 smaller companies admitted to trading. Out of the Baltic First North companies, only one has a market capitalisation of more than EUR 15m (MADARA Cosmetics).

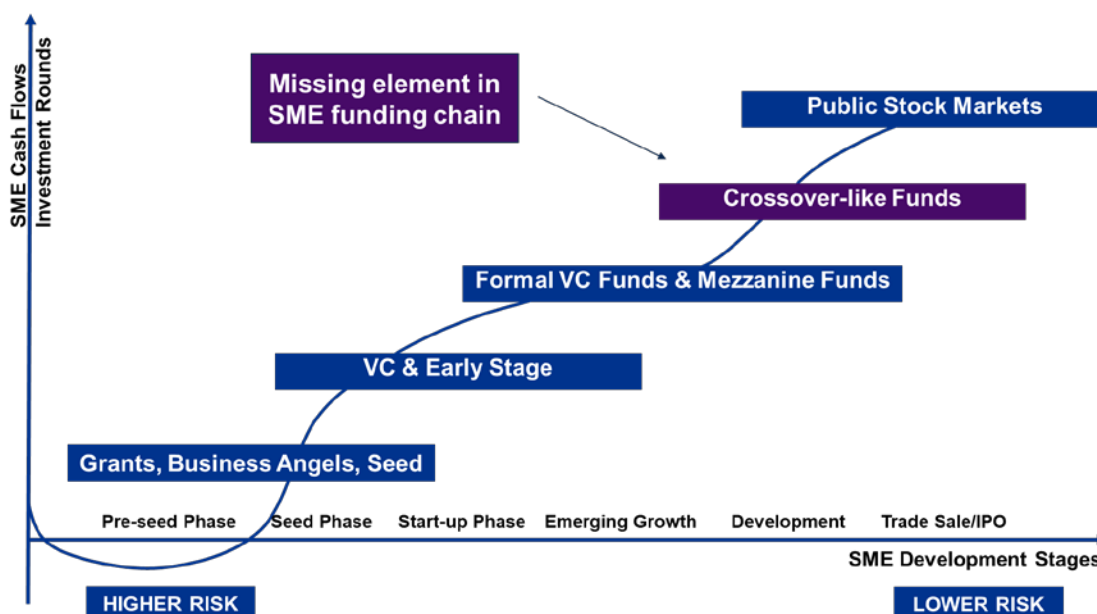
4.5 Findings/Market Failure

As described in detail in the previous sub-sections, despite the significant Baltic government efforts during the last 15 years mainly on the private equity part, there still are demonstrable and quantifiable market gaps both on the private equity and public equity sides of the Baltic capital market.

To recap, the Baltic annual private equity market gap can be estimated in the range of EUR 53.5m to EUR 406.7m using the traditional method, or a staggering EUR 10.8bn using the innovative method crafted by Fi-compass team of highly trained experts.

The Baltic public equity market gap has been analysed using mostly comparative methods due to the lack of existing recognised other, more sophisticated methodologies. The potential demand for public equity is estimated at around EUR 35bn for the Baltics. The theoretical market gap in terms of EUR is a staggering amount, but it needs to be taken into account that it includes the potential large-cap company presence/listing, representing a major part of that EUR amount. For our project purposes, we additionally looked at the SME and mid-cap segment, using tailor-made criteria and approach to design an analytical top-down investment funnel. Initially screened broad list of 20 076 companies is sequentially narrowed down to an estimate of potential 186 company listings over several year period. Below one can see a visual depiction of the equity capital market map with the clearly identified missing element in the SME funding chain.

Figure 10 Equity Capital Market Map



Source: KPMG

This section of the report has been prepared having in mind the standard required for the ex-ante assessment demonstrating the existence of a funding gap affecting eligible

undertakings in the targeted development stage, geographic area and, if applicable, economic sector.

As a result of performed analysis, there is a clear and justified need for State intervention (as defined in Section 3.3. of Communication from the Commission “Guidelines on State aid to promote risk finance investments” (2014/C 19/04)).

It is noted that such intervention via potential risk finance measure must be designed in such a way as to address the market failures identified in this analysis (taking place of ex-ante assessment).

The following sections of the report contain details of such intervention - potential risk finance measure - Investment Strategy (section 6.1) designed based on this identified market gap, Fund structure and terms (section 6.2) built around the required Investment Strategy, and further legal and tax analysis (section 9) to put everything in context.

Due to the scope of our assignment, the further sections of this report will focus primarily on the public equity part of the capital market and designing the solution to the market gap of the public equity side. Many facets of the public and private equity overlap, such as available investment fund structures, parts of investment strategy, tax and legal aspects et cetera, so the report will continue to include private equity aspects to the extent where there is overlap necessary to achieving aim of the assignment.

5 International Experience Analysis and Findings

5.1 Case Studies

This part of the report provides descriptions and analysis of several established incentives – with the main goal of identifying various instrument design solutions and learning points which may be useful in elaborating the CMDAF Baltic SME IPO Fund set-up.

Five distinct cases, four from Europe and one from South Korea are analysed in this section. In each of the cases the following structure is adhered to: (a) a general description of the case, (b) the facilitation of access to finance for SMEs in the particular case, (c) several learning points and takeaways from the cases for the elaboration of the CMDAF Baltic SME IPO Fund set-up.

Information for this part of the report has been drawn primarily from interviews with representatives of the financial institutions that have been directly responsible for implementing the respective financial instruments, supplemented by desk research.

5.1.1 EIF Baltic Innovation Fund I and II

The interview was conducted with a Senior Mandate Manager and a Private Equity Mandate Officer from the European Investment Fund.

5.1.1.1 *General Description*

The European Investment Fund (EIF) is a part of the European Investment Bank Group. Its central mission is to support Europe's micro, small and medium-sized businesses (SMEs) by helping them to access finance. EIF designs and develops venture and growth capital, guarantees and microfinance instruments which specifically target this market segment.¹³³ The overall approach of the EIF when designing financial instruments is to design them by sharing risks with EIF's partners so as to multiply public resources and increase the supply of finance. EIF has been at the core of setting up both Baltic Innovation Fund I and Baltic Innovation Fund II.

The two main objectives of the EIF are the following¹³⁴:

- Fostering EU objectives, notably in the field of entrepreneurship, growth, innovation, research and development, employment and regional development;
- Generating an appropriate return for the shareholders, through a commercial pricing policy and a balance of fee and risk based income.

¹³³ European Commission, European Investment Fund announces €300 million of space sector finance, 2021

¹³⁴ EIF, Who we are, 2021

Baltic Innovation Fund I

The Baltic Innovation Fund (BIF I) is a Fund-of-Funds initiative of EUR 130m (the initial investment totalling EUR 100m followed by a EUR 30m top-up) launched by the EIF in close co-operation with the Baltic national promotional institutions – KredEx (Estonia), Altum (Latvia) and Invega (Lithuania) to boost equity investments made into Baltic SMEs with high growth potential. BIF was launched in 2012 and is fully committed.¹³⁵

Baltic Innovation Fund II

Baltic Innovation Fund II (BIF II) is a EUR 156m Fund-of-Funds initiative launched by the EIF in co-operation with the Baltic national promotional institutions – KredEx (Estonia), Altum (Latvia) and Invega (Lithuania). It is building on the success of its predecessor, the BIF I.¹³⁶

5.1.1.2 Involvement in Facilitating Access to Finance and Developing Public Capital Markets

Baltic Innovation Fund I

The BIF I was launched in 2012 with an initial funding of EUR 100m (EUR 40m was invested by the EIF and a EUR 20m investment was made by each of the Baltic states), which was increased by EUR 30m in 2015 in view of making additional fund investments. A long term goal of the fund-of-funds from the outset was to ensure a self-sustainable private equity ecosystem by supporting teams and attracting institutional LPs. The Investment period of the BIF I ended in 2018 with investments made in seven funds out of which five were from emerging teams.¹³⁷

The funds benefitting from the BIF I and currently investing in the Baltic market are¹³⁸:

— BPM Mezzanine Fund	EUR 70m
— Livonia Partners Fund	EUR 73m
— Karma Ventures Fund	EUR 70m
— BaltCap Growth Fund	EUR 40m
— INVL Baltic Sea Growth Fund	EUR 165m
— Change Ventures Fund II	EUR 21m

Funds benefitting from the BIF I that have closed their investment period and are now in the divestment phase:

— BaltCap Private Equity Fund II	EUR 82m
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¹³⁵ EIF, Baltic Innovation Fund 1, 2020

¹³⁶ EIF, Baltic Innovation Fund 2, 2020

¹³⁷ EIF, The Power of 3 investing in the future of the Baltics, 2020

¹³⁸ EIF, Baltic Innovation Fund 1, 2020

As of 30 June 2020, the BIF I's resources supported funds with financing of EUR 522m. Of this, close to EUR 260m has already been invested into 54 companies.¹³⁹

Another key goal for the BIF I as highlighted by the representatives of the EIF is to attract private and institutional investors to the equity asset class and markets. Hence, judging from the hard data as well as the conducted interview, it is evident that the BIF I has not only significantly contributed to the development of venture capital and private equity in the Baltics, but also provided a signalling and a market education effect. The existence of the BIF I has also greatly contributed to increasing knowledge and experience of the local teams managing venture capital and private equity investments, thereby levelling up the overall development of the national economies of the Baltic states.

The BIF I exit strategies from invested companies have not included IPO's or other types of listings as a specific objective, and no listings have happened. The EIF representatives commented that the BIF I follows natural market dynamics, and other exit routes are perceived as more feasible and realistic than listing at the Baltic or foreign stock exchanges. The same is expected regarding future BIF I exits, but the possibility of listings is not excluded in the future, however currently there are no known plans or indications about BIF portfolio companies listing in the Baltics.

The BIF I has shown positive returns. As of 31 March 2020 the returns can be measured at 1.12x (Total Value To Paid In) and the Net Internal Rate of Return measures at 4.3%¹⁴⁰. Additionally, the BIF 1 has invested EUR 230m and supported upwards of 8100 jobs in 46 portfolio companies, according to the information as of 31 December 2019. The investee companies had experienced a 72 percent increase in headcount and a 102 percent increase in turnover since the respective investment dates on 31 December 2019. Ultimately the portfolio companies contributed upwards of EUR 80m in tax contributions for the year of 2019, while recording a cumulative turnover greater than EUR 730m.

Baltic Innovation Fund II¹⁴¹

The BIF II continues to sustain investments into private equity and venture capital funds focused on the Baltic states over a period of 5 years – following its signature in July 2019 – to boost equity investments into SMEs with high growth potential.

BIF II aims to build a balanced portfolio of growth and later stage venture funds with an investment focus on the Baltic states. Co-investment opportunities may be also considered.

The EIF, as manager of BIF II, openly considers the following investment opportunities:

- Investments into venture capital and private equity funds (including hybrid debt-equity funds) with proven experience and insight into the Baltic market;

¹⁴⁰ EIF, The Power of 3 investing in the future of the Baltics, 2020

¹⁴¹ EIF, Baltic Innovation Fund 2, 2020

- Co-investments alongside investment funds, family offices, business angels or institutional investors into early to growth phase SMEs. The BIF II co-invests with selected investors, which are domiciled in the Baltic states, or provide for a relationship with the Baltic ecosystem, or are considering investments into the Baltic states.

The plan of the BIF II is to fund 7 to 8 funds each with 10 to 12 company investments. By investing BIF II resources (EUR 156m), the EIF is expecting to mobilise at least EUR 350m of additional private funding.

In terms of developing the markets the EIF with the BIF II is seeking to set the best market practices and standards. Moreover, as the venture capital and private equity investment culture has evolved from the BIF I to the BIF II, it can be seen that *inter alia*, public funds are being used as a catalyst of a larger scale involvement of private investors in venture capital and private equity investments.

5.1.1.3 *Learning Points and Takeaways for the CMDAF Baltic SME IPO Fund*

The BIF I and the BIF II are examples of how a targeted action and collaboration between an IFI, the Baltic governments and the respective implementing agencies have contributed to both – significantly enhancing access to finance to SMEs (via increased availability of venture capital and private equity financing) and fostering development of the venture capital and private equity culture and overall financial literacy through it.

The BIF I and the BIF II structure-wise serve as good examples of effective and efficient fund management where the EIF has taken on ensuring the management process via applying the best market practice-based EIF's fund selection and management procedures as opposed to using the national procurement procedures. If possible, from an implementation point of view, this could also be considered in the case of the CMDAF Baltic SME IPO Fund.

The BIF's critical mass effect, achieved by pooling the three Baltic country resources and markets together, with a top-up of IFI resources, allowed for the creation of the underlying BIF funds which were attractive to private investors, who evaluated them as feasible investment opportunities, and contributed an unprecedented amount of private resources. The same critical mass approach is targeted in the CMDAF Baltic SME IPO Fund case, including the attraction of private investors, although in stages.

The important coordinator and guide role of an experienced senior project partner (EIF) should also be not underestimated in the harmonisation of the three sovereign Baltic partners with less experience in equity instrument structuring and the divergence of the national decision making chains. Currently this role is largely undertaken by the project expert team.

5.1.2 TESI Finland

The interview was conducted with the Development Director and the Director of Growth and Industrial Investments.

5.1.2.1 *General Description*¹⁴²

The Finnish Industry Investment Ltd (TESI) is a state-owned investment company, with a mission to develop the Finnish venture capital and private equity market as well as to promote Finnish business and overall economic growth in Finland, whilst operating on a commercial basis and being financially profitable.

TESI operates on market terms, hand-in-hand with private investors on the same terms as them and with the same expectations for returns. TESI operations are regulated by a special law and by government decrees. TESI invests in venture capital and private equity funds as well as directly in growth companies.

The cumulative total of EUR 669m of capital provided to TESI by the Finnish government has grown into EUR 1088m of shareholders' equity (as at the end of 2019). This emphasizes the success of the TESI team in achieving both the policy and commercial objectives of the company.

TESI channels the returns from its investments back into new investments. In 2019 TESI made new investments and commitments amounting to EUR 133m. TESI's current portfolio includes 719 companies.

5.1.2.2 *Involvement in Facilitating Access to Finance and Developing Public Capital Markets*

TESI does not have a specific formal policy objective to develop the public capital markets, but two types of TESI activities do contribute to this cause. The instruments developed and offered by TESI are in line with the substantiated requests of the market players and the analysis of market gaps.

Firstly, TESI has in its investment instrument toolbox a concept called IPO Underwriting. It means that TESI participates in IPOs as an anchor investor or as a co-investor. TESI does not undertake technical (direct) listings. The focus is on SME IPOs. According to TESI, some of the reasons for Finnish companies choosing listing rather than private equity stem from the many entrepreneur-driven company founders' unwillingness to give up control.

So far TESI has completed two investments in this category, one in 2018 and the other in 2019, with about EUR 3m committed in each case. The potential investee company interest has been much higher, but TESI is extremely selective in order to maintain its „quality stamp” reputation, and only picks deals where it can add clear value whilst maintaining strict commercial discipline. TESI does not mind spending extra time working with a company to add value as opposed to hastening the course of relationship building at the cost of adding insufficient value in the process.

¹⁴² TESI, About TESI, 2020

TESI invests on market terms, and investments are state aid free. TESI invests mostly its own funds from a gradually grown balance sheet. Investments are done from one legal entity. TESI does have internal valuation and other support functions, but always uses external assistance for financial and legal due diligence. TESI would usually be ready to take around 1/3 of the total new listing, with a maximum up to 1/2, for the investment deal to remain state aid free. TESI would normally not want to take a seat on the investees management board, since it does not want to have access to internal information. TESI tries not to trade in its own investment. After an investment, normally a 5% change in ownership triggers red flags. Apart from going public, the exit of investments by TESI can take different forms, including the investee company finding investors outside the public realm, and thereby not going for an immediate listing or a listing at all.

Apart from the IPO Underwriting, TESI has not gotten into any other similar transaction structures, but does not exclude doing so in case of a market need.

Secondly, TESI has had several (3) cases where it has been onboard as a private investor already before the IPO and that way participated in the IPO process. These cases relate to the regular TESI activity, where TESI invests in risk capital funds or directly in private companies, and those companies or companies from risk capital fund's portfolios sometimes get IPO'd or listed through other mechanisms. Typically, if investing at a pre-IPO valuation and the IPO not taking place, TESI would expect to see the subsequent valuation go down.

In case TESI invested in a fund that in turn invested in a pre-IPO company, TESI would not count this as a pre-IPO investment in its own books.

5.1.2.3 *Learning Points and Takeaways for the CMDAF Baltic SME IPO Fund*

TESI highlighted during the interview, that for the IPO Underwriting concept, their observation was that a major reason for companies both considering listing and the ones TESI underwrote to an IPO was the ability for their owners and management to retain full control over the company, as opposed to a standard risk capital fund investment model.

This supports the findings of the CMDAF Baltic SME IPO Fund market gap assessment that such companies constitute one of the key potential CMDAF Baltic SME IPO Fund market segments.

In general, the TESI IPO Underwriting concept is very close to the proposed CMDAF Baltic SME IPO Fund model, but with some important distinctions. Firstly, the CMDAF Baltic SME IPO Fund is planned to operate significantly more dynamically, pro-actively identifying Baltic companies that could be a good fit to the Baltic stock markets, and nurturing and educating them in that direction, in the same way professional private equity fund managers nurture and grow their proprietary deal flow. Secondly, part of the mandate of the CMDAF Baltic SME IPO Fund, in addition to the provision of access of finance for SMEs, is the development of Baltic capital markets. With this twin mandate in mind, the CMDAF Baltic SME IPO Fund would normally look to invest in Baltic SMEs either at the IPO moment or before that, but with a clear commitment of the investee

company to eventually go public. Thirdly, CMDAF Baltic SME IPO Fund would likely have a more complex legal structure due to the nature of the participants of the CMDAF Baltic SME IPO Fund – three Baltic Governments and an IFI, if possible, on the fund level. Finally, it is important to note that despite the fact that Finland represents a top 6 country in the EU/EEA/CH region in terms of market capitalisation to GDP, such programmes are still being nurtured for SMEs.

Due to the economic, the geographical and the historical proximity of the Baltics and Finland, and observed TESI expertise in the subject area, ideas of further collaboration with TESI could be considered for the CMDAF Baltic SME IPO Fund.

5.1.3 National Stock Exchange Development Fund Hungary

Out of all case studies that are a part of this report, the case of the National Stock Exchange Development Fund Hungary (NSEDf) was the only case where despite numerous attempts it was not possible to arrange an interview with the manager of the fund. Hence, the information for this particular case is based solely on secondary information obtained from the fund manager's website.¹⁴³

5.1.3.1 General Description

The fund is an initiative by the Hungarian State to develop the alternative market segment in the Budapest stock exchange and it is managed by Széchenyi Venture Capital Fund Management Zrt, a state owned company whose trustee is the Hungarian Ministry of Finance.

The Fund may invest in private companies or public limited companies listed on Hungarian MTFs in public and private transactions. Irrespective of the industry, the NSEDf invests in companies that undertake to list on the BSE Xtend market (MTF) within 12 months and their medium-term goal is a public issuance on the regulated market. The general target group includes companies that are characterised by:

- Having a significant business growth potential,
- Balanced development forecastable for the long term,
- The operations of the company are transparent and adaptable to the requirements of the stock exchange,
- The owners are interested to receive the capital and to cooperate with the investors are committed to the planned listing on the stock exchange,
- A realistic exit strategy for the disposal of the Fund's investments.

The size of a transaction may not exceed HUF 4.5bn (EUR 12.5m) or 15% of the fund's limit (this means a ceiling of nearly HUF 2bn (EUR 5.6m) at the current limit of HUF 13bn

¹⁴³ SZTA, National Stock Exchange Development Fund, 2018

(EUR 36m). It is expected that investments will average around HUF 1bn (EUR 2.8m), which already includes the amount provided by co-investors.¹⁴⁴

The NSEDF acquires only a minority stake (a maximum of 49 percent). It acts as a silent partner in the given company, so the acquisition of a shareholding is not accompanied by a direct right to manage the company. The investment is primarily a capital increase, with a possible buy-out of existing owners only up to 25% of the total investment

The fund may not invest in companies that are already listed on a regulated market, so companies that are already included in the BSE Premium and Standard markets. On the other hand, the fund may make capital investments in companies listed on Xtend (as it is not a regulated market, but an MTF platform). The NSEDF may invest (subscribe for shares) during companies first listing on the regulated market.

However, the fund may not finance the following activities: (a) corporate reorganisation, (b) loan replacement, member loan financing, (c) fulfilment of an obligation to a third party, (d) activity that is morally or legally incompatible with environmental and social needs.

The first investment period runs until 30 June 2021. Based on the fund term sheet, the investment period is 5 years, while the full fund period is 12 years.

In all cases, the investment is made through a co-investment with a private investor, where the ratio of private capital involved in the investment must meet the mandatory minimum ratios set out in Article 21 of the GBER. The expected private co-investor participation rates are 10 (for start-ups), 40 and 60 percent depending on the age of the target company. According to the fund's internal rules, the proportion of private capital must be at least 40 per cent for companies under seven years and 60 per cent for those above. The scope of the final beneficiaries is also governed by Article 21 of the GBER. Accordingly, the SME in question cannot be listed on a regulated market (alternative platforms can be considered an exception in this respect under points 76 and 81 of the GBER, so the MTF market is an exception) or must meet at least one of the following conditions:

- They have not yet operated in any market;
- They have been operating in any market for less than 7 years since the first commercial sale;
- They require an investment that, based on a business plan for entering a new product or geographic market, exceeds 50 percent of their average annual sales in the previous 5 years.

The involvement of private capital is supported by incentives such as yield diversion (asymmetric profit sharing), loss sharing and the conclusion of individual agreements with future private investors.

¹⁴⁴ Exchange rates as of 08.01.2021

The average maturity of a pre-IPO investment is up to 24 months, the average maturity of an IPO investment is 3-5 years, however, the planned maturity of each transaction - neither pre-IPO nor IPO investments - may not be longer than the current maturity of the Fund.

The expected return rate is always project-dependent. In the case of the NSEDF, it determines the expected return specifically on the basis of industry-specific benchmarks. The Fund will sell its shares on an appropriate schedule.

5.1.3.2 *Involvement in Facilitating Access to Finance and Developing Public Capital Markets*

The aim of the NSEDF is to increase the number of Hungarian SMEs appearing on the domestic capital market, primarily on the Budapest Stock Exchange - the main market or the BSE Xtend platform, thus contributing to the diversification of financing instruments for businesses to mature in the market and be able to grow further. The capital programme focuses on supporting the development of domestic businesses, including competitiveness, growth, and critical factors for efficiency improvement. As part of this, it can be possible to contribute to accessing new, even foreign markets, investing, expanding the existing product ranges, strengthening management, moving towards a digital economy, and implementing business development solutions that help to improve existing operations and gain new customers. It can also provide demand for the company's shares during the IPO.

As the primary objective of the fund is for the companies it finances to appear on the BSE Xtend market within a maximum of 2 years and to appear on the regulated markets of the Budapest Stock Exchange through a public issue within 2-5 years, capital investments should primarily serve development and growth, and to create the conditions for a public listing. These can be, for example, strengthening the management, implementing IT systems, tidying up the legal structure or even improving the companies' image.

5.1.3.3 *Learning Points and Takeaways for the CMDAF Baltic SME IPO Fund*

The main takeaway from the NSEDF is that the fund has a relatively similar investment strategy to the one of the CMDAF Baltic SME IPO Fund, in the sense that it supports the transition of SMEs from an unlisted to a listed status. The main difference is that the Hungarian government decided to use GBER-based state aid scheme, as opposed to a market-term based fund like the CMDAF Baltic SME IPO Fund.

The available secondary data provides limited information on how the NSEDF has been set up. However, there is no available secondary data on the actual performance of the NSEDF, which makes it difficult to judge if the investments have made their case.

The main takeaway is that the Baltics are not unique in striving to develop the capital markets via such initiatives, several other countries have done or are in the process of setting up similar initiatives, thus increasing pressure on the Baltics to not fail to deliver with the setting-up of the CMDAF Baltic SME IPO Fund. To avoid falling behind peer capital markets even more.

5.1.4 K-Growth South Korea

The interview was conducted with a Senior Manager at K-Growth, a Banker at the Korea Development Bank and a Team Leader of the fund management team at K-Growth

5.1.4.1 General Description

K-Growth is a South Korean quasi-development finance institution, predominantly owned by the state-owned Korea Development Bank, operating as an independent fund-of-funds investment firm specialising in VC and PE investments. K-growth has invested in over 190 funds dedicated to providing capital to companies at different stages of their life-cycle: ranging from seed, early, expansion, mature to distressed stage. As of August 2020, K-Growth is managing 4 fund-of-funds with total committed capital of USD 15.2bn and investments in 2 581 enterprises, focusing on innovative start-ups and SMEs with operations in South Korea or related to South Korea.¹⁴⁵

K-Growth is indirectly supported by the South Korean government, with the vast majority of K-Growth funding coming from public sources. This gives K-Growth capital to collaborate with major GP's and LP's in the country.¹⁴⁶

In the scope of the CMDAF Baltic SME IPO Fund project there are two types of funds, which have similar characteristics to the CMDAF Baltic SME IPO Fund. The two funds are:

- The **KONEX Vitalization funds** launched in 2014 and 2017
(The KONEX is the securities exchange exclusively for SMEs (seeking funding) and venture companies (risk capitalists raising funds) prior to listing on the KOSDAQ¹⁴⁷)
- The **KOSDAQ Scale-up funds** launched in 2019
(The KOSDAQ is one of the regulated markets of the Korea Exchange (KRX) established in 1996¹⁴⁸ and modelled after NASDAQ)

The below table sets out the characteristics of funds in the two aforementioned fund-of-funds.

¹⁴⁵ K-Growth, Main, 2020

¹⁴⁶ K-Growth, About, 2020

¹⁴⁷ Korean LII, 2020

¹⁴⁸ Korean LII, KOSDAQ, 2020

Table 56 K-Growth funds (Selected Sample)

Initiative	Fund establishment date	Fund size	Number of companies invested amount	Investment amount per deal	Market Caps	Investment period	Fund period	Expected returns
KONEX Vitalization funds	2014	USD 37-38m	17 companies	USD 2-4m	USD 20-50m	4 years	8-10 years	1.4x up to now, 2.2x expected for the remaining assets
	2017 (1)	USD 35m	15 to 17 companies	USD 2-4m	USD 25-100m In special cases up to USD 300m	4 years	8-10 years	1.3x+
	2017 (2)	USD 30m	16 companies	USD 2-4m	USD 30-120m	4 years	8-10 years	1.3x+
KOSDAQ Scale-up funds	2019	USD 100m	3 funds 7 companies	Preferred USD 5-10m	-	3 years	5 years	-

Source: KPMG, interview with K-Growth representatives

5.1.4.2 Involvement in Facilitating Access to Finance and Developing Public Capital Markets

K-Growth has recognised that Korean SMEs have high growth potential, however if they remain unlisted finding sources for financing can be very problematic. The government is supporting access to finance to SMEs. The KONEX was created as a medium for unlisted companies to eventually become listed on the KOSDAQ. The KONEX allows for listing of companies at lower requirements (i.e. eased burden of disclosure and corporate governance, lower regular maintenance costs etc.) than those existing on the KOSDAQ. Essentially, in comparison with the Baltic alternative one may compare the KONEX and the KOSDAQ with the Nasdaq First North and the Nasdaq Main List respectively.

The KONEX Vitalization funds

The main purpose for the KONEX Vitalization funds was to bridge the SMEs from an unlisted status to the KONEX securities exchange. K-Growth has been the main backer of the funds having invested around 50% of the KONEX Vitalization fund size, while the other half came from the private sector (large corporates, finance institutions, family offices). The GPs managing the respective funds are rather flexible in applying the

investment strategy and the investment amounts. Normally, the GPs would invest above 50% of the total investment – as a key investor. In some duly justified cases the funds could finance even up to 100% of the financing sought by the investees. All the funds have different GP's, the GP's are selected through K-Growth's own competitive procedure. First the candidates apply, then due diligence follows, lastly pitches are made before choosing the preferred candidate.

In terms of sourcing the deals, the procedure foresees complete reliance on the GPs in sourcing the investment targets. Every GP has procedures for finding the best investees – based on knowledge, experience and their network. Overall, with the positive overall development of SMEs in Korea, the general trend has been towards increasing potential capitalisations and hence somewhat lower number of necessary investment targets.

Funds can invest in pre-listing companies as well as a listed company on the KONEX. GPs have so far invested much more in pre-listing than in listed companies.

Investments are carried out on commercial terms – there are no subsidies from the government.

The GP may rely on third party information, but the GP needs to conduct their own independent evaluation of investment opportunities, including valuation. K-Growth never intervenes in the fund investment process (incl. valuations).

Sometimes the funds ask for board member seats, but it also happens that they remain as passive investors.

The success for the three KONEX Vitalization funds varied. The first fund established in 2014 fully realised the goal of the fund, which ultimately lead to the listing of the companies on the KONEX. Later 6 out of 17 went on to list on the KOSDAQ. In the last fund, only one company went to the KOSDAQ, although it must be noted that there could be some other companies going to the KOSDAQ, as the last two 2017 sub-funds have just recently finished investing.

The other funds, established in 2017, were less successful policy-aim-wise and the companies mostly did not list on the exchange. The reasons stated were:

- The KONEX has failed to become successful and failed in attracting institutional investors
- The KOSDAQ listing requirements were eased
- Growth and development of the KOSDAQ negatively impacted the growth of the KONEX

The KONEX Vitalization Funds were not restricted in their exit strategies, with all main routes available:

- IPO
- Trade sale
- Strategic buyer (via M&A)

The funds do not hold shares of listed companies for too long – they try to sell when reasonably possible.

The first fund achieved a total realised multiple above 2x, with a realised multiple at a healthy 1.4x, whilst the last two funds are at 1.3x total realised multiples as of this moment. Since the investments have not been exited completely, the funds can show good performance considering the remaining assets in the funds.

Currently there are no plans for new KONEX related funds in the foreseeable future, mainly due to abovementioned difficulties encountered by 2017 fund edition.

The KOSDAQ Scale-up funds

The three KOSDAQ scale-up funds were launched in 2019. The funds are different to the KONEX funds, because the main goal of the KOSDAQ funds is to boost growth of companies already on the KOSDAQ market by providing them with mezzanine-type debt and equity, although an equity investment has thus far not taken place. The funds essentially help listed companies to scale up as fast as possible. The typical investment period is three years and the fund period – five years. The very idea of the funds is to help listed companies grow, and not the stock exchange development per se.

Capital is allocated to three funds, the funds collectively reach the size of USD 100m, where K-Growth provides half of the funding, and the other half is provided by private Korean companies. Each fund has a different manager. Under the fund terms, equity investment is allowed as well, but in practice only debt has been distributed thus far. In deals funded by the KOSDAQ Scale-up funds, there are no co-investors on the deal level, the whole deal amount is covered by the fund. Companies on the KOSDAQ are well-known and appealing to investors. The funds are more market orientated, meaning there is no capital market development policy involved in the rationale behind these funds.

Currently, there are no intentions to launch a new fund, although the potential is being considered in the light of how the market environment can be levelled up by presence of this sort of funds.

5.1.4.3 Learning Points and Takeaways for the CMDAF Baltic SME IPO Fund

The essence of the concept and the financial instrument implemented in South Korea by K-Growth was looked at, to reflect and look for ideas and learning points, which could be transferred to or emulated in an instrument such as the CMDAF Baltic SME IPO Fund.

Business Model Proven Commercially

This case shows that it is possible for such a crossover fund business model, like the KONEX Vitalization fund, investing in unlisted SMEs to bring them to the listed market can be commercially feasible. The returns of all three KONEX Vitalization funds are commercial successes, with achieved total realised multiples in the range of 1.3x-2x, with the realised multiple for the oldest fund of 1.4x.

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Business Model Proven as a Policy Success

The first fund formed in 2014 was able to bring the majority of investee companies to the KONEX and 6 out of 17 investees further advanced to the KOSDAQ. The CMDAF Baltic SME IPO Fund would operate with a similar policy goal. Still, it needs to be noted that the two subsequent KONEX Vitalization Funds established in 2017 only partially reached this policy goal, with a minority of their investee companies pursuing the stock market listing route, thus the difficulty of the policy goal should not be understated.

The main issue, which the two 2017-vintage KONEX Vitalization funds experienced, regarding companies listed on the KOSDAQ being more appealing for investors rather than the ones listed on the KONEX may be less applicable to the Baltics. This is because the capital markets in the Baltic region are less developed while any new players even on the alternative market would likely garner some interest from potential investors. Pricing expectations of shareholders needs to be tempered with a size discount for valuation of very small companies. Moreover, marketing resources/overall promotion of the offering requires careful consideration as does the exact route to be taken, including, in some cases, the possibility of pursuing a direct listing as a first step.

5.1.5 Fondul Proprietatea Romania

The interview was conducted with two Vice Presidents/Investment Analysts from Franklin Templeton - the fund manager.

5.1.5.1 General Description

According to Fondul Proprietatea (FP), Romania is the only country in Eastern Europe where it has been attempted to find a solution for restitution at its actual value of the property confiscated by the previous communist government.¹⁴⁹

Fondul Proprietatea was established in 2005 to assure the financial resources necessary to compensate the persons abusively expropriated. Following the fulfilment of specific phases strictly determined by law, holders of compensation titles have become shareholders of the Fund. The compensation has been made in shares, representing the actual value of the real estate which are not given back in kind.¹⁵⁰

FP is a joint stock company operating as a closed-end investment company (Alternative Investment Fund) without a set lifetime, incorporated in Romania, trading on the Bucharest Stock Exchange since January 2011, and on the London Stock Exchange since April 2015.¹⁵¹

The fund is one of the largest listed funds in the world with a current Net Asset Value (NAV) of USD 2.56bn as at 31 August, 2020, trading at a discount to book value of 18.75 percent on BVB, and 20.61 percent on LSE, as at 15 September, 2020. This is not unique to the fund itself, as other similar instruments also generally trade with a NAV discount.

¹⁴⁹ Fondul Proprietatea, Fund history, 2020

¹⁵⁰ Fondul Proprietatea, Fund history, 2020

¹⁵¹ Fondul Proprietatea, About the fund, 2020

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The fund's long-term objective is increasing the fund's exposure towards listed companies to 100 percent, by listing a number of underlying holdings and disposing of other stakes that will not be listed.

Since the start of the mandate, the fund manager has paid out RON 6,739.6m (around EUR 1.4bn¹⁵²) in total gross distributions, representing an average annual yield of 6-7 percent

The fund's manager seeks to add value through active management of the fund's portfolio. The focus is on introduction of proper corporate governance in SOEs, and measures to improve efficiency and profitability of all portfolio companies (including certain legal actions to protect the value of underlying holdings)

The shareholder structure¹⁵³:

- Romanian institutional shareholders 31.11%
- The Bank of New York Mellon (depository bank for Global Depository Receipts) 22.59%
- Romanian private individuals 17.92%
- Foreign institutional shareholders 11.56%
- Foreign private individuals 2.97%
- Ministry of Public Finance 0.09%
- Treasury shares 13.76%

FP has a total of 7,584 shareholders (as of 31 August, 2020).

FP's investment objective is the maximising returns to shareholders and the increase of the net asset value per share, through investments predominantly in Romanian equities and equity linked securities, subject to legislation and regulations in force. The Fund's investments primary goal is long term capital appreciation via investments primarily in Romanian equities with strict adherence to the principles of value investing.

The portfolio is heavily weighted towards the Power, Oil and Gas sectors (approximately 79% of NAV) through a number of listed and unlisted, privately-held and State-controlled entities.¹⁵⁴ As at 30 September, 2020 the portfolio was made up of companies in the following sectors¹⁵⁵:

- Electricity: generation 50.34%
- Oil & Gas 13.40%
- Electricity & Gas: distribution, supply 11.34%
- Infrastructure 10.45%
- Heavy Industry 2.56%
- Aluminium 1.45%
- Others 0.20%
- Net Cash and receivables 10.26%

¹⁵² Exchange rate on 19.01.2021

¹⁵³ Fondul Proprietatea, Shareholder structure, 2020

¹⁵⁴ Fondul Proprietatea, Investments, 2020

¹⁵⁵ Fondul Proprietatea, Fund portfolio, 2020

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As at 30 September 2020, FP's portfolio included holdings in 33 companies: 7 listed companies accounting for 18% of the NAV and 26 unlisted companies, accounting for 72% of the NAV.¹⁵⁶

In 2010 Franklin Templeton (FT) started managing the fund.

5.1.5.2 *Involvement in Facilitating Access to Finance and Developing Public Capital Markets*

The fund is dual-listed on the Bucharest and London stock exchanges. According to the fund manager's representatives, the fund is very liquid on the London stock exchange and the liquidity has transferred into the local market in Romania.

FP's representatives highlighted that they had not anticipated the acceleration of and the tremendous impact of the fund after they took control of it in 2010.

The managers worked very diligently on marketing strategies for the fund and they credit a lot of success of the fund to marketing.

The fund is very active in share buybacks.

5.1.5.3 *Learning Points and Takeaways for the CMDAF Baltic SME IPO Fund*

Learning points from FP's activity are not directly applicable to the CMDAF Baltic SME IPO Fund case because of the initial setup of FP with the goal of restitution of expropriated assets as well as because of its primary activity of managing and periodically disposing an existing portfolio of state owned companies transferred to it by the government, as opposed to making new investments in private companies.

At the same time, FP is living proof that capital market can be an active player in the development of a national economy outside of the top tier capital markets, although with a different investment strategy if FP is to be compared with the intentions of the CMDAF Baltic SME IPO Fund.

The project experts also note that there is a specific size restriction for the CMDAF Baltic SME IPO Fund: focus on SMEs. This limits the international investor scope as the market capitalisations would neither singularly, nor likely as a full portfolio of investments be of sufficient scale.

¹⁵⁶ Fondul Proprietatea, Fund portfolio, 2020

5.2 Equity Issuer Experience Across the Baltics

5.2.1 Linda Nektar

Home market: Tallinn, Estonia

Market capitalisation on 31 December 2020¹⁵⁷: EUR 11,892,073

An interview was conducted with the chairman of the supervisory board and majority co-owner. The interviewee's answers were supplemented with data from Nasdaq Baltic.

5.2.1.1 *The Company:*

AS Linda Nektar is an Estonian-based beverage company with origins in the 1940s. The company is providing fermented beverages for the drinks industry focusing on unpacked fruit wines under a Business-to-Business model. The company's production facility is located in a logistically favourable position relative to the Baltic and Northern European markets. Extensive R&D efforts have led to breakthroughs in the field of aroma stripping and recovery and this, along with the planned geographical expansion, are expected to be the key focal points in the coming years.¹⁵⁸

According to the Chairman, the company was previously a subsidiary of a Finnish state owned alcohol producer. An opportunity was presented to purchase the company and over the years it was transformed from a Business-to-Consumer to a Business-to-Business model.

The current turnover of the company is around EUR 2-3m.

The turnover declined over the last 2 years, mainly being affected by a change in legislation, which impeded the use of the technology in possession of the company. The product portfolio was forced to be changed. Around 60 per cent of the products did not exist 2 years prior, while in terms of turnover the new products made up around 40 to 50 per cent of the turnover. Nevertheless, the company has returned to a positive growth rate.

The EU level legislation changes which affected the business were directives in 2018, which countries implemented at a different pace, and soon will be harmonised across the EU, thus normalising the industry standards for all.

5.2.1.2 *The Offering:*

The fundraising took place via private placement in May 2015, in which EUR 0.82m was attracted by issuing 146 429 shares, at a share price of EUR 5.6. The fundraising attracted new investors, which resulted in the shareholder structure changing to 84 per

¹⁵⁷ Nasdaq Baltic, Market capitalisation from 29.12.20 to 30.12.20, 2021

¹⁵⁸ Nasdaq Baltic, Linda Nektar, 2020

cent of share being owned by the existing investors and 16 per cent owned by the new investors.¹⁵⁹

According to the Chairman, the company raised the funds in order to invest in more capacity. At the time of listing the company had a good balance sheet and wanted to scale-up the operations and create tools for further growth.

Private equity was not considered as an alternative to raising funds on the public markets and a partial reason for going to the stock exchanges was the reluctance to give up equity cheaply.

Investors were mostly private, also some semi-institutional and institutional investors took part in the public offering.

The listing process, from start to finish, took around 9 months. Cost wise, the listing in the eyes of the company was not a financial burden and could not be considered as a significant cost.

5.2.1.3 *Takeaways From the Listing Process:*

The company is considering the potential necessity for financing over the next few years. At this point, the company is not excluding any financing options.

The company feels that other companies are afraid of the bureaucracy and the listing process. However, they see it as a very helpful tool to structure everything in the company, it is happy to be audited and also see it as a guideline to keep it in shape.

One of the main reasons to list, in the eyes of the company, is having the listed “stamp of approval”, which, in the eyes of society, could mean that it is an above average company making it easier to attract higher skilled workers, which is especially important for companies such as Linda Nektar, which are located in rural areas.

Currently the company does not have an options scheme for its employees, just on the supervisory board level, but has considered to roll it out in the future.

5.2.1.4 *Upsides of Listing on the Public Capital Markets:*

Keeps a company in shape constantly (e.g. transparent accounting, corporate governance); helps to adhere with rules and laws; a quality stamp; the cost of capital seems reasonable.

5.2.1.5 *Downsides of Listing on the Public Capital Markets:*

The company sees no clear downsides, however would benefit from increased liquidity, as there is too little activity in the market in the Baltics in their eyes.

¹⁵⁹ Nasdaq Baltic, IPO case studies, 2020

5.2.2 MADARA Cosmetics

Home market: Riga, Latvia

Market capitalisation on 31 December 2020¹⁶⁰: EUR 74,630,992

The interview was conducted with the Managing Director and shareholder of MADARA Cosmetics

5.2.2.1 *The Company:*

MADARA Cosmetics was founded in 2006 and it operates in the field of natural cosmetics. Each product is exclusively developed and manufactured in MADARA Cosmetics' own laboratories and production facilities. The company exports its own branded products worldwide as well as offers contract manufacturing services.¹⁶¹

Prior to listing on the Nasdaq First North alternative market, in 2008 a first fundraising round took place in which a lot of private equity funds made offers to invest, however it resulted in a better offer and investment from a local angel investor (who successfully exited after listing). In the years between the first fundraising and the stock market listing, the company managed to operate and grow without attracting additional equity by reinvesting earnings and using debt financing from banks and the development finance institution Altum.

The average annual growth rate of the company turnover from 2008 onwards has been around 30 percent, remarkably stable and fast growth for a Baltic company.

5.2.2.2 *The Public Offering:*

In 2017 during the IPO, MADARA Cosmetics placed EUR 3.3m, giving up 15 percent of equity. Total demand represented 255% of the offer base and around 700 retail investors participated in the transaction. It was an initial public offering in both Latvia and Estonia.

There were no tenders issued for PE funds alongside the public offering, nevertheless there was a keen interest from PE funds. Ultimately, the company did not explore any of private equity offers that were made. The main reasons for not exploring in more detail the vast array of offers was because the offers contained lower valuations of the company. Additionally, the company owners did not want to lose control, as usually PE funds like to impose significant control and influence over the operations of the investee companies as well as the exit process might not be easy at all, especially if the new owner is again a new investment fund with target to sell again in a few years.

5.2.2.3 *Takeaways from the Listing Process:*

The process for preparing was quite lengthy and meticulous, thus the actual valuation of the company did not come to it as a surprise. For Latvia the valuation was rather high,

¹⁶⁰ Nasdaq Baltic, Market capitalisation from 29.12.20 to 30.12.20, 2021

¹⁶¹ Nasdaq Baltic, MADARA Cosmetics, 2021

however in Europe for a cosmetics producer the valuation was considered adequate. The higher valuation aspect was not the main aspect for the decision to issue equity on the stock exchange, the main driver behind the decision was a conceptual decision from the company to go public. Other aspects include the good reputation and governance associated with listed companies. Furthermore, involving their clients in the story of the company by allowing them to become investors and shareholders simultaneously.

According to the Managing Director, listing can definitely be considered as a relatively significant step in the development path of a company. The culture of the company has to adapted to that, which is associated with a listed company and for some typical local companies with a single owner and decision maker it might be difficult to fit that mould. Although initially difficult to grasp, rather soon after listing it becomes easy to live with the requirements of a public market, including more open reporting, adhering to corporate governance principles etc.

Regarding the future, the company is not in need of additional capital for the near future, because it can manage to fund its projects from its cash flow and leverage if necessary. However, if the need for additional capital would increase beyond the said capability, the stock exchange would be the preferred medium for raising additional capital. The next step would be easier for the company because of the know-how in its possession and it could transcend the Baltic market and reach markets outside of Europe.

5.2.2.4 *Upsides of Listing on the Public Capital Markets:*

The stamp of approval from the stock exchange is an important aspect, especially for a company with publicly well-known brand. An increase in the transparency of the company and good corporate governance are considered assets on the way to increasing the shareholder value. Extra marketing is a benefit of the status of a listed company, as it creates not only inherent trust, but also wider brand recognition.

5.2.2.5 *Downsides of Listing on the Public Capital Markets:*

For some companies it could be hard to adapt to the required level of transparency and corporate governance required for listed companies, although this has not been the case for MADARA Cosmetics.

5.2.3 **NEO Finance**

Home market: Vilnius, Lithuania

Market capitalisation on 31 December 2020¹⁶²: EUR 10,316,550

The interview was conducted with the Chairman of the Board of NEO Finance.

¹⁶² Nasdaq Baltic, Market capitalisation from 29.12.20 to 30.12.20, 2021

5.2.3.1 *The Company:*

NEO Finance administers the peer-to-peer (P2P) lending platform Paskolu klubas, where people can lend to each other. In foreign markets, the company operates under the name of NEO Finance, and offers the citizens of the EU and EEC investing in Lithuanian consumer loans. All company activities are enabled by the Electronic Money Institution licence, which allows operations of P2P lending, as well as consumer credit markets, across the entire European Union. NEO Finance is supervised by the Bank of Lithuania.¹⁶³

During the course of a year the company had three fundraising stages. EUR 210 thousand was attracted by seed investors in a crowdfunding campaign. An additional EUR 400 thousand was invested by private investors before the IPO. During the IPO the company managed to attract EUR 600 thousand. For all of the fundraisings the valuation of the company was the same.

5.2.3.2 *The Public Offering:*

The road to the public offering was rather difficult. The first problem arose when searching for a broker to sell shares, nobody would commit to it. The company decided to sell the shares themselves and set up a technical partnership with Šiaulių Bankas, which had a direct relationship with Nasdaq Baltic.

The company created their own IT programme/ platform in order to offer the shares and utilised the Dutch auction method to settle on the final price.

The chosen certified advisor for the admission process to the First North alternative market was Sorainen. To seek out international investors, a roadshow to the Netherlands was organised.

As the public offering was conducted without a broker the costs were significantly lower. With a broker the costs could have reached EUR 200 thousand (according to the Chairman), but NEO finance managed to limit the costs to EUR 70 thousand plus VAT. Half of the costs were attributed to the preparation of information documents and project management. In retrospect, the company could have paid somewhat less for preparation of information documents, thereby making the process more efficient from expense side.

The company was hoping to attract around EUR 1m during the IPO, but managed to attract EUR 600 thousand. The IPO took place in three countries: Lithuania, Estonia and the Netherlands. 80 percent of the shares were sold through their platform and the other 20 percent was sold by brokers. Among the investors there were no institutional investors, 30 percent were legal entities from Estonia, Lithuania and the Netherlands, and 70 percent of investors were private individuals.

In the IPO outside of the Baltics (in the Netherlands) EUR 60 thousand were attracted, which made it quite worthwhile to seek investors from the particular country. However, NEO Finance already had a presence in the country and for them it was a lot easier to reach out to investors than it would be for an average company from the Baltics.

¹⁶³ Nasdaq Baltic, NEO Finance, 2021

There were certain problems in the distribution of shares as some of the investors did not have security accounts, and the company asked the investors to create the accounts in order to hold the shares.

The public markets were chosen for fundraising for two reasons. Firstly, many Baltic VC funds refused to finance the company, because the funds are funded by the EIF and others which forbid investments in companies which provide consumer loans. Secondly, the board strategy was to attract as many investors as possible and wanted to popularise their platform across other countries. The company was successful in onboarding more than 300 investors, which became active users on the P2P lending platform.

The yearly costs associated with being listed on the alternative market are not very high for the company and are not a financial burden for it.

5.2.3.3 *Takeaways From the Listing Process:*

The company felt that it was a right step for the company to list on the First North market. Currently, the company is a scale-up company, which is putting a lot of emphasis on corporate governance and transparency, compared to some of the competitors on the market. However, to keep the same level as the main market companies, they would have to increase costs quite dramatically.

A possible bond issue is considered, in which their unique platform could be used for the public offering.

The company has no plans to de-list in the future and could possibly explore a prospect of an SPO in the future. In the more distant future, it could be possible that the company seeks to move up to the main regulated market.

5.2.3.4 *Upsides of Listing on the Public Capital Markets:*

Listing on the stock exchange increases the trust and confidence of investors for the company, which is crucial, because the company offers financial services. The listing also managed to garner the attention of investors outside of the Baltics.

5.2.3.5 *Downsides of Listing on the Public Capital Markets:*

Small public offerings are very difficult to organise, because it is difficult to garner interest and to find partners, such as brokers.

6 CMDAF Baltic SME IPO Fund Investment Strategy, Structure and Governance

6.1 Investment Strategy

This CMDAF Baltic SME IPO Fund Investment Strategy is a result of market analysis and instrument design work described in earlier sections of this Report. The wording below is drafted in a way to allow directly transposing it into the planned CMDAF Baltic SME IPO Fund Agreement as an annex (“Investment Strategy”) at such point when the Fund Agreement will be drafted. For avoidance of doubt, the planned CMDAF Baltic SME IPO Fund Agreement is intended to include an industry-standard Fund Advisory Board mechanism, which, inter alia, should provide guidance on interpretation of specific cases, if requested by Fund Manager, and have a waiver right on duly justified exceptional cases submitted by Fund Manager, where deviation from this Investment Strategy would be in the best interest of Fund investors.

To reiterate, the CMDAF Baltic SME IPO Fund (“the Fund”) has two main aims – a) a commercial objective – to achieve risk-appropriate financial returns for its investors (commercial feasibility), and b) a policy objective – to improve SME and Small and Innovative mid-cap access to finance, and to facilitate the development of public capital markets.

6.1.1 Investment Focus

The Fund will operate as a specialist financial intermediary targeting listing stage investments, supporting IPOs and private placement-related fundraisings with immediate listings by acting as a pre-announced “cornerstone investor”. As such, the Fund will take a material allocation¹⁶⁴ of the shares or securities¹⁶⁵ issued and provide a strong signalling effect to other potential investors.

Moreover, pre-listing stage investments will also be pursued where there is a contractual commitment to a target listing within a certain time period. This listing target will include transactions under the aforementioned methods or even direct listings where deemed more suitable. Secondary Public Offerings and secondary listings would be outside the Fund investment scope.

Shares and securities acquired by the Fund would be mainly newly-issued, but not excluding acquiring also from existing owners. Acquisitions from existing owners to be capped at maximum 50% of any investment case, with majority of funding going towards growth financing of each investee company against newly-issued shares and securities.

¹⁶⁴ Understood as typically at least 25% of the shares or securities issued.

¹⁶⁵ Including convertibles/quasi-equity.

6.1.1.1 *Typical Investment Cases*

Would be companies, where:

- **Owners/management** are already pursuing or contemplating an IPO or other type of Baltic stock market listing;
- **Owners/management** are not willing to share control, are not ready to accept forced exit (drag along, tag along) clauses, are fearing inherent instabilities associated with standard private equity fund needs to exit after a finite period and new unknown owner(s) coming in after a few years, are not satisfied with private equity valuations and restrictions on raising additional capital upon entry of a private equity fund;
- **Company** which has a slower growth trajectory not justifying the high cost of capital inherent in private equity, but acceptable for somewhat less costly public equity. This would also include cases where private equity funds have already invested in the company, but now the company growth has plateaued, reducing business risk;
- **Existing private equity fund portfolio company** which requires new funding and is actively contemplating a listing either immediately, or, within a certain period of time in the case of pre-listing investments.

6.1.1.2 *Sector*

Generalist with special attention paid to sectors with above-average growth, in particular mature manufacturing and services businesses with multi-country sales/ client base, good reputation and market visibility.

6.1.1.3 *Investment Stage*

The Fund will target established profitable companies with enterprise values between EUR 5m and EUR 100m. The Fund 1) will participate in initial public or private offerings related to both the main market and the multilateral trading facility (MTF) alternative market of typically the Nasdaq Baltic stock exchange; and 2) will invest in private pre-listing stage Baltic companies with a clear intent to list in a reasonable period of time (indicatively 12-24 months). In case of pre-listing, the Fund will require a **Listing requirement** to be met, as described below. For avoidance of doubt, the Fund, having invested in pre-listing stage, can follow-on invest in the listing stage.

6.1.1.4 *Geography*

The Fund will focus on companies located in the Baltic countries: Lithuania, Latvia and Estonia. The Fund will target equal allocation (in terms of amounts) between each country, with potential IFIs/EU SME IPO Fund contribution, if available, to be used opportunistically. Should investee company operations be located across several Baltic countries, the allocation key will be the company headquarters' registration country/main place of business.

6.1.1.5 *Investment Amounts*

EUR 0.5-5m range per investee company initial investment, with follow-on capability, but not exceeding cumulatively (including any follow-on investments) 15% of the Fund size for a single investee company. For avoidance of doubt, the Fund follow-on capability ends at IPO or first listing, to not be used in SPOs or secondary listings.

6.1.1.6 *Co-Investment Requirement*

The Fund will invest up to 50% of the total investment cost (gross proceeds per company listing case terminology) in each transaction, with the rest required to come from other investors qualifying as “private investors” under the EU state aid rules¹⁶⁶.

6.1.1.7 *Listing Requirement*

Pre-listing investments will be pursued only where there is a commitment to target listing within a certain time period, in written form by the eligible investee company. This listing target will include transactions under the aforementioned methods or even direct listings where deemed more suitable. Indicatively, the requirement will be to target listings in the following 12-24 months (unless the circumstances are unfavourable for listing), with agreed roadmap annexed to the investment agreement.

6.1.1.8 *Eligible Stock Exchange*

There will be no formal restrictions on eligible stock exchanges.

It is expected that typically listings will be done on the Nasdaq Baltic regulated market or Nasdaq Baltic First North alternative market as a consequence of the Fund targeting only Baltic enterprises and of size typically too small for regulated markets of foreign stock exchanges and too unknown for alternative markets elsewhere.

6.1.1.9 *SME & Small Mid-Caps*

The Fund will invest only in SMEs and Small and Innovative mid-caps, as defined in General Block Exemption Regulation (GBER) or Guidelines on State aid to promote risk finance investments (Risk Capital Guidelines) as applicable.

6.1.1.10 *Holding Period*

Normally up to two years prior to the pre-agreed listing date target (without prejudice to any listing delays caused by unfavourable market conditions) and typically several years after listing, with self-imposed post-listing lock-up (reasonably aligned with other investors subject to lock-up) to ensure stock price stability and send appropriate signals to other investors about the Fund’s conviction in an investee company’s prospects. This is also to avoid undertaking an exit in unfavourable market conditions. No minimum disposal transaction size exists if the aforementioned conditions for the holding period are met.

6.1.1.11 *Responsible Investing Policy*¹⁶⁷

The Fund’s Responsible investing Policy will encapsulate the integration of environmental, social and corporate governance (ESG) considerations into the

¹⁶⁶ Private investors as defined in Communication From The Commission Guidelines on State aid to promote risk finance investments (2014/C 19/04) „Private investors will typically include the EIF and the EIB investing at own risk and from own resources, banks investing at own risk and from own resources, private endowments and foundations, family offices and business angels, corporate investors, insurance companies, pension funds, private individuals, and academic institutions”.

¹⁶⁷ See also section 9.7.1.10

investment management processes of the Fund in the belief that these considerations could provide enduring benefits for the Fund, the investee companies and the community at large, reduce risks, improve financial performance and drive positive social and environmental outcomes. This Policy will describe the criteria for inclusion (positive screening) or exclusion (negative screening) of investee companies based on their exposure to certain ESG characteristics or factors. The characteristics or factors can range from sector or industry to social or environmental impact on the community in which the investee company operates. Companies with exposure to “problem” or “sin” industries would be excluded.

Further “**Regulatory & governmental**” criteria to be added, when there is more clarity on:

- Funding sources –ESIF requirements. Elaborating what are the exact requirements of particular IFIs as potential investors. Elaborating what are the exact requirements of EU SME IPO Fund as a potential investor.
- CMDAF Baltic SME IPO Fund final positioning under EU state aid rules and choice of applicable framework, currently envisaged state-aid-free (passing Market Economy Operator test in Risk Capital Guidelines);

6.1.2 Value Creation

6.1.2.1 *Fund Manager Approach in the Pre-Listing Phase*

Practical involvement on a strategic and an operational level, with focus on improving investee companies’ «stock market readiness». On top of a more traditional hands-on private equity fund manager role, the Fund will also play a positive role supporting the steps of the transition from a private company to public company (e.g. financial reporting standards, corporate governance and shareholder communication).

6.1.2.2 *Fund Manager Approach During the Listing Phase*

By undertaking a cornerstone (declared) investor’s role, this helps provide confidence to other, private sector investors (both large and small) that a certain level of analysis has been undertaken by a competent investor and the risks of investing in such a smaller capitalisation company have been analysed and deemed sufficiently mitigated to warrant investment. This is particularly important as the smaller companies dominate Baltic economies whilst very few being presently listed on the various Nasdaq Baltic Exchanges (including alternative market). Acting as a pre-announced “cornerstone investor”, the Fund will increase trust of the market in the investee companies thereby increasing the likelihood of successful listing.

6.1.2.3 *Fund Manager Approach in the Post-Listing Phase*

Activist investor, often with pre-agreed council member seat, actively monitoring minority shareholder rights to both protect the Fund’s investments and create positive spill-over effects to the wider market, making minority investments in Baltic SMEs and Small-Caps a safer and more investable asset class. The Fund Manager also ensures that the investee company undertakes adequate investor relations/ corporate access activities both in the build-up to listing and in the post-listing phase.

6.1.3 Portfolio Model/Fund Size

The target is to raise a EUR 80m fund with a minimum size of EUR 60m and a hard cap of EUR 100m. The Fund intends to build a balanced and diversified portfolio. With the average initial ticket of EUR 2-3m this would allow for 21-24 investments at target fund size, 15-18 at minimum fund size. With investees typically being established growth and late stage companies, a decent portfolio diversification is expected.

The Fund will have a follow-up capability, but not exceeding cumulatively 15% of the Fund size for a single investee company, to be used opportunistically.

6.1.4 Exit Strategy

The potential exit opportunities are assessed before each investment is made. The standard exit route, against which the potential investment will be evaluated, will be the sale of shares at some point after the listing of the investee company on typically the respective Nasdaq Baltic stock exchange.

Shares may be sold in distinct or several block parcels to other investors. Alternatively, a gradual disposal strategy by selling directly in the spread during market hours may also be used. The choice of sales approach will be based solely on commercial return considerations.

The selling timing will be decided independently by the Fund Manager aiming to maximise Fund investor returns, taking into account (inter alia): the Fund's overall targeted returns, the investee company's expected vs. actual progress in operations, liquidity available/required for other more attractive investments and absolute market valuation levels of the investee company/relevant sector.

Forced exits would only be necessary should events such as squeeze-out processes appear (for the regulated market). In the case of the listed investee company deciding to leave the alternative market before the Fund has exited its investment, the shareholder(s) suggesting de-listing would be expected to make an offer for shares held by the Fund (and other minorities) which would mirror an obligatory buyout offer to minority shareholders for such a scenario on the regulated market (including the price setting formulas). This could be part of the Shareholders' agreement, providing further comfort for other minority investors that fair compensation would be received. While no minimum listing period for the investee company would apply, reasons for de-listing would be limited to takeover of all of the shares of the investee company or corporate failure rather than a spontaneous unilateral decision by the controlling shareholder(s) to do so.

In the case of an unforeseeable failure to list the investee company on typically the Nasdaq Baltic stock exchange, the typical private equity exit routes will be considered – strategic or trade sale, management or other shareholder buyout, with the approach to be based solely on commercial return considerations.

In case of failure to list based on non-force majeure causes, that would trigger clauses in shareholder (investment) agreement transforming this minority private equity investment into expensive mezzanine-type debt, providing both exit route and making it uneconomical for companies actually not willing to list to engage the Fund in the first place.

6.2 CMDAF Baltic SME IPO Fund Structure & Governance

Per best market practice, choice of Fund structure, including the domicile, should be a result of a multi-criteria commercial, legal and tax assessment of what would make the most practical and efficient solution to accommodate both the expected portfolio and the expected fund investors.

The expected portfolio is a function of the Fund's Investment Strategy, described in detail in the previous section, and there is a good level of visibility and clarity present.

As regards to accommodating the expected fund investors, the discussions are ongoing and the level of clarity is currently lower. The Fund appears to be advancing towards a policy-goal heavy investment strategy whilst being funded primarily by European Structural and Investment Funds funding, , channelled through state-owned national promotional institutions, which together means a significant amount of both legal requirements¹⁶⁸ and operational considerations¹⁶⁹ not typical to fully private investment funds and managers.

The current analysis and discussions regarding the Structure of the Fund that would accommodate both the expected portfolio and expected fund investors are described below. See also appendix E for the Structure discussion document discussed in December project Steering Committee.

6.2.1 Legal Set-Up

Usually it is administratively cheaper and easier to operate a fund registered in the same domicile where the majority of investments are located, but not necessarily tax-efficient. Our initial tax and legal analysis, described in detail in dedicated section 9 indicate that several Baltic domiciles could be an efficient solution for the Fund, so no additional analysis of further, foreign non-Baltic domiciles was deemed necessary. The specific choice among the Baltics domiciles and possible legal structures will need to consider both economic and political aspects, which are fluid and too early to conclude at this point.

An important legal set-up element is the choice to have a fund manager and the Fund itself as two separate legal entities or combined into a single entity. The market standard is separate entities, some of the reasons are listed below.

¹⁶⁸ EU and national RRF rules, EU and national state aid rules as applicable to stay within MEO parameters, national rules related to public funding and participation

¹⁶⁹ Active minority stakeholder right protection, listing specifics, managing and divesting listed portfolio, non-controlling stakes, no drag along tag along, likely non-standard incentive/carry scheme

- Separate entities are typically used if the GP is expected to manage several funds and for the separation of financial flows (investments, management costs, carry etc);
- Cross-fund liability risk.

Separate entities were also used in most of the analysed international case studies.

On the other hand, a single entity could be more cost and administration-efficient if a captive investment manager and no further separate funds are envisaged. This was the case in Finnish case study of TESI (Finnish Industry Investment).

6.2.2 Governance

The governance, which includes the management structure and guidelines, is being designed according to the best market practices, based on commercial logic arising from the Investment Strategy described in the previous section, incorporating legal requirements and practicalities of the chosen Fund structure, and any informal input and guidance from potential investors, which are expected to be primarily the Baltic states at this stage.

The first important governance element is the choice between an independent or a captive fund manager. The pros and cons are described below.

Table 57 Comparison of Characteristics of Independent and Captive Fund Manager

Independent manager (IFI or selected via a competitive procedure)	Captive manager (joint subsidiary by 3 Baltic NPIs, based on Nordic examples)
<ul style="list-style-type: none"> — Best market practice; — Minimises political influence risks on management of the Fund; — Initial feedback from the experienced Baltic fund managers lukewarm about interest in managing this Fund; — Mitigates potential conflicts of interest arising in the decision making process as purely commercially driven mandate would be in place. 	<ul style="list-style-type: none"> — Non-standard investment strategy with significant policy-driven activities (“market gendarme” role after listing, actively policing minority shareholder rights); — No ready-made team on the market; — Captive investment manager owned by NPIs could be set up by head-hunting individuals as opposed to procuring a complete team; — Captive team easier to control and incentivise; — Joint management processes by the 3 NPIs may prove to be complicated.

Source: KPMG

Due to this choice between an independent or a captive fund manager having fundamental implications on the further governance questions, these further questions have been put on hold until there is some resolution or guidance from the Fund's investors. As a clear next step, it is planned to have a Baltic NPI meeting to discuss this and other related issues and details, ultimately choosing the way to proceed.

Lastly, it is just highlighted that all practicalities of the Fund corporate governance will have to be carefully considered, as some of the previous pan-Baltic efforts have turned out to be a struggle due to unclear or unreasonably fragmented governance structures, which seemed good on paper, but turned out more complicated in application. Having governments as investors instead of private investors means a more imperative need to have everything well thought through from the beginning, because any modifications are harder just logistically.

6.2.3 Terms and Conditions

With many details still being fluid in the previous sub-sections, only a part of the terms and conditions can be detailed at this point. To reiterate, the ambition is to design everything according to best commercial market-practices, as far as applicable and optimal.

Firstly, an important element is the choice between closed-end and evergreen fund. The pros and cons are described below.

Table 58 Comparison of the Characteristics of Closed-end and Evergreen Fund Forms

Closed-end	Evergreen
<ul style="list-style-type: none"> — Closed-end structure typically required by governments to provide intervention reassessment option, by institutional investors for liquidity/exit reasons. 	<ul style="list-style-type: none"> — The market gap has to have a permanent nature to justify the evergreen approach.
<p>Recommendation:</p> <ul style="list-style-type: none"> — Fixed-term investment strategy with flexible winding-up deadline. 	
<p><i>Source: KPMG</i></p>	

Secondly, the design of the Fund's management team alignment of interest instruments. Alignment of interest is achieved via two instruments – the team's own commitment (aligning downside risk) and an incentive/carried interest scheme (aligning upside potential). These are not trivial design questions for a fund with such a non-market tested and a policy-goal heavy investment strategy. Simply applying market-standard clauses does not seem an obvious solution. Some considerations are described below.

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- Complicated for independent teams due to a non-standard investment strategy if significant policy-driven activities/costs are not directly contributing to the Fund's profitability;
- Not fully relevant for a captive team, in such a case the alignment of interest is typically achieved through bonus/incentive schemes only;
- Could be managed through a performance-based remuneration/incentive scheme.

Thirdly, the national quotas subject. As the funding may come from ESIF resources earmarked for deploying in each particular Baltic country, the Fund will need to target country allocations at least at the country contribution level, with the rest of the Fund (IFIs, fund manager, etc. contribution) being invested opportunistically, without geographical restrictions.

7 CMDAF Baltic SME IPO Fund Investment Pipeline

There are two parts to any fund pipeline/deal flow discussion, macro (top-down) and micro (bottom-up) level.

7.1 Top-Down Pipeline Analysis

The first, top-down or macro-level part – number and typology of qualifying investment targets – enterprises in target geographies – Lithuania, Latvia and Estonia, and other top-down analysis of quality and depth of potential market opportunities. This part has been covered in less detail within the earlier section 4.3.4 Demand Consolidated.

To illustrate quantitative total maximum scope of number of companies in the Baltics that could fit the broader initial criteria of Fund's investments, a sample size of potential investment targets was calculated across the Baltics. The project experts devised a set of criteria against which the number of companies was calculated in each of the Baltic states. The following criteria were put forward by the project experts to identify the initial broader potential scope of investment targets (all criteria need to be satisfied for every company to be included in the scope):

- Revenue in year 2019: EUR 1m to EUR 100m;
- Number of employees in 2019: up to 499;
- Total assets in 2019: up to EUR 86m;
- Total equity in 2019: \geq EUR 0;
- Owners and UBOs of the company should be disclosed.

Secondary Baltic Registries of Enterprises' data users in each of the Baltic states were approached¹⁷⁰ to estimate the number of companies falling under the aforementioned criteria. The following number of companies satisfying the aforementioned criteria (all criteria for every company) were identified in:

- Estonia – 5 202 companies;
- Latvia – 5 991 companies;
- Lithuania – 8 883 companies.

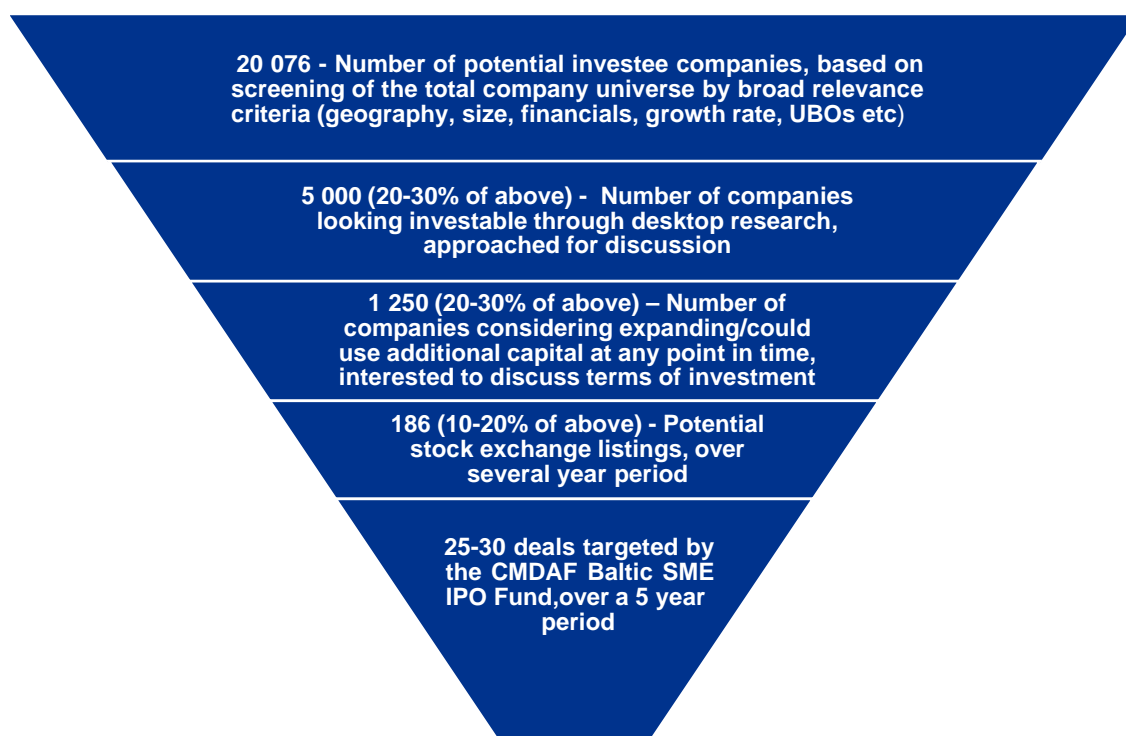
The total number of companies in the Baltics falling under the criteria set above accounts for 20 076 companies, and that is a very large number of companies on the initial list. This would be the work of the prospective Fund manager to navigate through the larger scope with the view to select a much narrower sample of potential investment prospects to be addressed proactively. That could be done by increasing the bottom threshold of turnover, adding additional information on past performance (i.e. checking financial data for desired trends etc.) and by checking various metrics. This sort of financial analysis would be available to the Fund manager, since detailed information (basically all information in an electronically useable format from annual reports) on the said scope of companies can be easily obtained.

¹⁷⁰ Firms.lv (Latvia); Credit info Lithuania; Äripäev (Estonia)

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Below, the project experts have designed an investment funnel that shows the sequence and logic of progressively narrowing down the initial pool of potential investees (as described within funnel) to a smaller pool, from which the Fund will source the few deals planned each year.

Figure 11 CMDAF Baltic IPO SME Fund Investment Funnel



Source: KPMG

7.2 Bottom-Up Pipeline Analysis

The second, bottom-up or micro-level part is specific enterprises identified *prima-facie* qualifying under the Fund Investment Strategy and looking for funding with similar parameters to what the Fund plans to offer. It has to be understood that identifying a portfolio of pipeline candidates is typically a task for the selected fund manager. Therefore the project experts here function as a proxy for the future Fund Manager, building the Fund's investment case for the first round of Fund investors. Thus, the project experts have worked to identify the potential pipeline candidates based on the draft Fund investment strategy formulated in Section 6.1., based on extensive previous experience and presence in the Baltic region.

Specifically, LHV's active presence in the Baltic region has enabled it to proprietary source most of its past listing cases. LHV together with its various partners have built a wide network of local company owners and managers which provides them access to exclusive deals in the region. This is similar to KPMG's experience and presence.

Currently, the team of project experts has an active pipeline of 21 potential investment opportunities that fit into the Fund's investment strategy. The majority of these were proprietary sourced by the team and *prima facie* qualify under the Fund Investment Strategy and are shown in the Table 59 Potential Investee Companies below.

There is a higher proportion of candidate companies from Latvia. This is influenced by the fact that the listing support programme has been successfully initiated there, both publicising the public equity as a funding route and lowering costs associated with it, while the process of launching similar listing support programme is still only being finalised in Lithuania and appears to have been on hold in Estonia.

The entries below relate to companies where either mandates have already been executed with a member of expert team or there has already been some ongoing dialogue with the intention to pursue such a transaction at the indicated time. The entries may include situations where dual track processes and/or debt financing may also be pursued, not necessarily only focusing on capital markets transactions. Moreover, there may be a minor element of existing shares sold, however, the majority would consist of new capital being raised.

Table 59 Potential Investee Companies

Company	Sector	Indicative transaction size (EUR m)	Timing (forecast year)
1	Light Manufacturing	2.5	2022+
2	Media	2.5	2022+
3	IT	1.5	2022+
4	Light Manufacturing	1.5	2021+
5	Light Manufacturing	4.0	2022+
6	Food products	6.0	2021+
7	IT	2.0	2022+
8	Food products	5.0	2021+
9	Light Manufacturing	3.0	2022+
10	Corporate services	2.0	2022+
11	Wholesale services	2.5	2023
12	Retail	2.5	2022+
13	IT	3.0	2022+
14	Light Manufacturing	1.5	2021+
15	Light Manufacturing	2.0	2022+
16	Biotech-Pharma	4.0	2022+
17	Food products	1.5	2021+
18	Food products	2.5	2022+
19	Building & Construction	5.0	2022+
20	Light Manufacturing	1.5	2021+
21	Holding Company	2.0	2021+

It is intended that the Fund Manager, when selected, will be similarly qualified, bringing to the table reputation, expertise and wide local network, enabling similar access to proprietary deal-flow. The Fund Manager team will undertake both top-down sector analyses and bottom-up market scouting to identify the most interesting opportunities to be approached.

Additionally, all upcoming Baltic listings will be considered for Fund investment, if matching the Fund Investment Strategy.

8 CMDAF Baltic SME IPO Fund Fundraising and Potential Investors

8.1 Discussions With Potential Investors

For a greenfield fund like CMDAF Baltic SME IPO Fund with a market development role on top of a normal commercial role, the attraction of investors, especially the initial investors, is a challenging. Different investors have different risk appetites and different levels of sophistication. Historically, Baltic investment funds have been dominated by the EIF, the EBRD and the European Structural and Investment Funds funding channelled through to funds by the national promotional institutions (Invega, KredEx and Altum), with Baltic pension funds providing most of the remainder.

The project experts have organised meetings and interviews with potential investors, using several iterations of the draft Fund terms and strategy as a reference.

The first potential investors approached were the public sector – the national governments through the Ministries of Finance, as those stand to benefit from the positive non-monetary externalities like the capital market development on top of the commercial returns. Thus the governments of Latvia, Lithuania and Estonia were the first targets for fundraising, expected to invest in the Fund through their national development finance/promotional institutions (Altum, Invega and KredEx) that already hold a portfolio of investments in risk capital funds from various European Structural and Investment Funds supported programs and stakes in the Baltic Innovation Fund I and II.

The discussions are ongoing, and there is a positive traction. The situation seems the most advanced in Lithuania and Latvia, with European Structural and Investment Funds resources having been mentioned as the most likely funding sources, whilst resources from the national envelope of the EU Recovery and Resilience Facility also not yet fully excluded. Additionally, both in Latvia and Lithuania the possibility to use some reflows from previous ESIF programmes has been mentioned, as a way to smooth out any issues with ESIF main funding, if identified (for example any minor ineligible costs, timing mismatches etc.). . Notably, in January 2021 all the main Latvian financial industry stakeholder organisations – the Latvian Venture Capital Association, Finance Latvia Association, Nasdaq Latvia and the Financial and Capital Market Commission signed a joint letter addressed to the government of Latvia¹⁷¹, expressing strong support for the CMDAF Baltic SME IPO Fund initiative. The Estonian funding situation is not so advanced, but progress is being made.

It is important to highlight that investments by national governments can come from several different public resource types, which each entails different regulatory, administrative and economic consequences, with some resources being better suited than others for the CMDAF Baltic SME IPO Fund specifics. Our current understanding of these resource types are outlined below:

¹⁷¹ See Appendix D

1. ESIF 2021-2027 resources - potentially an excellent match for the Fund if it could be simultaneously available in all three Baltic states on the same conditions and monitored by the European Commission in a unified manner, thus allowing perfect alignment both in terms of national timelines, rules and restrictions, monitoring, and corporate governance;

2. EU Recovery and Resilience Facility (non-green or non-digital envelopes) – potentially an excellent match for the Fund if it could be simultaneously available in all three Baltic states on the same conditions and monitored by the European Commission in a unified manner, thus allowing perfect alignment both in terms of national timelines, rules and restrictions, monitoring, and corporate governance.

N.B. If RRF not simultaneously available in all three Baltic States and different funding source is used in each country, the suitability of RRF needs to be reassessed.

N.B.B. There is a no full clarity whether the Fund would be able to invest after 2026 due to differing interpretations of RRF rules and no clarification by EC yet.

3. EU Recovery and Resilience Facility (green or digital envelopes) – same as above, except the green or digital restriction narrowing the Fund Investment Strategy somewhat. Disclaimer – RRF green and digital envelope restrictions are still being analysed and this position on suitability may be not final;

4. Reflows from previous ESIF or other financial instruments – excellent fit, if available;

5. Redistributions of earlier state budget allocations to other, not-fully-utilised financial or other instrument, where insufficient market demand or other reasons freeing part of the earlier allocation – excellent fit, if available;

6. State budget – excellent fit because of the smallest administrative and regulatory overhead as opposed to any other public resources. It does not have the advantage of pre-existing unified RRF or ESIF rules and the EC oversight, but that can largely be replicated through the Fund legal documentation;

7. Balance sheet investment by national promotional institutions – excellent fit, if available.

The second potential investor group approached were the private investors that have already invested in Baltic investment funds, thus demonstrating a certain level of risk appetite and openness to this segment. A full spectrum of the private investor segment was analysed, with the organising of meetings and interviews targeting both the largest Baltic private institutional investor with Scandinavian ownership as well as the very active locally owned institutional investor with a perceived higher risk appetite. The feedback received was consistent within the spectrum, indicating that it is applicable generally, and not specifically to these particular investors.

Reactions were two-fold, with private investors praising the governments' initiative to develop the Baltic capital market, but hesitant to invest themselves due to the perceived

higher risk and no track record of adequate return expectations of the untested market business model of the Fund. Importantly, the private investors did not reject the investment idea as such. They accepted the theoretical basis behind the Fund's business model, and appreciated the plan to structure the Fund on commercial terms and best market practices. Thus the private investor feedback can be summarised as follows – the government should take the initial “*proof-of-concept*” risk inherent in any new product launch, but once the Fund would be validated by the market, they would be interested to consider investing in the Fund.

The third potential investor group approached were international financial institutions that are eligible to invest in Europe-focused investment funds, starting from the EBRD, the NIB, the CEB and ending with the EIF, with various other market participants in the middle. From previous experience, the EBRD and the EIF prefer private market validation via at least soft commitments from a significant amount of private investors, hence why we analysed private investors before the IFIs. Important to highlight that private investors presence is not the only principal criteria for IFI investing, with other criteria including a viable investment strategy, credible pipeline and experienced fund management team. NPIs like the Nordic peers TESI and Saminvest will also be considered, but paying attention to geographical investment restrictions of such institutions.

The discussion process is ongoing and it is too early to report anything tangible. An Important factor slowing down IFI investment discussions is that IFIs typically want to see the full details of a potential fund project (including the fund team, main terms, legal set-up et cetera) before seriously analysing and discussing an investment. In a nut-shell, there needs to be a bankable proposal in place prior to investors assessing a certain structure. This is why perhaps institutional investors are reluctant at an initial stage to commit. That was also the case with K-Growth and only in time private investors joined. Importantly, there have also been no clear rejections by any of contacted private investors of the Fund's idea and business model, the issue is just proving it will work in practice as good as in theory, meaning generate first track-record. At the same time, governments as investors want to know if any IFI is joining as an investor, because that may have an impact on their views on the optimal fund structure or other important parameters.

The EU SME IPO Fund is also being considered as a potential investor, but due to it being implemented by the European Commission through a partnering IFI, it is treated as one of the sub-options within the IFI bucket.

European SME IPO Fund

The new Capital Markets Union (hereinafter, CMU) action plan¹⁷² stresses that creation of a full-fledged CMU among other matters is essential for mobilising private investment in companies and complementing public support. It brings a variety of funding alternatives, reduces dependence on a single source or a single provider of financing and reduces the funding gap.

¹⁷² European Commission, A Capital Markets Union for people and businesses-new action ,2020

More specifically, under Action 2 of the CMU action plan it is foreseen that a European level fund-of-funds, an EU SME IPO fund is to be set up to make it easier for small and high-growth companies, in particular in sectors of strategic importance to the EU, to raise capital and finance for their growth. On a high level, this is an indication of an existing funding gap on the European level that boils down to the separate country levels.

The EU's SME Strategy for a sustainable and digital Europe¹⁷³ also underscores that there is a financing gap in Europe faced by SMEs despite substantial support programmes on the EU and national levels. As elaborated in the said Strategy, to address the limited growth financing possibilities of SMEs in Europe, public funding could act as an anchor investment to attract private investors in high-growth, innovative SMEs at the stage of public listing.

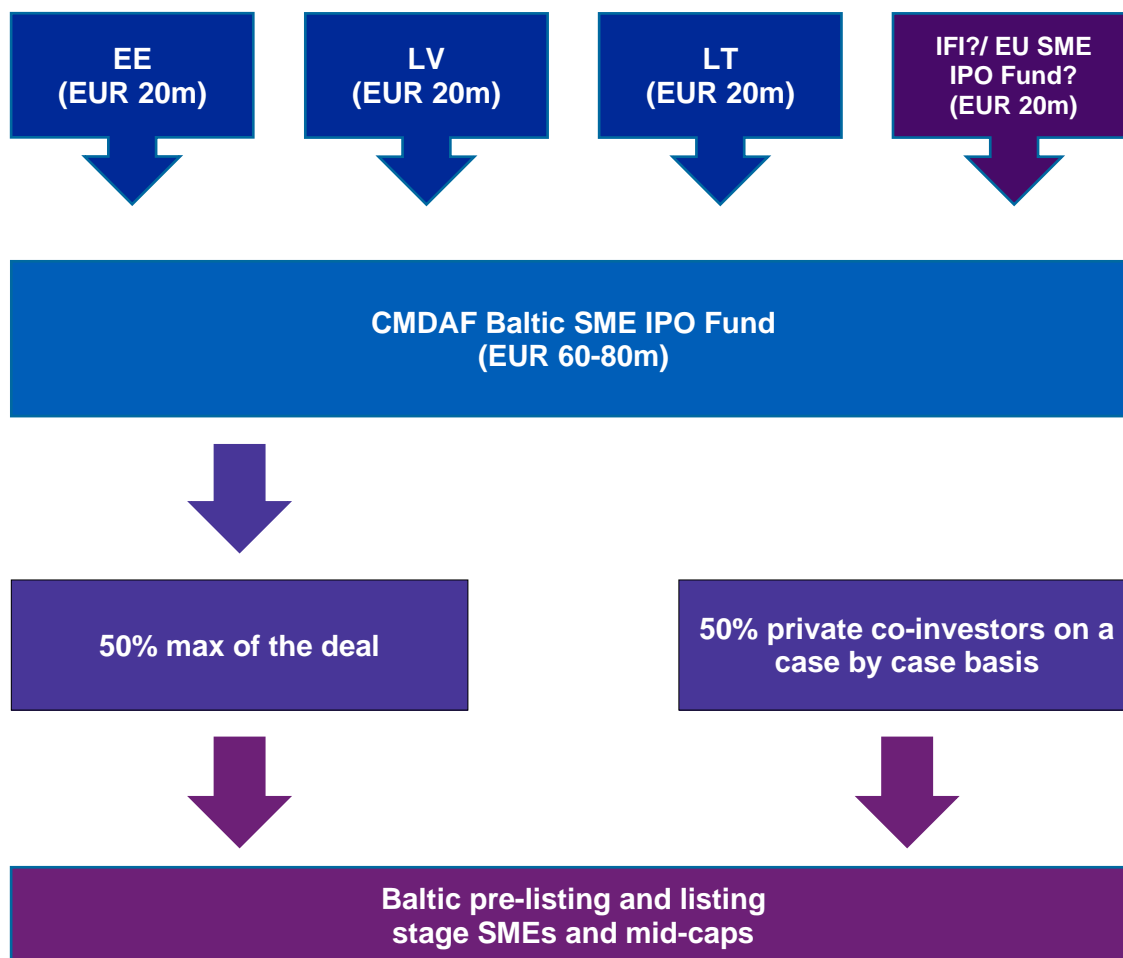
At a later stage private investors who have not yet invested in Baltic investment funds will also be approached. This group will primarily include institutional investors and UHNWI/HNWI/family boutiques qualifying as professional investors under MiFID II. Historically there has been negligible participation of retail investors in Baltic investment funds and under the latest EU regulations (primarily MiFID II) it could be outright prohibited because such funds could qualify as "complex financial instruments" under MiFID II. In terms of geography, one would look not only at the Baltics, but beyond – in a wider European and US context.

¹⁷³ European Commission, SME Strategy for a sustainable and digital Europe, 2020

8.2 Current Fundraising Plan

The current vision for the first closing of the Fund is envisaged as follows

Figure 12 Current Vision of the First Fund Closing and the Deal Level



Source: KPMG

More detailed potential investor report will be prepared once the Fund terms and investment strategy are finalised. As explained earlier in the report, many of the potential investors on the more professional end of investing, despite their general positive attitude towards the Fund, require finalised terms and strategy to provide their more elaborate opinion on potentially investing in/with the Fund. This would be done in the second stage of the CMDAF Baltic SME IPO Fund project.

9 CMDAF Baltic SME IPO Fund Legal Analysis

9.1 CMDAF Baltic SME IPO Fund State Aid Considerations

9.1.1.1 *Applicability of the EU State Aid Law*

Prior to assessing the potential State aid risks, it is necessary first to frame the scope of the EU State aid law in terms of its applicability to the risk finance scheme under examination. Article 107(1) TFEU by its terms applies solely to the benefits or advantages granted to the undertakings.¹⁷⁴ The notion of the “undertaking” has been interpreted broadly by the Court of Justice of the European Union (CJEU) to include any entity engaged in an economic activity, regardless of its legal status,¹⁷⁵ form of incorporation and source of finance.¹⁷⁶ Thus, classification of the entity under the laws of incorporation does not affect applicability of the State aid rules *per se*.¹⁷⁷ The extent of engagement of the entity in an economic or commercial activity instead plays a decisive role in determining whether the entity under consideration constitutes an “undertaking” within the meaning of Articles 101(1) TFEU. Thus, applicability of the State aid rules to the risk finance scheme under examination depends on the following entities being recognised as undertakings, namely (i) a government investment vehicle (GIV) established and/or appointed as a shareholder of the Fund by each Member State (MS) individually; (ii) the Fund itself established as a financial intermediary to accommodate the funds; (iii) actual and/or potential shareholders co-investing with MSs into the Fund as independent private investors; (iv) the entrusted entity appointed as a financial manager to manage the funds, as well as (v) potential investees, in particular small and medium sized enterprises (SMEs), as well as small mid-caps and innovative mid-caps.¹⁷⁸ The following section will focus on identifying entities of the risk finance scheme, which constitute “undertakings” within the meaning of Articles 107(1) TFEU.

Government Investment Vehicle

If a new GIV is established or an existing one is appointed by the MS to exercise beneficial ownership over the capital shares of the Fund, such GIV will constitute an inalienable element of the risk finance scheme under examination. The only purpose of

¹⁷⁴ Treaty on European Union and the Treaty on the Functioning of the European Union at p. 91 stands as follows: “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the internal market”.

¹⁷⁵ Case 118/85 Commission v Italy [1987] ECR 2599, para. 11.

¹⁷⁶ Case C-41/90 Klaus Höfner and Fritz Elser v Macrotron GmbH. [1991] ECR I-01979, para. 21. Joint Case C-159/91 and C-160/91 Christian Poucet v Assurances Générales de France and Caisse Mutuelle Régionale du Languedoc-Roussillon [1993] ECR I-637, para. 17, Pavel Pavlov and Others v Stichting Pensioenfond Medische Specialisten [2000] ECR I-06451, para. 74

¹⁷⁷ The same methodology is applied to determine an “undertaking” within the meaning of Article 107(1) TFEU. See, Pavel Pavlov and Others v Stichting Pensioenfond Medische Specialisten [2000] ECR I-06451, para. 74

¹⁷⁸ See, for the definition of SME Article 2 of Annex I of the Commission Regulation (EU) No 651/2014 declaring certain categories of aid compatible with the internal market in application of Articles 107 and 108 of the Treaty. See also for the definition of small mid-caps and innovative mid-caps see Recital 47(1) & (b) of the Guidelines on State aid to promote risk finance investment (2014/C 19/04).

such GIVs, however, is to act as a shareholder of the Fund. The primary functional role of GIVs as shareholders of the Fund is to ensure equal playing field for MSs and private investors on the level of the Fund in terms of corresponding legal and/or tax implications. Recital 16 of the Notice on the notion of State aid, hereinafter referred as the State Aid Notice, provides that:

“the simple fact that an entity holds shares, even a majority shareholding, in an undertaking providing goods or services on a market does not mean that that entity should automatically be considered an undertaking for the purposes of Articles 107(1) TFEU. Where that shareholding only gives rise to the exercise of rights attached to the status of shareholder as well as, if appropriate, the receipt of dividends, which are merely the fruits of the ownership of an asset, that entity will not be considered an undertaking, if it does not itself provide goods or services on a market”.¹⁷⁹

Therefore, introduction of such GIVs into the aforementioned risk finance scheme shall be considered as a mere act of internal organisation by the MSs to secure better implementation of the scheme under examination.¹⁸⁰ Accordingly, GIVs will not constitute “undertakings” within the meaning of Articles 107(1) TFEU to fall outside the scope of the EU State aid law.

Capital Market Development Accelerator Fund

Due to the precise form of incorporation of the Fund as a legal entity have not been crystallised yet, it is worth mentioning that the notion of an “undertaking” encompasses not only state-owned,¹⁸¹ public and private companies,¹⁸² but also partnerships,¹⁸³ associations, co-operatives as well as variety of other legal forms, subject to their direct or indirect engagement in an economic or commercial activity.¹⁸⁴ Thus, any entity will be recognised as an “undertaking” within the meaning of Articles 107(1) TFEU, if it is involved in “offering of goods or services on the market, which could at least in principle, be carried on by a private undertaking in order to make profit”.¹⁸⁵ The currently available draft of the CMDAF Baltic SME IPO Fund Investment Strategy, hereinafter referred to as the draft CMDAF Baltic SME IPO Fund Investment Strategy, clearly emphasises commercial nature of its key activity aiming at achievement of the “risk-appropriate financial returns for its investors”.¹⁸⁶ In fact, the Fund will be providing financial services aiming at achievement of a plausible profit for its public and private investors as a return on commercially viable financial investments. Although the details of the draft CMDAF

¹⁷⁹ Case C-222/04 Ministero dell'Economia e delle Finanze v Cassa di Risparmio di Firenze SpA, Fondazione Cassa di Risparmio di San Miniato and Cassa di Risparmio di San Miniato SpA [2006] ECR I-00289, paras 107 to 118

¹⁸⁰ Case C-301/12 Cascina Tre Pini Ss [2014] ECLI Identifier: ECLI: EU:C:2014:214, para. 42 and Case C 428/07 The Queen, on the application of Mark Horvath v Secretary of State for Environment, Food and Rural Affairs [2009] ECR I-06355, para. 50.

¹⁸¹ Commission Decision (EEC) 82/861 [1983] 1 CMLR 457 (Re British Telecommunications) upheld on the appeal in Case 41/83 Italian Republic v Commission of the European Communities [1985] ECR at p. 00873.

¹⁸² Case 118/85 Commission v Italy [1987] ECR 2599, para. 11

¹⁸³ See, for instance, 73/323/EEC: Commission Decision relating to proceedings under Article 85 of the EEC Treaty (IV/26.825 - PRYM-BEKA) (October 8th, 1973) and Case 258/78 L.C. Nungesser KG and Kurt Eisele v Commission of the European Communities (1982) ECR 1982 p. 02015.

¹⁸⁴ See, for instance, EU case law referred to in “Section 21A Competition: General Principles”, Law of the European Union, (ed. by D. Vaughan CBE QC and A. Robertson QC) (2010), pp. 41-45.

¹⁸⁵ Case 118/85 Commission v Italy [1987] ECR 2599. para. 36.

¹⁸⁶ Investment Strategy 6.1

Baltic SME IPO Fund Investment Strategy will be finalised on a later stage, its key activity will undoubtedly remain economic in nature. Therefore, it is reasonable to suggest that the Fund will be recognised as an “undertaking” for the purposes of the EU State aid law.

Potential International Investor

In the light of the potential allocation of the shares in the capital of the Fund to one of the International Financial Institutions (IFIs), like the European Investment Bank (EIB) and/or any other qualified international co-investor, it is worth considering applicability of the EU State aid law to the international financial institutions.¹⁸⁷ EU State aid law applicability to IFI depends on it being initially recognised as an “undertaking” within the meaning of Article 107(1) TFEU. Article 4(1)(26) of the Regulation (EU) No 575/2013 defines financial institution as an undertaking other than a credit institution or an investment firm, “the principal activity of which is to acquire holdings”.¹⁸⁸ Thus, Article 4(1)(26) expressly defines financial institution as an “undertaking” for the purpose of *Acquis Communautaire*. The notion of an undertaking, however, is a relative concept, which means that an international financial institution may be recognised as an undertaking in regards to some of its activities, but not the others. Accordingly, an international financial institution will be recognised as an undertaking, insofar as it is acting in pursuit of its commercial objectives as an independent private investor. Whether or not international financial institution falls within the scope of the EU State aid law, thus, depends on the facts of a particular case under consideration.

Alternative Investment Fund Manager

In the light of the presumed pursue by the Fund of the alternative investment fund (AIF) status within the meaning of Article 4(1)(a) of the Directive 2011/61/EU, its entrusted fund manager shall be registered as an Alternative Investment Fund Manager (AIFM), hereinafter referred to as the Manager. Article 4(1)(b) of the Directive 2011/61/EU defines AIFM as a legal entity, “whose regular business is managing one or more AIFs”.¹⁸⁹ Accordingly, a straightforward commercial nature of the AIFM activities brings it within the scope of the EU State aid law as an “undertaking”.

SMEs & Mid-Caps Investees

The draft CMDAF Baltic SME IPO Fund Investment Strategy defines potential investees of the Fund as SMEs, small mid-caps and innovative mid-caps at the pre-listing stage,

¹⁸⁷ See, Section 2.4 of the State Aid SA. 57409 (2020/N) – Latvia COVID-19: Recapitalization Fund (06.07.2020) C (2020) 4656 FINAL at pp. 4-5.

¹⁸⁸ Article 4(1)(26) of the Regulation (EU) No 575/2013 of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012. OJ L 176, 27.6.2013 p. 20, provides: “‘financial institution’ means an undertaking other than an institution, the principal activity of which is to acquire holdings or to pursue one or more of the activities listed in points 2 to 12 and point 15 of Annex I to Directive 2013/36/EU, including a financial holding company, a mixed financial holding company, a payment institution within the meaning of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market, and an asset management company, but excluding insurance holding companies and mixed-activity insurance holding companies as defined in point (g) of Article 212(1) of Directive 2009/138/E”.

¹⁸⁹ Article 4(1)(a) and Article 4(1)(b) of the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (E)

as well as existing private equity fund portfolio companies contemplating listing upon receipt of the pre-listing investment.¹⁹⁰ In the light of the key characteristics of the investment cases listed in the draft CMDAF Baltic SME IPO Fund Investment Strategy, it is reasonable to expect all forthcoming investees of the Fund being engaged in the economic or commercial activities. Accordingly, potential investees of the Fund shall be considered “undertakings” within the meaning of Article 107(1) TFEU for the purposes of the State aid risks assessment.

Sub-concluding Remarks

The aforementioned considerations indicate that Article 107(1) TFEU applies throughout the risk finance scheme under examination with the only exception of the government investment vehicles introduced by the MSs as shareholders of the Fund. Therefore, State aid related risks shall be addressed on the following levels of the risk finance scheme, namely (i) the level of the IFIs or other qualified international investor co-investing into the Fund, (ii) the level of the Fund acting as a financial intermediary, (iii) the level of the AIFM managing funds of the Fund, as well as (iv) the level of the potential investees constituting end beneficiaries of the risk finance scheme.

9.2 Risk Finance Scheme Analysis

The risk finance scheme under examination shall be assessed against the conditions set forth in Article 107(1) TFEU. The CJEU case law has crystallised the following cumulative criteria for the measure to fall within the scope of EU State aid law, namely: (i) the measure shall be imputable to the State and involve the use of State resources, (ii) conferring an economic benefit or advantage, (iii) which favours selectively certain undertakings, and therefore (iv) distorts or threatens to distort competition and affects trade between MSs. The Commission has also developed and refined the market economy investor principle (MEIP) to deal with the second criterion of Article 107(1) TFEU, i.e. assessment of the conferred economic advantage granted to the undertaking.¹⁹¹ The classic test relied on by the Commission and the European courts is whether the undertaking has obtained an economic advantage as a result of the measure under consideration, which it would not receive on the same terms from a hypothetical private investor of the size comparable to the aid grantor in question. In order to respect the neutrality of treatment between public and private undertakings enshrined in Article 345 TFEU, MEIP, as well as its iterations, such as the market economy operator principle (MEOP), shall be applied equally to the measures targeting public and private undertakings.¹⁹² Section 2.1 of the Risk Finance Guidelines, provides additional insight on the application of the MEOP to the risk finance schemes at the level of the investors, the financial intermediary and its manager, as well as potential investees.¹⁹³ The

¹⁹⁰ Investment Strategy 6.1

¹⁹¹ Article 4(1)(a) and Article 4(1)(b) of the Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (E)

¹⁹² Article 345 TFEU of the Consolidated versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal C 326, 26/10/2012 at p.194.

¹⁹³ Recital 29 of the of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014

following section will focus on reviewing MEOP compatibility of the risk finance scheme on each of the aforementioned levels.

9.2.1.1 *Investor Level of the CMDAF Baltic SME IPO Fund Scheme*

Transfer of State Resources and Imputability

Although originally causing considerable controversy on the interpretation of the first criterion of Article 107(1) TFEU, the CJEU case law has finally settled the debate by adopting a cumulative construction of the provision.¹⁹⁴ Recital 38 of the State Aid Notice emphasises that “granting of an advantage directly or indirectly through State resources and the imputability of such a measure to the State are two separate and cumulative conditions for State aid to exist” even though “they are often considered together when assessing a measure under Article 107(1) TFEU”.¹⁹⁵ Thus, the first criterion of Article 107(1) TFEU requires simultaneous presence of both conditions, namely imputability of the measure to the MS as well as direct or indirect involvement of the state resources for its implementation.¹⁹⁶ Despite the primary source of the upcoming state capital investment into the Fund is not clear yet, the designated financial means will be channelled through the state budget regardless their initial affiliation to any of the financial instrument available either on the EU or MSs level. Recital 57 of the State Aid Notice indicates that “the origin of the resources is not relevant provided that, before being directly or indirectly transferred to the beneficiaries, they come under public control and are therefore available to the national authorities”.¹⁹⁷ It will suffice, therefore, to focus on the designated financial means leaving GIVs for Fund, as an initial starting point of the assessment.¹⁹⁸ Accordingly, the capital injection made by the GIVs into the Fund shall be evaluated against the aforementioned conditions of Article 107(1) TFEU.

¹⁹⁴ See P.Werner and M.Caramazza, “‘State’ Aid or Not – This is the Question”, *European State Aid Law Quarterly* (2019), issue 4, p.519 – 527 and F.Tomat, “*State Resources and Imputability to the State: A Clarification on the Scope of the Pearle Judgement?*”, *European State Aid Law Quarterly* (2014), issue 3, p.542. See further A.Biondi, “*Some Reflections on the Notion of “State Resources” in European Community State Aid Law*”, *Fordham International Law Journal*, (2006) Volume 30, Issue 5, pp. 1426-1448.

¹⁹⁵ Recital 38 of the of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014

¹⁹⁶ See, Case 82/77 *Van Tiggele* [1978] ECR 25, para. 24 & 25; Joined cases C-72/91 and C-73/91 *Firma Sloman Neptun Schiffahrts AG v Seebetriebsrat Bodo Ziesemer der Sloman Neptun Schiffahrts AG* [1993], para 19; Case C-189/91 *Petra Kirsammer-Hack v Nurhan Sidal* [1993] ECR I-6185, para 16; Case C-200/97 *Ecotrade Srl v Altiforni e Ferriere di Servola SpA* (AFS) [1998] ECR I-7907, para. 35; Case C-295/97 *Industrie Aeronautiche e Meccaniche Rinaldo Piaggio SpA v International Factors Italia SpA (Ifitalia), Dornier Luftfahrt GmbH and Ministero della Difesa* [1999] ECR I-3735, para 35, Case C-379/98 *PreussenElektra AG v Schlesweg AG* [2001] ECR I-02099, para. 58.

¹⁹⁷ Recital 57 of the of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014.

¹⁹⁸ It shall be emphasised that the present State aid analysis of the risk finance scheme only covers positive transfer of state resources in a form of a capital injection via special purpose vehicle. It is worth highlighting that no actual transfer of state resources is required for the state measure to fall within the scope of Article 107(1) TFEU. It is sufficient of the State to forego revenue that it would otherwise have received, including but not limited to, public debts waiver, tax reduction or exemption, and provision of goods and services at an undervalue. See further, recital 51 of the of the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (C/2016/2946) OJ C 262. p. 12. See also, Case C-387/92 *Banco de Crédito Industrial SA, now Banco Exterior de España SA v Ayuntamiento de Valencia* [1994] ECR I-00877, para. 14; C-404/97 *Commission of the European Communities v*

GIVs Capital Injection

The distinction between aid granted by the state and aid granted through state resources predominantly serves to bring within the realm of the EU State aid law not only aid granted directly by the state *via* central, regional or local budgets, but also aid granted by the public or private bodies, such as GIVs, established and/or designated by the MSs to administer the measure. In accordance with recital 39 of the State Aid Notice, the measure is by definition imputable to the MS, “if a public authority designates a private or public body to administer a measure conferring an advantage”.¹⁹⁹ The imputability of the measure to the MSs in case of GIVs is unquestionable. Recital 50 of the State Aid Notice provides that “a measure granting an advantage is not financed directly by the State, but by a public or private body established or appointed by the State to administer the aid, does not necessarily mean that the measure is not financed through State resources”.²⁰⁰ If read in conjunction with the relevant case law of the European courts, it is sufficient for the financial means “to constantly remain under public control and therefore available to the competent national authorities” to be qualified as state resources. In the context of the risk finance scheme under examination the GIVs constitute a mere extension of the state administering financial means allocated from the state budget. The aforementioned financial resources remain under an absolute control of the MS without any restrictions in terms of their availability. In regards to the GIVs’ capital injection into the Fund, therefore, both conditions of the first criterion of Article 107(1) TFEU are met, which means that positive transfer of the financial means from the GIVs to the Fund constitutes transfer of state resources based on the decision imputable to the MSs.

IFIs Capital Injection

Based on past experience with similar Baltic capital market initiatives (BIF, BIF2), it is possible that one of the IFIs will provide a capital injection into the Fund in the amount equivalent to the contributions of the MSs. Thus, it is necessary to consider whether IFIs capital injection will constitute a transfer of state resources within the meaning of Article 107(1) TFEU. In the joint statement on State aid matters in relation to the activities of the EIB Group, the Competition services of the European Commission and the European Investment Bank Group distinguish between following forms of financing managed by the EIB Group, namely: (i) where the EIB Group employs its own resources; (ii) where the EIB Group implements and manages MSs programmes; and (iii) where the EIB Group manages EU funds under the mandate from the European Commission. The joint statement indicates that the European Investment Bank (EIB) and European Investment Fund (EIF) “own resources awarded directly by the EIB Group do not constitute State aid under Article 107(1) TFEU” and “as such fall outside the scope of the State aid rules”.²⁰¹ If EIB/EIF or any other IFI is “investing at own risk and from own resources” in

Portuguese Republic [2000] ECR I-04897, para. 45; Cases T-204/97 & T-270/97 *PAC - Empresa para a Agroalimentação e Cereais, SA v Commission of the European Communities* [2000] ECR II-02267, para 81.

¹⁹⁹ See, for instance, Case C-482/99 *France v Commission* [2002] ECR I-4397, para. 24.

²⁰⁰ See, for instance, Case 78-76 *Steinike & Weinlig v Federal Republic of Germany* [1977] ECR 1977, p. 00595, para. 21.

²⁰¹ Joint statement by Joaquín Almunia, European Union Commissioner for Competition, and Werner Hoyer, President of the European Investment Bank (EIB), on State aid matters in relation to the activities of the EIB Group (24.01.2014). See also, Press release of the European Commission, “*State aid: Commission and EIB agree on State aid matters in relation to activities of EIB Group*” (21.01.2014). The same line of reasoning has been implied from the standpoint of the Commission regarding European Bank of Reconstruction and

its capacity of an independent private investor, no transfer of state resources will occur within the meaning of Article 107(1) TFEU.²⁰² Accordingly, IFIs' capital injection of own financial means at own risk falls outside the scope of the EU State aid law.

Economic Advantage

The following two dimensions shall be analysed, when assessing potential economic advantage of the GIVs' capital injection into the Fund, namely (i) advantage to the private investors co-investing with the MSs into the Fund to become its shareholders, as well as (ii) advantage to the private investors, who invest alongside the Fund into the investees. The economic advantage, if any, granted to the private investors in both instances will directly or indirectly manifest itself in the preferential terms and conditions enjoyed by the co-investors in comparison with the MSs shareholders. Although corporate architecture of the Fund as a legal entity is not determined yet, it shall be grounded in the system of the checks and balances ensuring equal treatment of its shareholders, such as proportionate allocation of the investment risks and distribution of the investment returns or losses between all the shareholders of the Fund. The financial losses of the Fund, if any, shall be covered by the assets of the Fund itself in accordance with the laws and regulations of the MS of incorporation.²⁰³ If the corporate architecture of the Fund prevents any disparities between the shareholders in favour of the private investors, which tend to improve their economic and/or financial position, it is considered that the risk finance scheme does not confer any economic advantage on the private investors of the Fund.

In regards to the private investors co-investing alongside the Fund, the Commission will consider a state measure compatible with MEOP, if it is made under the terms and conditions *pari passu* between public and private investors. In accordance with the recital 31 of the Risk Finance Guidelines, an investment is considered *pari passu*, when "it is made under the same terms and conditions by public and private investors, where both categories of investors intervene simultaneously and where such intervention of the private investors is of real economic significance".²⁰⁴ The test does not require a

Development (EBRD) resources constituting state resources only if MSs have discretion as to the use of these resources, in particular the selection of the beneficiaries of the aid. See, recital 60 of the Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (C/2016/2946) OJ C 262. p. 14, *in particular*, "Resources coming from the Union (for example from structural funds), from the European Investment Bank or the European Investment Fund, or from international financial institutions, such as the International Monetary Fund or the European Bank for Reconstruction and Development, are considered as State resources if national authorities have discretion as to the use of these resources (in particular the selection of beneficiaries)".

²⁰² See, footnote No 25 of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014, p.11, the Commission refers to the European Investment Bank (EIB) and European Investment Fund (EIF) "investing at own risk and from own resources", as private investors. See also, Article 2(72) of the 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. OJ L 187, 26.6.2014, p. 23, which defines independent private investor as an "investor who is not a shareholder of the eligible undertaking in which it invests, including business angels and financial institutions, irrespective of their ownership, to the extent that they bear the full risk in respect of their investment".

²⁰³ See further, Section 2.4 of the State Aid SA. 57409 (2020/N) – Latvia COVID-19: Recapitalization Fund (06.07.2020) C (2020) 4656 FINAL at pp. 4-5.

²⁰⁴ Recital 31 of the of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014, p.11. See also, Communication from the Commission concerning the prolongation and the amendments of the Guidelines on State Aid to Promote Risk Finance Investments (2020/C 224/02), in

hypothetical private investor to seek either the most profitable investment or short-term profits.²⁰⁵ It is also irrelevant for the test whether the hypothetical private investor might have obtained a better return on its capital by investing it elsewhere.²⁰⁶ The overall financial success of the investment, however, provides a strong indication that the original decision was driven by the commercial paradigm. Accordingly, State aid is present whenever MS makes available to an undertaking funds, which in the normal course of events would not be provided by a hypothetical private investor applying ordinary commercial criteria and disregarding other considerations of social, political or philanthropic nature.²⁰⁷

Due to the hypothetical nature of the private investor referred to in MEOP, there is no need to demonstrate that an actual private investor would have invested into the capital of the investee under consideration. However, “a capital contribution from public funds satisfies the test of a private investor operating under normal conditions of a market economy and does not imply the grant of State aid if, *inter alia*, it was made at the same time as a significant capital contribution by a private investor made in comparable circumstances”.²⁰⁸ In accordance with the recital 34 of the Risk Finance Guidelines, an independent private investment will be considered economically significant by the Commission, if it reaches 30% of the overall volume of the same investment transaction. It is worth mentioning that such threshold is indicative only by definition. The economic significance may be achieved potentially with a smaller number of shares due to the specific corporate architecture and/or overall shareholding structure. The draft CMDAF Baltic SME IPO Fund Investment Strategy limits the maximum volume of the investment within a specific public offering to 50% of the capital shares, thus, leaving remaining 50% of the offering to be acquired by the private investors.²⁰⁹ The percentage of the independent private co-investment reaches and surpasses required 30% threshold per each risk finance investment executed “in the same investment round, at the same time, same price, same risk, and according to the respective rules of the chosen trading platform”.²¹⁰ The aforementioned restrictions on subscriptions imposed by the CMDAF Baltic SME IPO Fund draft Investment Strategy on the Fund ensures compliance with the *pari passu* requirement.

particular, In the Guidelines on State aid to promote risk finance investments, point 174 is replaced by the following: “The Commission will apply the principles set out in these Guidelines for the compatibility assessment of all risk finance aid to be awarded from 1 July 2014 to 31 December 2021”.

²⁰⁵ Case C-305/89 Italian Republic v Commission of the European Communities [1991] ECR I-1603, paras. 19-20. See also Joined cases T-228/99 and T-233/99 Westdeutsche Landesbank Girozentrale and Land Nordrhein-Westfalen v Commission of the European Communities [2003] ECR II-435, paras. 250, 251, 253 & 258.

²⁰⁶ Case T-163/05 Bundesverband deutscher Banken eV v European Commission [2010] ECR II-00387, para. 58; Joined cases T-415/05, T-416/05 and T-423/05 Hellenic Republic (T-415/05), Olympiakes Aerogrammes AE (T-416/05) and Olympiaki Aeroporia Ypiresies AE (T-423/05) v European Commission [2010] ECR II-04749, para. 2133; Case C-124/10 European Commission v Électricité de France (EDF), French Republic, Iberdrola SA [2012] OJ C 217, 21.7.2012, paras 83-85.

Case T-163/05 Bundesverband deutscher Banken eV v European Commission [2010] ECR II-00387, para. 58

²⁰⁸ Case T-163/05 Bundesverband deutscher Banken eV v European Commission [2010] ECR II-00387, para. 58

²⁰⁹ Investment Strategy 6.1

²¹⁰ Section 2.3.3. of the Commission Decision on State Aid SA. 57590 (2020/N) – Czechia IPO Fund (08.10.2020) C (2020) 6805 FINAL at p. 5

Sub-concluding Remarks

It is reasonable to suggest that the risk finance scheme under examination does not confer economic advantage on IFIs co-investing into the Fund or private investors co-investing alongside the Fund into the investees. The risk finance scheme falls outside the scope of Article 107(1) TFEU on the level of the investors.

9.2.1.2 The Level of the Financial Intermediary and/or its Manager***The Financial Intermediary***

Recital 37 of the Risk Finance Guidelines provides that “the Commission considers that a financial intermediary is a vehicle for the transfer of aid to investors and/or enterprises in which the investment is made, rather than a beneficiary of aid in its own right, irrespective of whether the financial intermediary has legal personality or is merely a bundle of assets managed by an independent management company”, unless there are indications to the contrary.²¹¹ In the present case there are no actual or potential implications to question aforementioned presumption. On the contrary, present of the IFI co-investing on the equal terms with GIVs into the Fund constitute a good evidence of MEOP compliance.

The Remuneration of the Manager

In accordance with the CMDAF Baltic SME IPO Fund draft Structure, the Manager will act merely as a manager of the Fund in line with the arm’s length principle, i.e. without it co-investing alongside the Fund. In such case, the Manager will be considered as “a vehicle to channel the financing and not a beneficiary of aid, as long as it is not overcompensated”.²¹² If the Manager is selected as a result of the open, transparent, non-discriminatory and objective selection procedure and its remuneration reflects current market levels in a comparable actual or hypothetical situation, it shall be presumed that the Manager does not receive State aid.²¹³ Even if a public entity is appointed as a Manager without selection procedure, it shall be presumed that such Manager does not receive State aid as far as its remuneration reflects market levels.²¹⁴ Regardless of the selection and appointment procedure implemented within the framework of the risk finance scheme under examination, the key assessment criterion will remain remuneration of the Manager. Recital 143 of the Risk Finance Guidelines provides that the remuneration of the Manager may include an annual management fee, as well as performance-based incentives, such as excessive returns.²¹⁵ Insofar as the Manager receives a management fee and share of the excessive returns in line with the market-based remuneration rates available for the fund managers in comparable private equity funds, it will remain outside the scope of the EU State aid law.

²¹¹ In case of a co-investment, however, “financial intermediary may constitute aid unless such transfers or co-investments are made on terms which would be acceptable to a normal economic operator in a market economy”.

²¹² Section 2.3.3. of the Commission Decision on State Aid SA. 57590 (2020/N) – Czechia IPO Fund (08.10.2020) C (2020) 6805 FINAL at p. 5

²¹³ Recital 40 supra note 39

²¹⁴ Recital 41 supra note 39

²¹⁵ Recital 143 supra note 39. In particular, “The share of the excessive returns will be determined by the investors and defined in the corresponding agreement”.

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Sub-concluding Remarks

It is reasonable to suggest that the risk finance scheme under examination does not create economic advantage to the Fund and/or overcompensate its Manager. The risk finance scheme falls outside the scope of Article 107(1) TFEU on the level of the Fund and its Manager.

9.2.1.3 The Level of the Forthcoming Investees

CMDAF Baltic SME IPO Fund Capital Injections

In the context of the State aid analysis on the level of the investees, the transfer of the financial means from the Fund to the end beneficiaries constitutes the starting point of the assessment. It is necessary, therefore, to ascertain control of the MS over the financial means in the Fund as well as evaluate imputability of the corresponding measure to the MS. The formal independence of the financial intermediary from the state authorities does not suffice, in itself, to exclude state imputability. Thus, it is necessary to consider all circumstances to determine whether a particular measure is imputed to the MS or it is initiated as a result of the autonomous action of the financial intermediary.²¹⁶ The imputability largely depends on the extent of the state shareholding, state involvement in the appointment of the management board and other similar considerations. Although enjoying its rights as shareholders, MSs and IFIs and/or other qualified private investors cannot influence directly or indirectly decision-making process of the independent Manager, which takes decision exclusively based on the commercial viability of the corresponding investment. Moreover, financial means of the Fund remain under the complete control of and at the full disposal of the Manager. Accordingly, the funds of the Fund are no longer attributable to the MSs due to the ultimate lack of control.

Economic Advantage

In the recital 44 of the Risk Finance Guidelines the Commission acknowledges at least partial passage of the aid to the investees, when State aid manifested itself either on the level of the investor or the financial intermediary and/or its manager. This presumption remains accurate even if investment decisions have been taken by the Manager based on a purely commercial logic. In the light of the fact that State aid has not been established on any of the aforementioned levels of the risk finance scheme, "it is considered that the investee undertakings are not beneficiaries of the State aid, because the investment under consideration has been made under the market terms."²¹⁷

²¹⁶ It may be necessary to consider (i) the legal status of the undertaking (in the sense of its being subject to public law or ordinary company law); (ii) the integration of the undertaking into the structures of the public administration; (iii) the degree of supervision and management of the body by the public authorities; (iv) the nature of the undertaking's activities and the exercise of those activities on the market in normal conditions of competition with private operators; (v) the extent to which the contested decision was subject to the approval of, or requirements imposed by, the public authorities; (vi) the way in which the measure is presented by the public authorities.

²¹⁷ Recital 44 of the of the of the Communication Guidelines on State aid to promote risk finance investments. OJ C 19, 22.1.2014, p.12

Sub-concluding Remarks

It is reasonable to suggest that the risk finance scheme under examination does not manifest itself on the level of the forthcoming investees. The risk finance scheme falls outside the scope of Article 107(1) TFEU, because, as a general rule the Fund invests on the market terms.

9.2.1.4 Concluding Remarks

The comprehensive assessment confirms applicability of the EU State aid law to the risk finance scheme under examination. The State aid risk analysis indicates compatibility of the scheme with the MEOP requirements on all corresponding levels, namely (i) the level of the IFIs co-investing into the Fund, (ii) the level of the private investors co-investing alongside the Fund into the forthcoming investees; (iii) the level of the Fund accommodating the financial means, (iv) the level of the AIFM managing the financial means of the Fund, as well as (iv) the level of the forthcoming investees constituting final beneficiaries. Therefore, risk finance scheme under examination does not constitute State aid within the meaning of Article 107(1) TFEU.

9.3 Matters Relating to the Setup of the Fund

The Baltic states support a variety of different legal forms for entrepreneurial activities. This presents an opportunity to tailor and chose the most appropriate legal framework for the goals and activities of the Fund.

However, despite this backdrop, the rules regulating the most common types of corporate entities, namely – Public and Private Limited companies and two types of partnerships – General Partnership and Limited Partnership are similar. In addition, the activity of the European legislator has created some globally well-known types of legal arrangements that where not traditional to the Baltic states, namely, the fiduciary Bundle-of-Assets.

Given that a detailed analysis and conclusion on the most appropriate form and domicile for the Fund requires a holistic assessment, the foregoing analysis is characterised by strict conditionality. Furthermore, in the absence of some crucial strategic commitments, the following assumptions were made:

- The planned shareholder structure of the Fund is either: Latvia – 33.(3)%
- Lithuania – 33.(3)%
- Estonia – 33.(3)%

or

- Latvia – 25%
- Lithuania – 25%
- Estonia – 25%
- IFI investors – 25%

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The base scenario of investment in the Fund (on the fund level) is all three Baltic governments. Having an IFI joining them is considered beneficial, but not crucial for the process to move forward.

1. The use of assets from the state budget is not subject to conditions the effect of which would hinder the MEO compliance.
2. The Fund will pursue status of alternative investment fund (AIF) within the meaning of Article 4(1) (a) Directive 2011/61/EU

In the light of the aforementioned, for the purposes of this report, only legal forms that permit granting of an AIF status will be examined. In Latvia²¹⁸ and Estonia²¹⁹ an AIF status may be granted if the fund is a Public Limited, Limited Partnership or Bundle-of-Assets, whereas in Lithuania Public Limited, Private Limited; General Partnership; Limited Partnership and Bundle-of-Assets form is available.²²⁰

Therefore, following analysis will be conducted and conclusions will be posited focusing on Public Limited, Limited Partnership and Bundle-of-Assets legal archetypes.

9.3.1.1 *Brief Overview of Specific Archetypes*

Public Limited

Introduction

The term “Public Limited” is used to connote a legal entity governed by private law having the quality of legal personality and having the characteristic that its shares that correspond to its capital are capable of free transfer.

This is the most appropriate legal form for realisation of an economic interest having general goals and undetermined existence. This is the preferred form for an evergreen fund allowing the fund to constantly raise capital by utilising capital markets or over-the-counter private investors.

Control Type

Utilising the traditional model of governance, governance of a Public Limited is divided into three levels (or two levels if management and supervision is entrusted to the management) – the shareholders, management and supervision council.

Shareholders are persons that hold at least one company share. Shareholders can exercise their rights in the supreme corporate body of the company - a shareholder meeting. Each shareholder has the ability to influence the company's decisions in the

²¹⁸ Alternatīvo ieguldījumu fondu un to pārvaldnieku likums, Article 30

²¹⁹ Investēerimisfondide seadus Vastu võetud 14.12.2016, Article 2(2)

²²⁰ Lietuvos Respublikos Informuotiesiems Investuotojams Skirtų Kolektyvinio Investavimo Subjektų Įstatymo, Article 2 definition 12 and Article 4 (2).

meeting by votes, that are proportional to the shares owned by the person, unless the Public Limited issues different categories of shares. Shareholders meeting generally decides on changes in the articles of association, share capital, dividend distribution and other decisions of utmost importance.

Management of the company is usually carried out by the management board which is elected by the shareholders. The managing bodies main competence includes daily management and accounting of the company.

The supervision is carried out by the supervisory board that is elected by the shareholders. The supervisory council is a collegial body that is responsible for representing the interests of shareholders, planning the activities of the company and supervising the management board.

In short, shareholders are responsible for giving general strategic guidance and setting the annual goals. Management is tasked with conducting the usual commercial activity by representing (having capacity to bind the Public Limited) and managing the assets of the Public Limited, with supervisory board overseeing the daily activities of the management.

Economic Stake Type

An economic stakeholder (shareholder) that injects its thing or a right that has economic worth (assets) into the capital of a Public Limited, receives a right that has economic worth corresponding to its injection into Public Limited's capital and ownership of which is transferable without administrative decision of a state or the Public Limited or its other economic stakeholders, unless specific arrangements exist. Economic stakeholders cannot withdraw their injected capital unilaterally. Usually, the share is indivisible.

Capital Separation Type

A Public Limited separates economic stakeholders' capital based on personality. This means that upon injection of assets in its capital, Public Limited becomes an owner of assets and the fact that it is the case that the economic value of its capital is 0 does not affect capital of the shareholders, unless specific arrangements have been made with respect to particular company (e.g. Comfort Letter, specific obligations under a shareholders' agreement) and the law prescribes a specific right (as opposed to general right to damages) of enforcing such arrangements.

Establishing

Public Limited, after satisfying certain preconditions, including an agreement between founders, is incorporated by an administrative or judicial decision of authority entrusted with incorporation of enterprises (commercial register).

Limited Partnership

Introduction

The term “Limited Partnership” is used to connote a legal entity governed by private law based on convention between multiple persons without legal personality where at least one economic stakeholder (partner) of that convention is shielded from execution of the liabilities of the legal entity.²²¹

This is the most appropriate legal form for various IV's and non-permanent investment projects.

Control Type

The capital consisting of economic stakeholder's personal assets is separated from their personal capital and is managed by a partner or partners that are not limited partners. This means that the common assets are managed by a person that is not shielded from the execution of liabilities of the Limited Partnership.

Economic Stake Type

Generally, economic stakeholders do not receive any rights that have an economic worth for their participation in a Limited Partnership. In accordance with the interest separation and due to lack of legal personality, economic stakeholders remain owners of the assets demarcated for the purposes of pursuing an economic activity of a Limited Partnership. The capital gains or losses of a Limited Partnership are distributed proportionally unless the partnership agreement prescribes a different distribution. Economic stakeholders can withdraw their injected capital unilaterally, subject to specific commitments undertaken in a partnership agreement, however usually this withdrawal has third party effect only after this action is constituted in the commercial register.

Capital Separation Type

A Limited Partnership separates economic stakeholders' capital based on interest (activity) separation. Interest separation means that, for the purposes of execution of liabilities, assets used for the purposes of the economic activity of a Limited Partnership will have priority over economic stakeholders' personal capital (demarcated assets). Whereas the execution of liabilities of a Limited Partnership, cannot affect limited partners personal capital. If it is the case that the economic value of a Limited Partnership's capital is 0, the liabilities will be executed against an economic stakeholder's personal capital, unless that economic stakeholder is a limited partner.

Establishing

The Limited Partnership is established by an agreement between the partners, however is constituted as an entity by an administrative or judicial decision of authority entrusted with incorporation of enterprises (commercial register).

²²¹ Wallach, Frederick. Introduction to European Commercial Law. New York, N.Y., Oceana Publications pp.132-133.; Terry Prime and Gary Scanlan Limited partnership reform - the entity, the fiduciary duties and the execution of deeds, Comp. Law. 2007, 28(9), 26

Fiduciary Bundle-of-Assets (Under AIF Legal Framework)***Introduction***

While the FBA is not formally defined, its function and purpose is akin to a legal entity known in the common law jurisdictions – the trust. In continental terms this entity may be defined as an unowned capital managed by a certain legal person without that person gaining ownership, nor the capital's previous owners losing interest to their assets (fiduciary relationship).

Control Type

The control of FBA, which does not have a quality of legal personality, is controlled by a manager, necessarily a legal person. The relationship between the FBA and the manager is of custodian nature conceptually similar to a relationship between the inheritance consisting of bundle-of-assets and the custodian of such inheritance;²²² though, it must be emphasised, no undue analogies should be drawn from that legal framework (legal norms regulating inheritance). Therefore, a manager acts in the name and for the benefit of the FBA.

Economic Stake Type

The bundle-of-assets forms a single property right and is unaffected by the changes in the content of the bundle-of-assets. The investors that have injected their assets in the bundle-of-assets receive a part of that property right called "a unit". This unit is freely transferable.

Capital Separation Type

An FBA separates economic stakeholders' capital based on person-less fiduciary duty. This means that upon injection of a thing or a right that has economic worth into FBA's capital economic stakeholder is no longer an owner of that thing or right that has economic worth, retaining only a right of economic worth that represents a stake in FBA's capital and the fact that it is the case that the economic value of FBA's capital is 0 does not affect the capital of the economic stakeholder's personal capital.

Establishing

An FBA is established by a decision of an authority that regulates financial and capital markets in the respective state.

²²² See, for example, Civillikums. Valdības Vēstnesis, 42, 22.02.1937. Article 662.

9.3.1.2 Available Forms in the Baltic States

Public Limited

Estonia (Aktsiaselts)

The general model of Public Limited prescribed in the law of Estonia is generally consistent with the abstract model outlined in Figure 14 Public Limited Structure. However, the AIF regulation prescribes following deviations:

1. Possibility of unilateral redemption. Unilateral withdrawal of capital injected is possible and regulated by the internal procedures of a Public Limited.
2. Divisibility of a share. A share may be divided into fractional shares.
3. Prohibition of issuing preferred shares.²²³

In general, the law of Estonia diverges from rest of the Baltics on the following matters:

1. Shareholders obligation to contribute to the capital of a Public Limited. Law of Estonia prescribes an obligation to a shareholder that has consented to such an undertaking to provide capital. This means that such commitments could be executed through judicial settlements.
2. More permissive rules on prohibition to acquire own shares. Law of Estonia permits more exceptions for acquisition of a Public Limited's own shares. These are:
 - a. This occurs within five years after adoption of a resolution of the general meeting which specifies the terms and conditions and term for the acquisition or taking as security of shares and the minimum and maximum amounts to be paid for the shares;
 - b. The sum of the nominal values or book values of the shares held or taken as security by the public limited company does not exceed one-tenth of the share capital; and
 - c. Acquisition of the shares does not cause the net assets to become less than the total of share capital and reserves which pursuant to law or the articles of association shall not be paid out to shareholders.
3. Prohibited loans.²²⁴ Law of Estonia explicitly prohibits loans to shareholders, including to parent shareholders, members of the management, supervisory board or its procurator. This means that such a loan agreement is void.

²²³ Investeeringimisfondide seadus Article 17(3)

²²⁴ Äriseadustik Vastu võetud 15.02.1995 Article 281

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Latvia (Akciju Sabiedrība)

The general model of Public Limited prescribed in the law of Latvia is generally consistent with the abstract model outlined in Figure 14 Public Limited Structure. However, the AIF regulation prescribes following deviations:

1. Possibility of unilateral redemption. Unilateral withdrawal of capital injected is possible and regulated by the internal procedures of a Public Limited, if the Fund is registered as open-type;
2. Divisibility of a share. A share may be divided into fractional shares. This option is borrowed from corporate law of United States, where such action (stock-splitting)²²⁵ is performed in the interests of increasing liquidity of a share.

In general, the law of Latvia diverges from rest of the Baltics on the following matters:

- Prohibition to issue personal shares or options. Unlike laws of Lithuania and Estonia, if a Public Limited has received an AIF status issuance of personal (employee) shares is prohibited.²²⁶

Lithuania (Akcine Bendrove)

The general model of Public Limited prescribed in the law of Lithuania is generally consistent with the abstract model outlined in Figure 14 Public Limited Structure, except:

- Two-level governance and single-person management as a default rule. The key feature of the law of Lithuania is a single-person manager and two-level governance structure as the default governance setup, with a possibility to establish a traditional management board and a supervisory board as an option. This feature is particularly relevant in the context of the Fund because of its IV nature that makes some of the rationale behind the traditional setup less relevant.

With respect to AIF framework:

1. Possibility of unilateral redemption. Unilateral withdrawal of capital injected is possible and is regulated by the internal procedures of a Public Limited.
2. Prohibition to acquire own shares if the AIF status company is an investment company with variable capital (open-type).²²⁷

In general, the law of Lithuania diverges from rest of the Baltics on the following matters:

²²⁵ John Downes and Jordan Elliot Goodman Dictionary of Finance and Investment Terms (3rd ed. Barron's 1991) p.425.

²²⁶ Alternatyvo fondų un to pavaraldineiku likums Article 46(8)

²²⁷ Lietuvos Respublikos Informuotiesiems Investuotojams Skirtų Kolektyvinio Investavimo Subjektų Įstatymo, Article, Article 23(7)

1. Right to acquire own shares. Unlike laws of Latvia and Estonia, Law on Companies prescribes a right, not a list of exceptions, to acquire own shares. The exercise of this right is conditioned on:
 - a. A decision of the general meeting of shareholders. The decision of the general meeting of shareholders must, inter alia, specify the following:
 1. The purpose of the acquisition of the shares;
 2. The maximum number of the shares permitted for acquisition;
 3. The time limit within which the company may acquire its own shares. The time limit may not exceed 18 months;
 4. The maximum and the minimum share acquisition price;
 5. The procedure for selling its own shares and the minimum sale price. The procedure for selling the shares must ensure equal opportunities for all shareholders to acquire the shares of the company.
 - b. The total nominal value of its own shares being acquired by a company together with the nominal value of its other own shares already held by the company may not exceed 1/10 of the capital;
 - c. A company may not acquire its own shares if this would result in the equity capital falling below the aggregate amount of the paid-up capital, legal reserve and reserve for acquisition of its own shares;
 - d. A company shall be prohibited from acquiring its partly paid-up own shares;
 - e. A company may acquire its own shares if the reserve for acquisition of its own shares is formed in the company and the amount thereof is not less than the aggregate amount of the acquisition values of the its own shares being acquired.
 - f. Having acquired its own shares, a company may not exercise the property and non-property rights attached to the shares. The acceptance of shares as a safeguard for discharge of an obligation shall be equivalent to the acquisition of its own shares.
2. Legal reserve. A Public Limited has an obligation to have a legal reserve – 1/10 of the capital at the end of each financial year.
3. Shareholders obligation to contribute to the capital of a Public Limited. Law of Lithuania prescribes an obligation to a shareholder that has voted “in favour of providing a Public Limited with additional capital” at the general meeting to

provide such capital.²²⁸ This means that such commitments could be executed through judicial settlements.

Key Differences in Context

Generally, all corporate laws of Baltics vest very similar rules on structure, management, status of capital and establishment of a Public Limited. Therefore, no material benefit is envisioned in incorporating the Fund as a Public Limited in one as opposed to another Baltic state.

Bundle-of-Assets

The introduction of this form is caused by the implementation of AIFM Directive and Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) and it is observed that laws of Baltic states vest very similar rules on regulation of FBA. Therefore, in our opinion, there are no material differences or advantages of establishing the Fund in this form in a specific state.

Limited Partnership

Limited Partnership has been the preferred form of administering risk finance measures.²²⁹

The only universally applied criteria for this section will be the degree of party discretion (freedom to modify the structure and rules regarding Limited Partnership), the rest of the qualities of the respective legal frameworks will be assessed in purely relative terms.

Estonia (Usaldusühing)

The model of Limited Partnership prescribed in the law of Estonia is generally consistent with the abstract model outlined in Figure 13 Limited Partnership Structure.

Party Discretion

Limited Partnership regulation in Commercial Code of Estonia allows the highest degree of party discretion. Commercial Code of Estonia permits members to stipulate in their partnership agreement that a limited partner may participate in the management and representation of a Limited Partnership.

The law of Estonia diverges from rest of the Baltics on:

— Comprehensive framework for tradable capital participation

Unlike in the general regulatory regime of the Commercial Code, the capital of a Limited Partnership under AIF status form forms a unit of assets that is severed in to

²²⁸ Lietuvos Respublikos akcinių bendrovių įstatymas Article 14(3)

²²⁹ See, e.g. European Commission Letter to Latvia on 23 December 2004 N 360/2004, section 2.8.; see also, Morris C. The private fund limited partnership: the reform company lawyers have been waiting for?, Comp. Law. 2017, 38(6), 192-194, p.192

smaller distinct units that represent partner's *pro rata* participation in a Limited Partnership's capital - units. These units can be issued with different rights (for example, units that do not entitle the holder to vote in convention of the members). Moreover, given that units represent participation in the capital,²³⁰ are freely transferable²³¹ and grant the transferee the ownership stake in the common capital of the Limited Partnership, units are likely to be classified as tradable securities pursuant to most laws regulating financial instruments. While this possibility is also available in Latvia, Latvia's legal framework is not as comprehensive and well-integrated as the Estonia's framework.

Latvia (*Komandītsabiedrība*)

The model of Limited Partnership prescribed in the law of Latvia is generally consistent with the abstract model outlined in Figure 13 Limited Partnership Structure. However, the law of Latvia includes rather intriguing reference that a partnership can own property rights²³² even though it appears rather inconsequential and with limited practical effect.²³³ As a derogation, under the AIF regime a Limited Partnership must have a date of expiry.²³⁴

Party Discretion

Unlike Estonia, law of Latvia lacks of possibility to amend the role of a limited partner.

Lithuania (*Komanditine Ūkine Bendrija*)

The key divergence from the abstract model outlined in Figure 13 Limited Partnership Structure. and other laws of the Baltics is the legal personality of Limited Partnership.²³⁵ This means that unlike in most states, including Estonia, a Limited Partnership and not its partners become the owner of the assets it acquires using common assets.

Party Discretion

Law on Partnerships offers the most norms the content of which cannot be changed by the agreement of the parties.

The law of Lithuania diverges from rest of the Baltics on the following matters:

²³⁰ Investērimisfondide seadus Article 21(1)

²³¹ Investērimisfondide seadus Article 21(2)

²³² Komerclikums Article 90

²³³ Since, pursuant to Article 94 of Komerclikums, partners personal capital is not shielded from execution of the Limited Partnership's liabilities, whereas the capacity to own property is usually seen as quality of a legal personality, see, for example, Prime T., Scanlan G. p.263; Linards Muciņš 'Juridiskās personas jēdziens' In: Inovāciju juridiskais nodrošinājums: Latvijas Universitātes 70. konferences rakstu krājums. Rīga: LU Akadēmiskais apgāds, 2012, pp.163-170. Proper "endowment" of a legal personality to a limited partnership is not limited to a brief reference in a single norm and must be observed conceptually and holistically

²³⁴ Alternatīvo ieguldījumu fondu un to pārvaldnieku likums Article 45(2)

²³⁵ Lietuvos Respublikos ūkinių bendrių įstatymas Article 2(4)

1. Residence requirement.²³⁶ The head office of a Limited Partnership must be established and persist in Lithuania;
2. Transferability of limited partner's stake.²³⁷ Law of Lithuania recognizes a general transferability of a limited partners stake (and thus contribution in the capital of Limited Partnership);
3. Capacity to own assets. As a corollary of the legal personality, a Limited Partnership is capable of owning assets. Therefore, unlike in Latvia and in Estonia, partners do not become owners upon acquisition of a shares or assets other assets by a Limited Partnership;
4. Lack of right to deprive managing partner of his rights of management and representation. Unlike the law of Latvia and Estonia, law of Lithuania lacks right of a partner to initiate court proceedings to revoke the right of management from a mismanaging managing partner. However the law does include a right to expel a member.

Key Differences in Context

Generally, all corporate laws of Baltics vest very similar rules on structure, management, status of capital and establishment of a Limited Partnership. However, unlike with Public Limited, there appear to be important nuances both in general corporate law and in the regulation of Limited Partnerships in the context of AIF legal framework.

Estonia

An advantage of a Limited Partnership in Estonia is the fact that it can issue units and that the law ensures proper framework for the functioning of this option. This allows exit of partners without the necessity of liquidation and the entry of new partners. Moreover, since units represent contribution in the capital, the likely option of listing is of importance. The fact that the legal form combines flexibility of a Limited Partnership while retaining the freedom of exit and entrance of the Public Limited makes it an appropriate form for an IV.

Latvia

Latvia supports setup of an AIF in the form of a Limited Partnership. Whilst the legal framework in Latvia is less comprehensive as in Estonia, a Latvian Limited Partnership appears appropriate legal form for to be employed for the purposes of the Fund.

Lithuania

Lithuania supports setup of an AIF in the form of a Limited Partnership. However, law of Lithuania has some more stringent limitations especially in the specific regulation of an AIF set up as a Limited Partnership. For example, the requirements pertaining to non-

²³⁶ Lietuvos Respublikos ūkinių bendrijų įstatymas, Article 2(8)

²³⁷ Lietuvos Respublikos ūkinių bendrijų įstatymas, Article 9(1) 3)

association of assets with the manager of the AIF are comparatively more specific and restrictive than in Latvia.²³⁸ Overall the framework is similar to framework in Latvia.

On a Bilateral or Trilateral International Organisation

In broad terms, in international law states are generally free to regulate any subject-matter, insofar it is not prohibited by other relevant norms of international law the content of which is the contrary.²³⁹ This includes possibility of an establishing a multilateral (such as World Bank or Inter-American Development Bank) or bilateral or regional international organisations the purpose of which is investment (such as Nordic Environment Finance Corporation). Such organisations are not established by an act of domestic authority but rather by an international agreement or, possibly, international unilateral acts and therefore such entities exist outside of the domestic legal orders. This also means that states are free to prescribe special arrangements, such as, privileges (such as exemptions from taxation) and immunities (such as immunities from summons of the court), that deviate from the internal law.

However, membership of a special type of international organisation – the EU, has internally restricted this freedom. In accordance with its role of protecting the integrity and autonomy of EU law, the CJEU has recently found that if the subject-matter of an intra-EU international agreement (parties to the international agreement are member states of the EU) falls within the ambit of EU law and the parties have prescribed that any dispute arising of the interpretation or application of such agreement is settled by an instrument of judicial settlement that is not-CJEU the dispute resolution clause of that international agreement is precluded by the autonomy of EU law, meaning – unenforceable.²⁴⁰ This, however, does not preclude an agreement that, pursuant to Article 272 of the TFEU, prescribes that the disputes should be settled at the CJEU (therefore conferring CJEU jurisdiction). However, this option has generally been used to accommodate multilateral intra-EU agreements concluded under the auspices of the EU²⁴¹ and in order to further the implementation of the internal market.²⁴²

For the purposes of the CMDAF Baltic SME IPO Fund project, the Fund could be established as a regional (pan-Baltic) international organisation. While it is very unlikely that such organisation would be exempt from the applicability of State Aid rules, it could be used as a legitimate tool to protect the commercially driven nature of the Fund, for example, by setting certain immunities of the members of the Board. This could be used, if properly implemented and respecting rules on State Aid, to either exempt the Fund

²³⁸ Finanšu un kapitāla tirgus komisijas 2020. gada 18. augusta noteikumi Nr. 134 "Normatīvie noteikumi par kritērijiem kopējo ieguldījumu uzņēmuma atzīšanai par alternatīvo ieguldījumu fondu" vis-à-vis Lietuvos Respublikos Informuotiesiems Investuotojams Skirtų Kolektyvinio Investavimo Subjektų Įstatymo, Articles 16-19.

²³⁹ Permanent Court of International Justice The Case of SS. Lotus (France v. Turkey) Series A.-No. 70 September 7th, 1927, p.18

²⁴⁰ Court of Justice of the European Union Judgement of 6 March 2018, C 284/16, Achmea

²⁴¹ E.g. 1968 Brussels Convention on jurisdiction and the enforcement of judgments in civil and commercial matters. Done at Brussels on 27 September 1968

²⁴² Koen Lenaerts, Ignace Maselis and Kathleen Gutman EU Procedural Law (OUP 2015) pp.717-720

from applicability of TFEU 107(1) due to lack of imputability²⁴³ or at least buttress the compliance with MEO rationale.

It must be emphasised, that this option involves advanced cooperation between governments and administrative authorities of the Baltic states and **could be viewed unfavourably by the Commission**. Therefore, while remaining cognizant of the economic rationale of such a legal form, this option should not be pursued.

Conclusion

In the opinion of the experts, the most appropriate form and domicile for the Fund is a Limited Partnership.

Firstly, the Limited Partnership grants the most freedom of setup. Unlike Public Limited that comes with pre-determined structural setup, the Limited Partnership grants freedom to set up structural, decision-making rules and practices according to the specific circumstances of the Fund.

Secondly, the Limited Partnership fits the closed-type of the Fund. Given that capital raising after the initial injection is not expected and the listing not considered as the basic option any advantages of the Public Limited are nullified.

Thirdly, the Limited Partnership is more conceptually appropriate. Following the limited relevance of list-ability of the Fund, at least at the initial stages of the Fund's lifetime, and the IV-nature of the Fund, the determined purpose and longevity minded idea behind Limited Partnerships as opposed to the undetermined minded idea behind the Public Limited, prevails.

9.3.1.3 The Internal Structure of the Fund

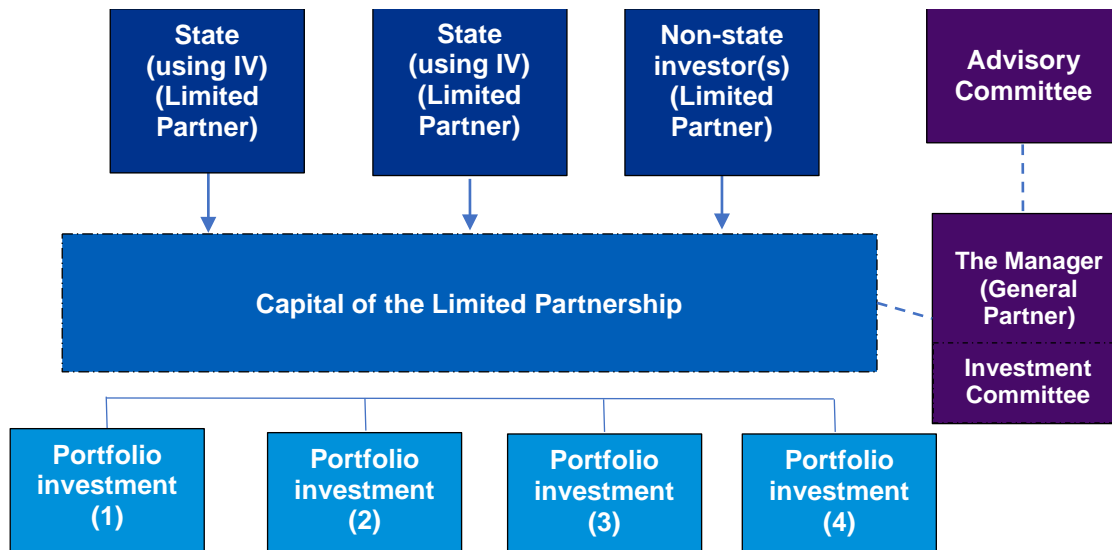
Given the assumption of pursuing an AIF status, the internal structure and functioning of the Fund is subject to some mandatory rules. The most material are outlined in this section.

Corporate Arrangements

As noted above, it is recommended to setup the Fund as a Limited Partnership. However, in the interests of comprehensive analysis, the possible structure of a Limited Partnership and Public Limited form of the Fund will be described.

²⁴³ See, for example, Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union C/2016/2946, paragraph 3.1

Figure 13 Limited Partnership Structure



Source: KPMG

Introduction

This structure envisions states (using government-controlled investment vehicles) and non-state investors (either individually or through a collective IV) as limited partners that commit and pool their assets to single Limited Partnership which then uses the common assets (the capital) to invest. Under this structure the Fund will apply for the grant of the AIF status with an external manager, a legal person, possessing an AIFM status or produce evidence that it is likely to get an AIFM status if chosen.

The Limited Partners

Limited Partners are the investors – persons that provide or commit assets to the capital of the Fund to be invested by the Manager, a general partner. The Limited Partners cannot participate in the management of the capital.

The Manager

Limited Partnership established in one of the Baltic states, would enlist an independent manager, selected in accordance with the necessary procedures, as a general partner who would be responsible for investing the common assets (the capital) in accordance with the partnership agreement, the investment strategy and the interests of the investors. The Manager would have the power and obligations:

1. To represent the Fund in relations with third parties and to conclude transactions on behalf of the Fund;
2. To manage the assets of the Fund, by, for example, participating in the governance of the portfolio companies (especially if some investment strategy consideration would prescribe active shareholding);
3. To perform accounting and reporting obligations.

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The Investor Advisory Council

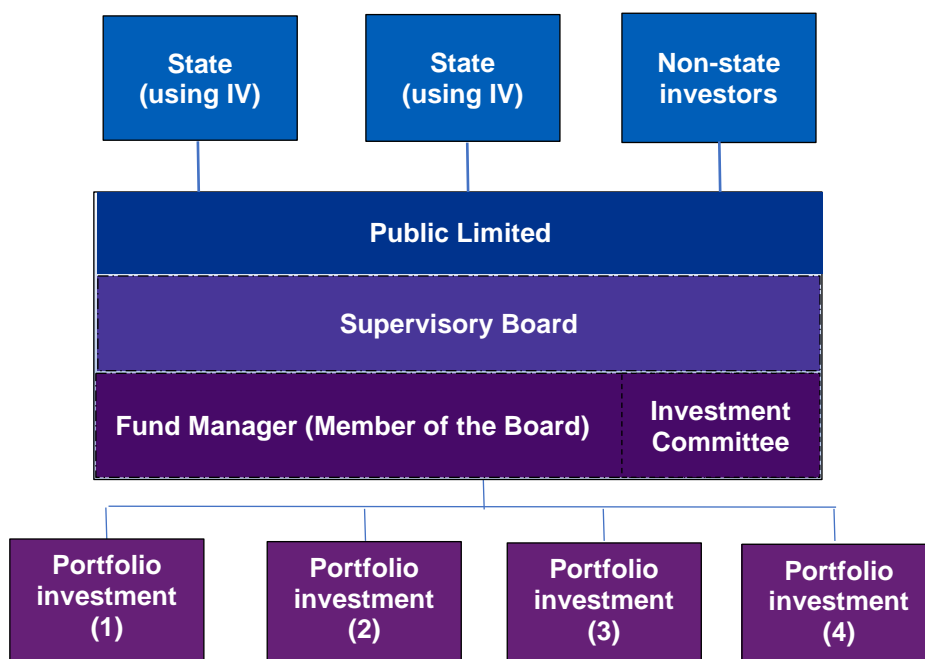
The Advisory Council, if established, would generally oversee and monitor the activities of the Manager. It would consist of experienced senior professionals nominated and representing the investors. It would have competence to:

1. To monitor the activities of the Fund, the implementation of the Fund's strategy, including the investments made and planned;
2. To decide on any existing or potential conflicts of interest related to the Fund and submitted for consideration by the Manager, a member of the Investment Committee or any Shareholder or about which the Advisory Council has become otherwise aware;
3. To decide on waivers and deviations from Fund Investment Strategy, based on proposal of Manager, within scope of authority given by the Fund agreement.
4. To consider, make recommendations, as well as take other necessary actions with respect to information submitted to the Advisory Council.

The Investment Committee

1. Best market practice is to fully delegate investment and divestment decisions to the key personnel of the Manager. Details to be discussed with the planned Fund investors, Baltic NPIs.

Figure 14 Public Limited Structure



Source: KPMG

Introduction

This structure envisions states (using GV's) and non-state investors as shareholders in an investment company. It is assumed that the Fund will be of a closed-end type and hence non-state investors will participate as the founders of the Public Limited thereby escaping the necessity for a round of capital raising. Under this model the Public Limited will apply for its registration as an AIF and as an AIFM under the internal manager registration.

The Supervisory Council

The Supervisory Council, if established, would oversee and audit the daily activities of the Manager. It would consist of key personnel of the investors. The Supervisory Council would have competence to:

1. To monitor the activities of the Fund, the implementation of the Fund's strategy, including the investments made and planned, and to provide its reports to the Shareholder;
2. To decide on any existing or potential conflicts of interest related to the Fund and submitted for consideration by the Manager, a member of the Investment Committee or any Shareholder or about which the Supervisory Council has become otherwise aware;
3. To consider, make recommendations, as well as take other necessary actions with respect to information submitted to The Supervisory Council.

The Manager

Public Limited founded in one of the Baltic states, would enlist an independent manager a legal person, selected in accordance with the necessary procedures. The Manager which either at the moment of selection must be registered as a AIFM or at least must demonstrate that it would meet the requirements to register as an AIFM.

The Investment Committee

The Manager would be assisted by an Investment Committee, established in and by the articles of association. Best market practice is to fully delegate investment and divestment decisions to the key personnel of the Manager. Details to be discussed with the planned Fund investors, Baltic NPIs.

Accountability and Reporting

Accountability and reporting requirements are set by the AIFM Directive.²⁴⁴ Therefore these requirements are harmonized and therefore no material differences between the laws of Baltic states arise. The relevant information to be provided is set out in the form annexed to the Regulation 231/2013 (Annex IV).

²⁴⁴ AIFM Directive Article 22-24

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The Fund's annual report should include, *inter alia*:

1. Balance sheet;
2. Profit and loss statement;
3. Cash flow statement;
4. Statement of changes in equity (or reserves);
5. Statement of funds in partners' accounts;
6. Summary of funds movements in Members' accounts;
7. All the reports and statements of the alternative investment fund manager and the corporate income tax return, as well as other such reports as are required by law.
8. In addition, the Fund should require the Manager to report on quarterly basis on:
9. information on paid-in capital,
10. Member account information,
11. A summary of the investment opportunities received during the quarter in question,
12. A report on each beneficiary in which the Fund has made an investment,
13. The valuation methodology of each Investment with justification,
14. Information on Members' parallel investments in beneficiaries and related fund co-investments,
15. Information on sales and sales revenues,
16. Information on the financial results of the Fund, as well as
17. Other topical issues or events that may significantly affect the Fund's operations.

9.4 Ownership Structure

9.4.1.1 Taxonomy and Analysis of Participating Interest According to Laws of Public Shareholding

Estonia

The Laws Regulating Public Economic Stake Holding

The public stake holding generally is regulated by *Riigivaraeasutus* (State Assets Act).

The Applicability of the Law Regulating Public Economic Stake Holding

The State Assets Act is applicable since, it is applicable to all assets of the state, that is, monetarily appraisable rights and obligations belonging to the state,²⁴⁵ including those held indirectly.²⁴⁶

Economic stake administrator in Estonia

Since no state will have a controlling interest, hence Estonia will have minority economic stake holding, the administrator of Estonia's stake holding will be the Ministry of Finance.²⁴⁷

Latvia

The Laws Regulating Public Economic Stake Holding

The public economic stake holding generally is regulated by:

1. *Valsts pārvaldes iekārtas likums* (Law on State Administration of Latvia);
2. *Publiskās personas kapitāla daļu un kapitālsabiedrību pārvaldības likums* (Law on Public Shareholding of Latvia);
3. *Publiskās personas finanšu un mantas izšķērdēšanas novēršanas likums* (Law on Transfer of Latvia).

The Applicability of the Law Regulating Public Economic Stake Holding

The Law on State Administration of Latvia is applicable since by incorporating a company the state is acting in private law.²⁴⁸

²⁴⁵ Riigivaraeasutus Article 1(3)

²⁴⁶ Riigivaraeasutus, Article 4(1)

²⁴⁷ Riigivaraeasutus, Article 5(3)

²⁴⁸ Valsts pārvaldes iekārtas likums. Latvijas Vēstnesis, 94, 21.06.2002 Article 87(1) subparagraph 3

None of the definitions prescribed in the Law on Public Shareholding of Latvia apply to minority economic stake holding, nor do they envision participation in a Limited Partnership. The closest definition for the case of a minority economic stake holding is found in Article 1(1) subparagraph 4 which prescribes:

“capital company controlled by a public person - a capital company, in which one or several public persons have a direct decisive influence;”

This definition, however, is inapplicable, due to, firstly, lack of control by a single state and, secondly, because, pursuant to customary international law, foreign state's acts in private law such as participating in a company,²⁴⁹ are considered as acts of a private person.²⁵⁰ Therefore, participation of Lithuania and Estonia cannot be considered as participation of “several public persons” even if the concept of “public person” does not have the same meaning as the concept used in the Law on State Administration of Latvia, that is, it covers any entity that, according to international law, is a state and is not limited to Latvia. It could be argued that the participation in the Fund, should the Fund be incorporated as a Public Limited, is covered by Articles 84 – 119, however this is controversial, since the capital company of public person is defined as:

“a capital company, in which all capital shares or voting stocks belong to one public person;”²⁵¹

Therefore, it is likely that the Law on Public Shareholding of Latvia is inapplicable. This, in all probability, would not relieve the Fund from observing the general principles of the management of the state assets.

Pursuant to Article 2(3) of the Law on Transfer of Latvia, the law is applicable to:

“[...] A capital company of a public person, a capital company in which a public person participation in the equity capital separately or combined exceeds 50 percent, as well as a capital company in which a capital company share of one or several public persons in the equity capital separately or combined exceeds 50 percent [...]”

Firstly, Latvia would not have a controlling interest in the Fund. Secondly, it appears that the Law on Transfer of Latvia is only applicable to legal entities having the quality of legal personality. Therefore, the Law on Transfer is likely to be inapplicable.

²⁴⁹ International Law Commission Draft articles on Jurisdictional Immunities of States and Their Property, with commentaries. Yearbook of the International Law Commission, 1991, vol. II, Part Two. pp.49-50, paras.7,8

²⁵⁰ Schmalenbach K. Commentary on Article 2. In: Dorr O., Schmalenbach K. (eds.) Vienna Convention on the Law of Treaties. A Commentary. Berlin: Springer-Verlag, 2012. p.36-37 para.26 Mann A. F. The Proper Law of Contracts Concluded by International Persons. British Yearbook of International Law, 1959, Volume 35; Gal I. The Commercial Law of Nations and the Law of International Trade. Cornell International Law Journal, Volume 6, No.1.; Separate Opinion of Judge Keith in: International Court of Justice Jurisdictional Immunities of the State (Germany v. Italy: Greece intervening), p.161-162, para.3

²⁵¹ Valsts pārvaldes iekārtas likums. Latvijas Vēstnesis, 94, 21.06.2002 Article 1(1) subparagraph 3

Economic Stake Administrator in Latvia

If the Fund is not setup as a subsidiary or established or incorporated in another Baltic state, and the Law on Public Shareholding is applicable, the administrator of the economic stake holding would be determined by the Cabinet of Ministers of Latvia.²⁵²

Lithuania

The Laws Regulating Public Economic Stake Holding

The public stake holding generally is regulated by:

1. *Lietuvos Respublikos valstybės ir savivaldybės įmonių įstatymas* (Law on State and Municipal Enterprises);
2. *Lietuvos Respublikos valstybės ir savivaldybių turto valdymo, naudojimo ir disponavimo juo įstatymas* (Law on Transfer of Lithuania).

The Applicability of the Law Regulating Public Economic Stake Holding

The Law on State and Municipal Enterprises only applies to fully state-owned companies.²⁵³ Therefore the Law on State and Municipal Enterprises does not regulate minority economic stake holding in foreign companies.

Pursuant to Article 7 of the Law on Transfer of Lithuania it is applicable to, inter alia, establishments and organisations that manage state assets. Therefore, the Law on Transfer of Lithuania would be applicable to the Fund.

Economic Stake Administrator in Lithuania

The Law on State and Municipal Enterprises prohibits state enterprises from participating in other legal persons.²⁵⁴ However, the national investment promotion body – Invega²⁵⁵ is exempt from this prohibition by a special law – Law on National Development Bodies.²⁵⁶ The Law on National Development Bodies cannot apply to the Fund, since all shares of the Fund will not be owned by the state of Lithuania.²⁵⁷ This means that, in the absence of a special law promulgated for the Fund, Lithuania may only participate if the shareholder is Invega.

Establishment Conditions Due to Public Economic Stake Holding

This section outlines the requirements and constraints on incorporation, establishment or acquiring economic stake posed by laws regulating public economic stake holding.

²⁵² Publiskas personas kapitāla daļu un kapitālsabiedrību pārvaldības likums. Latvijas Vēstnesis, 216, 31.10.2014. Article 10(2)

²⁵³ Lietuvos Respublikos valstybės ir savivaldybės įmonių įstatymas, Article 1, Article 2

²⁵⁴ Lietuvos Respublikos valstybės ir savivaldybės įmonių įstatymas, Article 3(4)

²⁵⁵ Invega, About Invega, 2021

²⁵⁶ Lietuvos Respublikos Nacionalinių Plėtros Įstaigų Įstatymas 2018 m. birželio 5 d. Nr. XIII-1257 Article 6(2)

²⁵⁷ Lietuvos Respublikos Nacionalinių Plėtros Įstaigų Įstatymas 2018 m. birželio 5 d. Nr. XIII-1257, Article 3

Requirement of Ex-Ante Assessment***Latvia***

Pursuant to Article 88 of the Law on State Administration of Latvia:

“A public person prior to establishing a capital company or acquiring a participation in an existent capital company shall carry out the evaluation of the intended activity by including also the economic evaluation in order to substantiate that effective achievement of the objectives laid down in Paragraph one of this Article is not possible otherwise. Upon performing the evaluation, the public person shall consult with competent authorities in the field of the protection of competition and associations or foundations which represent merchants, and also shall comply with the requirements of the laws and regulations governing the field of control of aid for commercial activity.”

Pursuant to Article 4 (2) and Article 5 of the Law on Public Shareholding of Latvia this obligation extends to acquiring shares.

Lithuania

Similar obligation, in substance, to obligation prescribed in Article 88 of the Law on State Administration of Latvia is prescribed by Article 22(2) of the Law on Transfer of Lithuania.

Estonia

Pursuant to Article 44 of the State Assets Act the resolution of the government of Estonia must provide:

1. Information regarding the state assets, including any encumbrances on the assets;
2. A justification of the expediency of the transfer and the impact of the transfer on the national budget;
3. The reasons related to selecting the particular method of transfer and to other important circumstances pertaining to the transfer;
4. The reasons for deciding to transfer for no charge or for a fee that falls below the usual value of the assets;
5. An assessment concerning the usual value of the assets;
6. Information regarding the detailed spatial plan concerning the assets;
7. Other reasons in relation to the circumstances.

Furthermore, upon establishing the Fund, the following must be provided:

1. The purpose of participation in the company and its relationship with the development strategy established for the area, and a reference to the specific strategic aim or measure;

2. The position of the ministry whose area of government includes matters that the company to which assets are ceded is involved in or will be involved in;
3. The strategy for the next four years, the investment plan and financial forecasts approved by the company's supervisory board, including the income statement, balance sheet and cash flow statement as of the end of the previous financial year;
4. The reason for the increase of share capital and the relevant financial and profitability calculations, if applicable.

Establishment Conditions

Latvia

The Law on State Administration of Latvia and Law on Public Shareholding of Latvia prescribes that a state may incorporate or acquire shares only if:

1. A market failure is prevented - a situation where the market is incapable of serving the public interest in the relevant field;
2. The activity of a capital company of a public person or a capital company controlled by public persons results in the creation of goods or services that are strategically important for the development of an administrative territory of the State or a local government or the State security;
3. The properties that are strategically important for the development of an administrative territory of the State or a local government or the State security are administered."

Given that the purpose of the Fund is to address an ill-functioning capital market in the Baltic states, the most appropriate legal basis for the establishment of the Fund is found in the Article 88 (1) subparagraph 1 of the Law on State Administration of Latvia.

Lithuania

Pursuant to Article 22(2) the Law on Transfer of Lithuania the establishment of (and capital injection thereof) of the Fund would require at least three of the following investment criteria to be met:

1. Investment will ensure the fulfilment of the obligations arising from the treaties of the Republic of Lithuania;
2. Investment is made into enterprises and/or facilities of strategic and key importance to ensuring national security in accordance with the Law on Enterprises and Facilities of Strategic Importance to National Security and Other Enterprises of Importance to Ensuring National Security, as well as other legal acts implementing the national security objectives which, inter alia, ensure the necessary decisive power of the State;

3. Investment promotes Lithuania's economic growth, enhances its economic independence and/or international competitiveness;
4. Investment will aim at ensuring economic and social cohesion of a municipality or the whole country within the EU, as well as on a regional level and worldwide;
5. Investment will result in the creation or development of infrastructure useful to the public (promotion of effective competition on internal market, improvement of the quality, choice and availability of public services);
6. Investment of the state and/or municipal assets (state or municipal contribution) will generate added value and ensure long-term economic sustainability of the activities generating the added value;
7. The investee will generate not only profit (income) but also social outcome (in the fields of education, culture, science, environment, health and social security, etc.), or ensure a more efficient performance of state and municipal functions set forth in laws of the Republic of Lithuania and Government resolutions;
8. Investment will be made into economic and social innovations, development of knowledge economy and creation of high technologies, where that is one of the main objectives of activities of the investee;
9. The investment objective and desired outcome are laid down in legal acts implementing strategic planning documents."

Additionally, the State may invest assets by acquiring units of an investment fund, only where:

1. The investment strategy of the investment fund, investment restrictions and specialisation in the geographical area or branch of the economy are in compliance with the objectives and approaches of the state policy on the promotion of small and medium-size businesses;
2. The investment fund is a closed-ended investment fund;
3. It is provided for in the instruments of incorporation of the investment fund that investors represent their own interests when adopting decisions;
4. It is specified in the instruments of incorporation of the investment fund that, when adopting investment decisions, a detailed investment proposal shall be prepared for each investment, containing a market and sales analysis of products or services provided by the enterprise, profit development and forecasts, the anticipated return on investment and/or other information necessary for the adoption of a decision;
5. The management company of the investment fund complies with the requirements of legal acts of the Republic of Lithuania and is selected by a public tender;

6. The management company of the investment fund is a private legal person whose heads are of good repute and have the qualifications and experience meeting the requirements of the Law of the Republic of Lithuania on Collective Investment Undertakings.”

Therefore, Lithuania may only invest in the Fund if there is evidence that the Fund’s investment, which may be profit-driven, in addition to promoting small and medium enterprises would contribute to social goals and its investment strategy will target specific sectors of the economy. Hence the generalist type of the Fund is precluded.

Estonia

State Assets Act does not prescribe any establishment preconditions that would be material for the Fund.

9.4.1.2 Required IV’s or Other Arrangements

The public shareholding not only sets certain requirements regarding rationale for establishment (or incorporation) and continued stake and operational constraints on the functioning of the Fund in the form of laws regulating public economic stake holding, but also necessitates certain other legal arrangements.

IV’s within the General Structure

The state cannot pay taxes to itself. Therefore, at least with respect to Latvia, the MEO setup of the Fund necessarily requires an intermediary, governed by the private law, that would be the entity participating in the capital of the Fund and, if applicable, holding the economic stake.

This condition could be satisfied by incorporating a Private Limited that would act as a taxpaying holding company or by utilizing the existing national investment promotional instruments – Altum, Invega and KredEx.

Freedom of Operation Analysis

Consequences of Application of Laws Regulating Transfer of State Assets

As noted above, Law on Transfer of Lithuania and State Assets Act is applicable and would regulate the acts of the Fund. Therefore, the Fund would have to comply with various principles of public law as well as specific regimes governing additional reporting and disclosure.

Ease of Transfer of Securities Owned by the Fund

The relevant legal framework of transfer of securities held by the Fund consists of four types legal acts:

1. Laws regulating private agreements and legal capacity of the legal person or other entity (i.e., Civil Law and Commercial Law, depending on the choice for a particular contract);

2. Laws regulating sale of financial instruments (i.e. *Finanšu instrumentu tirgus likums, Väärtpaberituru seadus, Lietuvos Respublikos Finansinių priemonių rinkų įstatymo pakeitimo įstatymo*);
3. Laws regulating use of state assets (i.e. Law on Transfer of Lithuania, State Assets Act, Law on State Administration of Latvia);
4. Laws regulating AIF's.

General Provisions

Generally, due to harmonization stemming from MiFID II and since laws regulating property and transfer of ownership are similar, no material advantages are identified. However, since laws regulating the sale of a public economic stake are not harmonized and do not vest similar rules, the requirements stemming from these laws are noteworthy.

Latvia

Laws regulating public economic stake holding do not prescribe any specific requirements to transfer of securities owned by the Fund.

Estonia

Pursuant to Articles 30 and 31 of the State Assets Act state assets may be transferred by:

- Public auction;
- Selective tender;
- Discretionary procedure.

In addition, state-owned securities may be transferred:

1. By way of a public sale, including by way of a public tender or sale in a regulated securities market following the procedure specified in section 74 of this Act;
2. When making a takeover bid for shares in accordance with section 165 of the Securities Market Act;
3. When effecting a takeover of shares within the meaning of Chapter 291 of the Commercial Code;
4. When redeeming or repurchasing units in an investment fund;
5. When exchanging shares, convertible debentures or other securities for different securities;
6. In the acquisition of own shares by a company;
7. In an offer of shares to the other shareholders of the company;

8. By means of a sale of the right of pre-emption to subscribe for shares in a public limited company;
9. Under other conditions provided by legislation or in the emission of the securities.

Furthermore, pursuant to Article 39:

“(1) the decision to transfer securities sets out at least the name of the issuer and the type, number and, where it exists, the nominal value of the securities to be transferred. In the case of the transfer types listed in points 5 and 9 of subsection 1 of section 31 of this Act, the decision to sell must also set out the amount or the minimum amount of the compensation to be paid for a share.

In the case of a public sale of securities, the decision to transfer the securities must set out:

1. The procedure of public sale (a public offering or sale in a regulated market);
 2. The sale conditions listed in subsections of 3–5 of this section;
 3. Where necessary, the conditions for postponing or stopping the public sale and for changing the time-limits and conditions related to the sale;
 4. Other important circumstances related to the public sale or important circumstances concerning the preparation of the sale.
- (3) In the case of a public offering of securities, the decision to transfer securities must set out:
1. In the case of a public offering at a predetermined price, the offering price;
 2. In the case of a public offering at an equilibrium price to be determined in the course of the offering, the principles based on which the offering price is determined;
 3. The principles of establishing the results of the offering;
 4. The rules governing the distribution of the securities between the investors;
 5. The procedure for submitting and considering offers.
- (4) The body deciding the transfer may stipulate, as a condition of the public offering, an obligation to register the securities for trading in a regulated market, in this case also determining the regulated markets in which registration for trading must be sought.
- (5) Where securities are to be transferred in a regulated market, the decision to transfer securities must also set out the minimum selling price of the securities and, if necessary, the schedule of the sale.

- (6) Where shares are transferred as part of a takeover bid, the decision to transfer securities must, in addition to the information specified in subsection 1 of this section, set out:
1. A reference to the takeover bid and the essential conditions of the bid;
 2. The takeover price of the shares and the manner of payment for the shares;
 3. Reference to acts (acceptance or offer) performed in the course of the takeover bid.
- (7) Where securities are exchanged for other securities, the decision to transfer securities must, in addition to the information specified in subsection 1 of this section, set out information regarding the securities received and the number of securities received per each security given in the exchange.
- (8) Where shares in a public limited company are transferred by way of a targeted offer to another shareholder of the company or other shareholders of the company, the decision to transfer shares must, in addition to the information specified in subsection 1 of this section, set out:
1. The price or starting price (minimum price) of the offer, where it is practical to determine such a price;
 2. The name of the shareholder or the names of the shareholders whom the offer targets or the criteria for targeting the shareholders;
 3. The procedure and time-limit for submitting offers.
- (9) Where shares in a public limited company are transferred subject to preferential rights to subscribe for the shares, the decision to transfer the securities must, in addition, set out:
1. The subscription price of shares or the starting price, where it is practical to determine such a price;
 2. If necessary, the requirements which the subscribers need to meet.

The above noted procedures and conditions are applicable to exit of the Estonian state from the Fund and are likely to be applicable to sale of securities owned by the Fund. However, given that the procedures and conditions are not commercially unreasonable they do not present a material hinderance to operations of the Fund.

Lithuania

Law on Transfer does not specifically regulate transfer of the securities of the Fund, however, specific rules may be prescribed by the government of Lithuania.²⁵⁸

²⁵⁸ Lietuvos Respublikos valstybės ir savivaldybių turto valdymo, naudojimo ir disponavimo jūo įstatymas Article 23

Matters Related to Exit

Under the applicable statutory framework of the three Baltic states, the units of the Fund would have to be issued on the name of the unit-holder. The units cannot have a nominal value. Both the subscription and redemption of units can take place according to the conditions of subscription and redemption set forth in the instrument of incorporation of the Fund (i.e., the Articles of Association). The conditions of subscription and redemption shall also be specified in the prospectus of the Fund.

The Fund set up as an AIF is allowed to issue units of different classes. The particulars of rights attaching to each particular unit class shall be specified in the instrument of incorporation of the Fund (i.e., the Articles of Association).

For the marketing of units of the Fund and subscription by the investors, the following should be necessary:

1. An application for unit subscription submitted to the AIFM or, if the Fund is self-managed, to the Fund itself, in writing or in electronic form;
2. Acceptance of the instruments of incorporation of the Fund; and
3. Full payment of the amount of acquisition of the units, as determined based on the issue price of the units in cash, or, where this is acceptable by the AIFM or the Fund, if it is self-managed, in the form of assets into which the Fund is allowed to invest in accordance with its investment policy, which are valued in accordance with the provisions specified according to the instrument of incorporation of the Fund.

The redemption or repurchase of units of the Fund shall take place in accordance with the conditions set forth in the instrument of incorporation of the Fund (i.e., the Articles of Association). Such conditions should also be specified in the prospectus of the Fund. The units can be redeemed at the redemption price of the next scheduled redemption date following submission of the redemption application. The redemption price should be specified in the instrument of incorporation of the Fund. The instrument of incorporation of the Fund shall also set forth the final date for the submission of redemption applications so that the redemption price is paid for the redeemed units as of the next scheduled redemption date, following submission of the application.

In order to proceed with redemption of units of the Fund, the investors shall submit a written or electronic application to the AIFM or, if the Fund is self-managed, to the Fund itself. No conditional applications for the redemption of units should be permitted. An application to shift from one investment segment of the Fund to another investment segment of the Fund, or from the Fund to another AIF would have to be treated as redemption of units of the Fund.

The value of the redeemed units of the Fund shall be paid in cash. The payment shall take place within the period set forth in accordance with the instrument of incorporation of the Fund.

The issue of redeemed units or repurchase of units should not be permitted:

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- a. For as long as the Fund, provided it is not self-managed AIF, has not appointed an AIFM;
- b. For as long as the Fund has not appointed a depositary.
- c. Where the AIFM of the Fund has been dissolved, is under liquidation, or is subject to administration or similar proceedings, but no replacement AIFM has been appointed.

Furthermore, given the specific purpose of the Fund following must be ensured:

Planned Exit

As noted above, it is expected that the Fund will be a closed-end type and shall be used for a specific purpose. Therefore, and in accordance with a legal requirement set by the law of Latvia, if the Fund is established as a Limited Partnership, it must have an expiry date or prescribe that a certain event would mark the exhaustion of the purpose of the Fund. Therefore, procedures for redemption in the case of a Planned Exit must be established in the constitutional documents of the Fund.

Early Exit

Given the liberal regime of economic stake redemption within the AIF framework it is important that a well-designed procedures and conditions are set in the constitutional documents of the Fund. It is contrary to the purpose of the Fund to allow early exit of the investor states. Therefore, the constitutional documents of the Fund should clearly reflect that the stake redemption should be only possible after the elapse of a certain period of time. However, stricter rules on early exit should not prejudice of unilateral redemption rules, by completely prohibiting it, since the contrary could indicate non-commercial considerations.

Exit by sale

Given that the economic stake is freely transferable non-state investors could transfer their economic stake before the planned exit. The constitutional documents of the Fund should include procedures and conditions to prevent that such exits have an adverse effect on the functioning of the Fund.

9.4.1.3 On List-ability of the Fund

Should the possibility to list the Fund (admit its shares or units to trading on a regulated market) after its use for the purposes of implementation of the CMDAF Baltic SME IPO Fund project has been exhausted be of importance, the following is noteworthy:
Pursuant to Article 51(5) of the MiFID II:

“A transferable security that has been admitted to trading on a regulated market can subsequently be admitted to trading on other regulated markets, even without the consent of the issuer and in compliance with the relevant provisions of Directive 2003/71/EC. The issuer shall be informed by the regulated market of the fact that its securities are traded on that regulated market. The issuer shall not be subject to any

obligation to provide information required under paragraph 3 directly to any regulated market which has admitted the issuer's securities to trading without its consent."

Therefore, if an asset is a transferable security it can be admitted to the trading to a regulated market.

Pursuant to Article 4 definition 44 of the MiFID II:

"transferable securities' means those classes of securities which are negotiable on the capital market, with the exception of instruments of payment, such as:

- a. Shares in companies and other securities equivalent to shares in companies, partnerships or other entities, and depositary receipts in respect of shares;
- b. Bonds or other forms of securitised debt, including depositary receipts in respect of such securities;
- c. Any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures;"

Since MiFID II prescribes a harmonized framework for regulation of capital markets, assets falling within "transferable securities" are capable to be admitted to trading to regulated markets in all member states. The securities of an AIF status fund's albeit in share or unit form are freely transferable and therefore securities. Therefore, unless there is explicit prohibition to admit units or shares of an AIF status fund to a regulated market the Fund's securities will be admissible.

Estonia

Law of Estonia prescribes certain restrictions on admission of an AIF status fund's units. Pursuant to Article 10 of the *Investeerimisfondide seadus* which prescribes that:

1. An offers of units or shares of a fund is deemed to be an offer of securities for the purposes of § 11 of the Securities Market Act;
2. A fund which units or shares are publicly offered for the purposes of § 12 of the Securities Market Act is a public fund;
3. Units of a limited partnership fund may not be publicly offered;
4. In addition to the provisions of subsection 12 (2) of the Securities Market Act, an offer shall not be deemed to be public if the offer is submitted by a fund manager, investment firm or credit institution upon management of a securities portfolio or guaranteeing of an offer or issue of securities for the purposes of clause 43 (1) 4) or clause 44 6) of the Securities Market Act to a respective person only;

5. The provisions of Parts 2 and 4 of the Securities Market Act concerning public offer of securities and admission thereof to trading on a regulated market of an EEA Member State apply to public offer of securities of a closed-ended public fund which is not a pension fund.”²⁵⁹

Furthermore, it is noteworthy that pursuant to Article 20(3) of the *Investeerimisfondide seadus* AIF status Limited Partnership cannot be transformed (reorganised) into a different type of a company.

The regulated market operator – Nasdaq Tallinn, explicitly permits admission of an AIF status securities.²⁶⁰ Therefore, if the Fund is set up as a Limited Partnership, then it is not permitted, inter alia, to admit its units to regulated markets in Estonia directly.

Latvia

Alternatīvo ieguldījumu fondu un to pārvaldnieku likums, lacks an admissibility restriction²⁶¹ and therefore the units of the Fund²⁶² could be listed in a regulated market in Latvia, regardless of its form. The regulated market operator – Nasdaq Riga, permits admission of an AIF status securities through general definition of a “tradable security” as prescribed in MiFID II.²⁶³

Lithuania

The regulated market operator – Nasdaq Vilnius, explicitly permits admission of an AIF status securities.²⁶⁴

9.4.1.4 Applicability of Public Procurement and Competition Law

Public Procurement

The applicability the law governing public procurement in the Baltic states is harmonised and regulated by the norms included in the Directive 2014/24/EU of the European Parliament and of the Council of 26 February 2014 on public procurement and repealing Directive 2004/18/EC (Directive 2014/24).

Pursuant to Article 2 of the Directive 2014/24:

²⁵⁹ Investeerimisfondide seadus, Article 10

²⁶⁰ Nasdaq Baltic, Listing Rules of Nasdaq Tallinn Clause 10, 2020

²⁶¹ Alternatīvo ieguldījumu fondu un to pārvaldnieku likums, Article 41

²⁶² Finanšu instrumentu tirgus likums, Article 41(1) and Article 1(1) definition 30

²⁶³ Nasdaq Baltic, Nasdaq Riga Rules on Listing and Trading of Financial Instruments on the Markets Regulated by the Exchange, adopted by Riga Stock Exchange Management Board Meeting May 18, 2007 Clause 4.2, 2007

²⁶⁴ Nasdaq Baltic, The Listing Rules of AB Nasdaq Vilnius, adopted by Management Board of AB Nasdaq Vilnius Minutes No. 09-88 as of 1 June 2009 Clause 8, 2009

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“contracting authorities’ means the State, regional or local authorities, bodies governed by public law or associations formed by one or more such authorities or one or more such bodies governed by public law;

[..]

‘bodies governed by public law’ means bodies that have all of the following characteristics:

- (a) They are established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character;
- (b) they have legal personality; and
- (c) they are financed, for the most part, by the State, regional or local authorities, or by other bodies governed by public law; or are subject to management supervision by those authorities or bodies; or have an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities, or by other bodies governed by public law;”

As clarified by Recital 10 of the Directive 2014/24

“The notion of ‘contracting authorities’ [...] For that purpose, it should be clarified that a body which operates in normal market conditions, aims to make a profit, and bears the losses resulting from the exercise of its activity should not be considered as being a ‘body governed by public law’ since the needs in the general interest, that it has been set up to meet or been given the task of meeting, can be deemed to have an industrial or commercial character.

Similarly, the condition relating to the origin of the funding of the body considered, has also been examined in the case-law, which has clarified inter alia that being financed for ‘the most part’ means for more than half, and that such financing may include payments from users which are imposed, calculated and collected in accordance with rules of public law.”

Given that the Fund aims to have a commercial character and it will not be constantly re-financed, but rather will receive a lump sum capital injection, it is possible that it would not come into ambit of the applicability of laws implementing Directive 2014/24.

Competition Law

As noted earlier, the Fund would be an undertaking and thus subject to Competition rules. Given that it would be an entity governed by private law, it would not enjoy any specific treatment with respect to enforcement of the competition law.

9.4.1.5 Disclosure Pursuant to Laws Regulating Public Shareholding

Pursuant to Laws Regulating Public Shareholding

Pursuant to Article 75(3¹) of the State Assets Act:

"The administrator of a partially state-owned company which for the purposes of the State Budget Act is part of central government must, when exercising its founder's or shareholder's rights, take steps to ensure that the following specific requirements are reflected in the articles of association of the company:

1. All of the company's receipts and expenditures are reflected in a balanced budget which is drawn up in conformity with the company's financial plan, with the rules concerning budget position set out in section 6 of the State Budget Act, with the rule concerning net debt set out in section 10 of the same Act, and with any limitations established in accordance with section 11 of the same Act;
2. Each year, the company draws up and presents, in accordance with the rules set out in section 12 of the State Budget Act, a financial plan to serve as the basis for the preparation of the company's budget."

Pursuant to Article 10(1) of the State Budget Act:

"It shall be ensured by law or on the basis of law that the difference between the debt obligations and the total amount of the liquid assets of a central government legal person planned as at the end of a budgetary year may form up to 40 per cent of the operating revenue planned for the same budgetary year throughout the period included in the financial plan submitted on the basis of § 12 of this Act. The Government of the Republic shall decide on the permission to increase the net debt in excess of 40 per cent, taking into account the requirements provided for in this Chapter."

Therefore, the Fund will have to report to the Estonian authorities on how it meets the budgetary requirements set by the Estonian government. The requirements stemming from this obligation are likely to be fulfilled by report prepared fulfilling the reporting requirements stemming from the AIF status.

According to Laws Regulating AIF's

The disclosure standard established under the Estonian Investment Funds Act, the Latvian Law on Alternative Investment Funds and Their Managers and the Lithuanian Law on Management Companies of Investment Undertakings for Professional Investors broadly corresponds to the requirements of the AIFM Directive. The three enactments require AIFMs to make certain disclosures to investors at the stage of prospectus in the effort to enable informed decision-making on the part of investors. The following information is subject to disclosure requirement to investors before they invest in the Fund:

- The investment strategy and investment policy of the Fund;
- Details of the procedures by which the Fund may change its investment strategy or investment policy, or both;
- The types of assets into which the Fund may invest;
- The techniques the Fund may employ;
- The use of leverage;
- Information on the identity of the service providers and the AIFM;

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- Investors' rights;
- Description of the delegation by the AIFM and the depositary;
- Description of how the AIFM complies with the professional liability risk requirements;
- Identification of the depositary, auditor and other service providers together with a description of their duties;
- Description of the main legal implications of the contractual arrangements entered into for the purpose of investment, including jurisdiction, applicable law and the existence, or not, of any legal instruments providing for the recognition and enforcement of judgments in the jurisdiction where the AIF is established;
- Description of the valuation procedure and of the methodology for valuing assets, including that used for valuing hard-to-value assets;
- Description of liquidity risk management procedures;
- Description of all fees, charges and expenses which are directly or indirectly borne by investors;
- Information on the issue and sale of interests and redemption rights both in normal and exceptional circumstances and existing redemption arrangements with investors;
- The net asset value of the AIF; and
- Its performance.

The required ongoing periodic disclosures by the Fund to investors in the form of annual reports, or other periodic reports, shall comprise the following information:

- The percentage of the Fund's assets which are subject to special arrangements arising from their illiquid nature;
- Any new arrangements for managing the liquidity of the Fund;
- The current risk profile of the Fund and the risk management systems employed by the AIFM to manage these risks;
- Any changes to the maximum level of leverage and to any right to reuse collateral or any guarantee granted under the leverage arrangements; and
- The total amount of leverage employed by the Fund.

When it comes to disclosure obligations in relation to supervisory authorities, the AIFM would have to regularly disclose certain information to the national supervisory authority of the Baltic state in which the Fund is established. This type of disclosure seeks to capture the markets where the AIFM actively trades for the Fund, along with the principal exposures and most significant concentrations for the Fund, including the following:

- The percentage of the Fund's assets which are subject to special arrangements because of their illiquid nature;
- Any new arrangements for managing the liquidity of the Fund;
- The current risk profile of the Fund and the risk management systems employed by The AIFM to manage market, liquidity, counterparty, operational and other relevant risks;
- The main categories of assets in which the Fund invested;
- The results of any stress tests required to be performed in accordance with the requirements of the applicable law;

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- The overall amount of leverage employed by the Fund;
- A breakdown of leverage arising from borrowing of cash or securities and leverage embedded in financial derivatives and the extent to which the Fund's assets have been reused under leveraging arrangements; and
- The identity of the five largest sources of borrowed cash or securities of the Fund and the amounts of leverage received from each of those entities.

Moreover, any preferential treatment of the investors of the Fund would have to be disclosed in the constitutive documents of the Fund. AIFMs having recourse to leverage for investment purposes are subject to various additional disclosure requirements. Further disclosure obligations would apply in the event of establishment by the Fund of one or more sub-funds and acquisition or disposal of, individually or jointly, of control in a listed or non-listed fund or company, other than a small entity.

9.5 Tax, Accounting and Reporting Matters

Estonia

An AIF that is a limited partnership fund under Income Tax Act is not subject to income tax in Estonia and is tax transparent. Any profit earned by the fund will be treated as the profit of the investors. The income of a common investment fund or a public investment fund is taxable in Estonia only to the extent that it is related to real estate located in the territory of Estonia.

Latvia

In Latvia an AIF is not a CIT payer - CIT or PIT have to be paid by the investor. The Latvian CIT Law does not specify that the aforesaid regulation applies only to a specific legal form of the AIF. Therefore, it may be assumed that an AIF, irrespective of its legal form, is transparent for income or corporate tax purposes and income is not taxed at the AIF level, but at the level of its partners, shareholders or investors.

Lithuania

A fund, irrespective of its legal, form that benefits from an AIF status, is a CIT payer under the Lithuanian CIT Law. However, income of a Lithuanian collective investment undertaking is CIT exempt irrespective of its legal form (i.e., investment fund or investment company), except if the income is received from the companies registered or otherwise organised in blacklisted jurisdictions (i.e. tax havens) or residents of such jurisdictions.

Other Considerations

Additional analysis of the tax, accounting and reporting matter landscape in the Baltics is elaborated on in appendix A.

9.6 Manager

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Fund managers manage the fund, select and evaluate investment targets, enter into investment transactions on behalf of the fund, ensure investment management and receive a management fee.

Generally, in as far, the AIFM is a legal person²⁶⁵ there are no specific legal form requirements. However, since law of Latvia prescribes an internal AIFM model, thereby uniting AIF and AIFM in a single legal person, the actual manager could be also a natural person.

AIFM of the Fund shall be selected in open transparent and professional procedure. Depending on the funding sources and investor composition, use of public procurement procedure may be necessary. This aspect will be analysed in detail within the final report.

In any case, the most industry-standard and process-efficient procedure will be sought, using industry experts, ideally from experienced IFI.

Idea is to look for qualified and credible team of individuals with a proven track record in this field, with following non-exclusive indicative list of criteria:

— Well-balanced team

Team members complementing each other in terms of skills and experience, with a proven ability to work together. Furthermore, the team must either be located/domiciled in the Baltic states, or in case of international manager, an appropriate local team should exist or should be established in the Baltic states. Emerging and/or first time teams would be also considered.

— Track record, proving adequate experience in the targeted investment area

Previous investments will be carefully analysed in order to understand the team's investment capabilities.

— Fund economics are commercially viable

One will have to demonstrate the ability to ensure the team's stability and the fund's investment capacity.

— Transparency

The legal and tax structure of the fund should be clear and transparent according to the market standard terms and conditions.

— Alignment of interest

The interests of all stakeholders in the fund are fully aligned.

²⁶⁵ Directive 2011/61 Article

9.7 Operating Requirements

9.7.1.1 *Operating and Regulatory Framework at a Glance*

Alternative investment funds (AIFs) are investment funds that fall outside the scope of the Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS)(the UCITS Directive). AIFs are subject to regulation under the Directive 2011/61/EU on Alternative Investment Fund Managers (the AIFM Directive). An AIF is defined to be any collective investment undertaking that raises capital from a number of investors with a view to investing in accordance with a defined investment policy which does not require authorization under UCITS Directive. AIFs are commonly understood to include hedge funds, private equity funds, real estate funds and institutional funds. In contrast to investment funds regulated under the UCITS Directive, AIFs typically target qualified investors. They invest in a broad range of assets, including assets not eligible for investment by UCITS, and are not subject to certain leverage restrictions.

The investment industry distinguishes between different types of AIFs depending on the possibility to redeem shares and the type of management. Such distinctions, however, are only used for practical purposes and have no regulatory underpinnings.

Open-ended AIFs are commonly understood to include AIFs the shares or units of which can be repurchased or redeemed at the request of shareholders or unitholders prior to liquidation or winding-up of the AIF, out of its assets in accordance with the procedures and frequency set out in the instrument of incorporation, prospectus or offering. A closed-ended AIF, in turn, is any AIF other than open-ended AIF. Another distinction is based on the type of management of AIF. Depending on the type of management, a distinction is drawn between self-managed AIFs and AIFs with an external alternative investment fund manager (AIFM).

An AIF may be structured as a corporate or contractual entity. A corporate entity would have legal personality, enabling it to hold legal title to assets. Corporate AIFs are governed by the principles of mandatory law. In contrast, contractual AIFs have no legal personality and are unable to hold legal title to assets, but enjoy the benefit of contractual freedom.

Regardless of whether a corporate or contractual entity is selected, an AIF incorporated in a Baltic state would need to take into account requirements of the AIFM Directive and legislation of the relevant Baltic state implementing the AIFM Directive (*Investeerimisfondide seadus* in the case of Estonia, *Alternatīvo ieguldījumu fondu un to pārvaldnieku likums* in the case of Latvia, *Kolektyvinio investavimo subjektų įstatymas* in the case of Lithuania), along with the rules and regulations promulgated thereunder.

9.7.1.2 *AIFM Authorisation and Appointment Requirements*

The AIFM Directive regulates the managers of AIFs, rather than the AIFs themselves, however the Member States are required to ensure that all AIFs within the scope of the authorisation requirements have a single AIFM responsible for ensuring compliance with the AIFM Directive. In order to manage or market an AIF, each AIFM requires

authorisation by its home-country regulator. To be eligible for authorisation, an AIFM must meet a number of requirements, including capital requirements. More specifically, an external AIFM would need to meet the minimal capital requirement of EUR 125 000, while an internally managed fund would need to have the minimum capital of EUR 300 000. Moreover, an AIFM managing investment portfolio in excess of EUR 250m would need to provide additional own funds corresponding to 0.02% of the excess amount, subject to an overall cap on capital of EUR 10m.

With respect to each AIF under its management, the AIFM would be required to appoint an independent depositary with responsibility for the safekeeping of assets, oversight of compliance by the AIF with applicable laws and monitoring of cash flows. The depositary would have to be established in the home country of the AIF and would need to be a regulated EU credit institution, EU investment firm or another institution already approved to act as a UCITS depositary. The AIFM would have to be a party to the depositary agreement alongside the AIF and there would need to occur an ongoing exchange of information between all the depositary, the AIFM and AIF (which is customarily ascertained by means of entry into a service level agreement).

In line with the requirements of the AIFM Directive, the legislation of all three Baltic states provides an exemption to AIFMs of smaller funds whose assets under management do not exceed certain thresholds. The thresholds are as follows:

- EUR 100m, including assets acquired through leverage, or
- EUR 500m where the AIF managed is not leveraged, investors have no redemption rights exercisable for a period of 5 years, and no rights are offered to retail investors.

The above exemption is known as “*de minimis* exemption”, while the AIFMs of smaller funds are customarily referred to as “smaller AIFMs”. In applying the *de minimis* exemption, the legislation of the three Baltic states provides that smaller AIFMs shall be subject to registration requirement with the supervisory authority in the home jurisdiction of the AIFM (the Financial Supervisory Authority in the case of Estonia, the Finance and Capital Market Commission in the case of Latvia, or the Bank of Lithuania in the case of Lithuania), along with certain with a narrower scope of disclosure and reporting requirements compared to large AIFMs. The disclosure and reporting requirements in the case of smaller AIFMs cover investment strategies, instruments traded, main risk exposures and principal concentrations.

Under the *di minimis* exemption, an opt-in procedure is available to small AIFMs considering the prospect of applying for a fully-fledged AIFM license.

9.7.1.3 Delegation Requirements

Under the standards established by the AIFM Directive, the AIFM cannot delegate functions to the extent that it becomes a letterbox entity. While virtually no regulatory guidance is available to assess what exactly constitutes a letterbox entity, it would appear that the AIFM must be able to preserve a degree of substance, activity and expertise, in particular, in the field of risk management and portfolio management, even if it delegates certain functions to third parties. Importantly, in order to comply with the

standards of the Directive the AIFM would be required to demonstrate an appropriate level of due diligence prior to engaging with the third parties and put in place robust proceedings for the ongoing monitoring of the delegate.

9.7.1.4 *Leverage Requirements*

The term “leverage” is defined by the AIFM Directive as any method by which an AIFM increases the exposure of an AIF it manages, whether through borrowing of cash or securities, or leverage embedded in derivative positions, or by any other means. The leverage rules are aimed at capturing and disclosing to investors the degree of leverage to which the Fund is exposed. Some of these disclosures are required to be made to investors before they invest, while others are required to be made on a periodic basis. The AIFM would have to employ two methods for calculating the amount of leverage to which the Fund is exposed (and the AIFM would need to ensure that the investors receive adequate information about these methods in order to avoid confusion over the meaning of reported leverage figures):

- The Gross Method; and
- The Commitment Method.

The AIFM Directive requires the overall leverage of the Fund to be expressed as a ratio between the exposure of the Fund and its net asset value.

When calculating the Fund’s exposure using the Gross Method, the AIFM would have to:

- Exclude the value of any cash and cash equivalents which are highly liquid investments held in the base currency of the Fund that are readily convertible to an amount of cash, subject to an insignificant risk of change in value and which provide a return no greater than the rate of a three month high quality government bond;
- Convert derivative instruments into the equivalent position in their underlying assets;
- Exclude cash borrowings that remain in cash or cash equivalent as referred to in the first bullet point above and where the amounts of that payable are known;
- Include exposure resulting from the reinvestment of cash borrowings, expressed as the higher of the market value of the investment realised or the total amount of the cash borrowed; and
- Include positions within repo or reverse repo transactions and securities lending or borrowing or other arrangements.

When calculating the Fund’s exposure using the Commitment Method, the AIFM would have to:

- Convert derivatives positions into the equivalent position in the underlying asset, provided certain conditions are met;
- Apply netting and hedging arrangements subject to specified conditions;
- Calculate the exposure created through the reinvestment of borrowings where that reinvestment increases the Fund’s exposure; and
- Include other arrangements in the calculation in accordance with specific requirements of the AIFM Directive.

9.7.1.5 *Risk management Requirements*

One of the most comprehensive requirements of the AIFM Directive is that the AIFM must ascertain that the risk management and portfolio management functions are independent of each other. To make sure the risk management function is independent, a set of safeguards would have to be put in place by the Fund. These include adequate provisions for the composition of the senior management and Management Board, along with the segregation of duties and responsibilities within the governance function, a remuneration policy and a conflicts of interest policy in order to identify, prevent, manage, and monitor all conflicts of interest that may arise internally.

9.7.1.6 *Valuation*

Under both the AIFM Directive and the implementing national legislation, the ultimate responsibility for the valuation of the Fund would appertain to the AIFM, unless the responsibility has been delegated to an approved third party to conduct external valuations. Furthermore, the AIFM would be required to have in place procedures designed for documenting the valuation processes and escalating issues, with the Management Board of the AIFM bearing the ultimate responsibility for all valuation-related matters.

9.7.1.7 *Reporting Requirements*

The AIFM Directive and the national implementing regulations require AIFM's to prepare an annual report for each AIF they manage or market in the EU which must be provided to investors on request. Moreover, AIFM's must provide investors with minimum pre-investment information, including in respect of investment strategy, objectives, and liquidity and risk management arrangements. AIFM's are also required to regularly disclose certain other types of relevant information, such as relating to their risk management arrangements and the results of any stress tests performed.

9.7.1.8 *Governance Requirements*

It should be borne in mind that both the AIFM Directive and the implementing national legislation place significant emphasis on having a robust governance and effective risk management culture, in particular in light of the AIFMs responsibility for ensuring proper accountability, valuation and flow of information. The governance aspects of AIFM are considered further down this analysis.

9.7.1.9 *Remuneration Policy*

In setting remuneration policies, must ensure compliance with the requirements of the AIFM Directive. Further details relevant to the contents of remuneration policies are contained in the ESMA AIFM Directive Remuneration Guidelines (ESMA/2013/ 232). The cornerstone requirements of the AIFM Directive and ESMA Remuneration Guidelines relevant to remuneration policies are governance, risk alignment and transparency.

Under the governance prong of the AIFM Directive, the Fund would be required to formulate a remuneration policy and, to the extent the Fund is "significant" in size, appoint a remuneration committee. According to the risk alignment prong, variable remuneration shall be performance-based and risk-adjusted through deferral, payment in instruments

and claw-back measures. Under the transparency prong of the AIFM Directive, the Fund would be required to disclose quantitative and qualitative information on its remuneration policies and practices. Notably, although the total remuneration of the Fund's staff would have to be disclosed in the annual report, no requirement on disclosing detailed information on remuneration policies and practices of the Fund to the broader public would apply.

Proportionality

The proportionality principle spelled out in ESMA AIFM Directive Remuneration Guidelines allows the Fund to disapply some of the requirements applicable under the AIFM Directive. The following factors should be assessed in determining the extent to which the requirements of the AIFM Directive could be disapplied: (1) size of the Fund, (2) nature, scope and complexity of the Fund, and (3) internal organisation of the Fund. All in all, depending on the outcome of the assessment, the Fund may disapply any of the following requirements: appointment of a remuneration committee, payment of variable remuneration in instruments, retention periods, deferral requirement and claw-back measures.

Decision-Making Process in Determining Remuneration

This section would have to outline the set of procedures for adopting and approving remuneration decisions for employees of the Fund and specify formulas and fixed benchmarks (to the extent applicable) used toward determining the size of remuneration, bonuses and other annual incentive awards. The section would also have to identify the factors such as non-financial goals and objectives used in making the determinations, including weighting considerations and correlation measures between the different factors.

Remuneration Policy Principles

This section would have to set forth the remuneration policy principles of the Fund as would need to be defined by the Management Board of the Fund. The recommended set of principles would have to embrace the following key considerations:

- Transparency: the remuneration policy should be clearly defined and shared with key stakeholders, including shareholders, clients, employees and regulators;
- Fairness: the individual benefits would have to be based on the effective contribution to the results of the Fund as determined by the Management Board, supported where possible by individual Key Performance Indicators (KPI);
- Long-term alignment of interests: the aim of the remuneration policy would be to create a win-win environment where the long-term financial interest of clients, employees and stakeholders of the Fund are aligned;
- Alignment with financial performance: the total variable compensation would have to be managed as a percentage of pre-bonus profit before tax and exceptional items, the total spend on compensation would have to be managed as a percentage of net revenue;
- Financial stability: the incentive remuneration should under no circumstances expose the Fund to undue increased financial or operational risks.

Identification of Material Risk-Taker Roles

This section would have to be aligned to the qualitative and quantitative criteria enumerated by the Regulatory Technical Standards (the RTS) to identify material risk takers (MRTs) under the EU Investment Firm Directive (EU) 2019/2034. The RTS seek to ensure that a sufficient level of scrutiny is applied by investment firms and competent authorities when identifying the categories of staff whose professional activities have a material impact on the Fund's profile or assets under its management.

The Link Between Pay and Performance

To the extent remuneration in the AIFM is variable and performance related, this section would have to describe the set of factors to which consideration should be given in determining the amount of such variable remuneration. The factors would usually include financial (e.g. overall performance of the AIFM over a pre-determined period of time, new net assets) and non-financial criteria (compliance with rules of conduct, compliance with the fund investment policy as evidenced by meeting certain ratios, compliance with risk management policy, meeting of responsible investing objectives). In addition, the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components would have to include a comprehensive adjustment mechanism to integrate all relevant types of current and future risks; such mechanism, to the extent applicable, would have to be described under the section on Quantitative remuneration information.

Controlled Functions

This section would have to describe the roles, duties and responsibilities of certain controlled functions of the Fund. Typically, the risk management function would have the responsibility for assessing how the variable remuneration structure affects the risk profile of the Fund. The compliance function would have to be responsible for analysing how the remuneration structure affects the Fund's compliance with legislation, regulations and internal policies. The internal audit function would be responsible for conducting periodical independent audits of the design, implementation and effects of the Fund's remuneration policies.

Under the proportionality principles and with the absence of a remuneration committee, the remuneration attributable to those engaged in risk and compliance functions would have to be directly overseen by the Management Board of the Fund.

Quantitative Remuneration Information

This section would have to describe the criteria used toward measurement of variable remuneration adjusted for current and future risks. The criteria would typically include a set of knock-in criteria (risk limit, relative active risk against a defined market index and absolute active risk) and knock-out criteria (violation of a risk limit and violation of a compliance rule).

9.7.1.10 Responsible Investing Policy

The Responsible investing (RI) Policy would have to encapsulate the integration of environmental, social and corporate governance (ESG) considerations into investment management processes of the Fund in the belief that these considerations could provide enduring benefits for the Fund, the investee companies and the community at large, reduce risks, improve financial performance and drive positive social and environmental outcomes. RI has become part of the regulatory agenda of the EU in February 2020 when the European regulator for the asset management industry, the European Securities and Markets Authority (ESMA) published its strategy on Sustainable Finance, which describes how ESMA will be placing sustainability at the core of its activities by embedding ESG considerations in its work.

Since 2020, the EU has been pursuing a broad array of legislative initiatives aimed at integrating ESG considerations into the investment strategies and procedures of EU-based investment managers. These include:

- Proposed amendments to Delegated Regulation (EU) 231/2013 under AIFM Directive to require AIFMs to take into account sustainability risks in their existing governance procedures and organisational structures, in their management of conflicts of interest and risk management policies and as part of their investment due diligence;
- Amendment to Regulation (EU) 2016/1011 (the Benchmark Regulation) by Regulation (EU) 2019/2089 (the Low Carbon Benchmark Regulation) introducing two new types of benchmarks: (i) the EU Climate Transition Benchmark and (ii) Paris Agreement-Aligned Benchmark;
- A range of proposals to Directive 2014/95/EU (the Accounting Directive) as regards disclosure of non-financial and diversity information by certain undertakings and groups of undertakings (the Non-Financial Reporting Directive or NFRD) on the reporting obligations to be imposed by the EU sustainable development initiatives;
- Regulation (EU) 2020/852 (the Taxonomy Regulation) and Regulation (EU) 2019/2088 (Disclosure Regulation) on the establishment of a framework to facilitate sustainable investment providing disclosure standards for financial market participants relating to the integration of sustainability risks into their investment strategies and processes.

The Disclosure Regulation, in particular, is at the heart of this development. Please note that the Disclosure Regulation will only apply from 10 March 2021, while some of its provisions are set to become effective by December 2022 only. The Disclosure Regulation will apply, among others, to AIFMs and requires certain disclosures to be made both at the level of the financial market participant and the level of the relevant financial product, such as AIF. The disclosure obligations will apply irrespective of whether the financial market participant pursues a sustainable investment strategy or not, with additional disclosure obligations attaching to the product promoting, among other characteristics, environmental or social characteristics. The Disclosure Regulation requires disclosures to be made: (i) on the website of the financial market participant, (ii) as part of the pre-contractual disclosures of the product, such as prospectus or offering documentation, and (iii) in annual reports.

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Definitions

This section would have to include definitions of the key terms and abbreviations used in the Policy.

RI Guidelines and Strategies

This section of the Policy would have to outline the core RI philosophy of the Fund. By way of an example, the philosophy of the Fund could be aligned to the UN Principles for Responsible Investment (PRI) comprising the following six principles:

Principle 1: Incorporating ESG issues into investment analysis and decision-making processes.

Principle 2: Being active owners and incorporating ESG issues into ownership policies and practices.

Principle 3: Seeking appropriate disclosure on ESG issues by investee entities.

Principle 4: Promoting acceptance and implementation of the Principles within the investment industry.

Principle 5: Working together to enhance effectiveness in implementing the Principles.

Principle 6: Reporting on activities and progress towards implementing the Principles.

In addition to outlining the core RI philosophy, this section would have to describe the minimum ESG standard to which the Fund would expect investee companies to adhere. By way of an example, the minimum ESG standard could be aligned to the ISO 14001:2015 EMS (Environmental Management Standard).

Positive and Negative Screening Guidelines

This section of the Policy would have to describe the criteria for inclusion (positive screening) or exclusion (negative screening) of investee companies based on their exposure to certain ESG characteristics or factors. The characteristics or factors can range from sector or industry to social or environmental impact on the community in which the investee company operates. Typically, companies with exposure to “problem” or “sin” industries would be excluded, while companies with positive ESG ratings would be included.

Engagement and Active Ownership Procedures/Approaches

This section would have to include an outline of long-term commitment and active ownership engagements employed or prioritized by the Fund with respect to investee companies. Examples include raising shareholder proposals on specific ESG-related issues at shareholder meetings and voting arrangements. The section would also have to describe the means of engaging with management and boards of directors of investee companies to improve their ESG performance as well as targeted initiatives and market initiatives, such as driving measurable outcomes with investee companies, industry,

thematic and country-specific initiatives, collaboration with peers, interdisciplinary experts and industry stakeholders to create best practices and shape legislation.

Reporting

This section would have to describe the procedures used by the Fund to report on its RI activities, either to a select group of stakeholders or broader public. By way of an example, the section could include an outline of review processes used by the Management or the responsible investment committee to make sure the objectives of the RI guidelines and strategies are met.

Policy Review

Efficient policies call for regular reviews. This section would have to describe the procedure for conduct of regular reviews, along with the set of factors and events triggering the necessity of extraordinary reviews.

The operating conditions for AIFMs impose substantial operating requirements which are largely inspired by the regulatory frameworks established under the AIFM and UCITS Directives and based on which supervisory authorities will assess the AIF. These include a formalised and documented due diligence procedure for the selection and ongoing monitoring of investments, with additional requirements applying to less liquid assets. The operating regime also imposes due diligence requirements on the selection and appointment of depositaries and other counterparties, which are limited to financially sound, and properly resourced supervised entities.

The operating framework also contains detailed rules on inducements, investor reporting obligations for subscriptions/redemptions, best execution requirements, and trading orders aggregation and allocation. The Board of Directors of AIFM will need to have sufficient skills, experience and knowledge to understand the risks involved in AIFM activities, and commit sufficient time to perform their duties and obtain training.

9.8 Compliance And Internal Policy

9.8.1.1 *Anti-Money Laundering Combating the Financing of Proliferation and Terrorism (AML/CFT) Policy*

Initial Risk Assessment

Establishment of an effective AML/CFT risk-based compliance system is critical to ensuring a robust risk management function of the Fund to identify, assess, manage and mitigate the types and nature of AML/CFT risks to which it is exposed. Risk assessment is the foundation to establishment of a proportionate risk-based AML/CFT framework of the Fund and allows to prioritize AML/CFT risk management and effectively carry out the planning and use of the necessary resources (e.g., the necessary information technology systems, employees, and qualifications). The Fund shall have a clear understanding of the AML/CTF risks and vulnerabilities that might arise during its operation. In the risk assessment phase, the Fund assesses the risks of possible money laundering, terrorism

and proliferation financing in line with the specifics of services provided, business partner profiles, the geography of distribution of services and channels for the supply of services. The Fund can and should put in place the appropriate compliance system to detect any suspicious activities/transactions by applying risk assessment procedures.²⁶⁶

Periodic Re-Assessment

Risk assessment shall be updated from time to time. The updates should, preferably, occur at least once in every 18 months. If the Fund significantly changes its services, the business partner profile, and other aspects of its operation, these changes should be subject to risk assessment. The Fund would need to assess whether the types of risks or the extent of risks to which it is exposed have changed, whether new circumstances affecting the risk profile have emerged, and to evaluate whether the existing risk management and mitigation measures are sufficiently efficient. It is advisable to ensure adequate and sufficient resources to manage and mitigate the risks.²⁶⁷

Due Diligence and Know Your Customer/Transaction

Business partner due diligence is a risk-based set of activities pertinent to each business partner. Due diligence and know your business partner procedure should be carried out to ensure a secure operating environment and prevent the money laundering and terrorist and proliferation financing risk. Nevertheless, each business partner has to be evaluated on an individual basis and depending on the nature and type of the business partner, due diligence procedure shall be carried out.

Suspicious Activities Reporting

According to the Law on the Alternative Investment Funds and Managers, the Fund shall have in place an internal policy on reporting suspicious activities/transactions. Hence, the Fund has to have explicit instructions not only on how to detect suspicious activities and report any suspicious transaction to the Latvian Financial Intelligence Unit. The reporting obligation also applies to funds causing suspicions that they have been directly or indirectly obtained as a result of criminal activity or related to terrorism and proliferation financing, or an attempt of such criminal offense, as well as cases where sufficient grounds exist for establishing a suspicious transaction.²⁶⁸

Maintaining Records

It is advisable to make and preserve copies of the documentation based on which the business partner's identification has been performed. The copies of the documents are used to evidence that business partner identification has been carried out according to the requirements of the laws and regulations. It is advisable for the Fund to keep

²⁶⁶ Financial and Capital Market Commission, Recommendations for the development of an internal control system for the prevention of money laundering and terrorism and proliferation financing and for customer due diligence, 2020

²⁶⁷ Financial and Capital Market Commission, Recommendations for the development of an internal control system for the prevention of money laundering and terrorism and proliferation financing and for customer due diligence, 2020

²⁶⁸ Law on the Prevention of Money Laundering and Terrorism and Proliferation Financing Section 30 (1)

business partner records for a maximum period of five years after termination of the relationship with the business partner.

Training

Employees of the Fund responsible for AML/CFT and sanctions compliance, shall undergo internal and external training in matters of due diligence, detection of suspicious activities/transactions, and the course of action to be taken in different situations. When planning training, the Fund should rely on risk assessment and evaluate what type of external training is needed. Training shall be meaningful, relevant to the employees concerned, and designed to provide useful expertise strengthening the existing experience as well as providing new insights into the AML/CFT field.

9.8.1.2 Conflict of Interest Policy

Policy Purpose

According to the Latvian Law on the Alternative Investment Funds and Managers, the Fund has to implement an internal conflict of interest policy. The conflict of interest policy seeks to protect the Fund's interest when it contemplates entering into a transaction or arrangement that might benefit the private interest of a member of a governance body of the Fund or employee or might result in a possible excess benefit transaction.

Identification

A conflict of interest can arise in many different forms and situations, but at the outset, it invariably involves some aspect of financial gain or benefit for the member of a governance body or employee that may or may not align with the overall interest of the business. For example, an employee who holds shares in a competing company may stand to gain by disclosing inside information to competitors. Potential conflicts of interest such as these would have to be addressed in the policy. The policy should also contain instructions on the course of action to be taken by members of governance bodies and employees if they believe that a conflict of interest exists, how the conflict would be investigated and resolved, who will be involved in resolving the conflict of interest, and so on.

Disclosure

In connection with any actual or potential conflict of interest, the interested person must disclose the existence of the personal interest and be given the opportunity to disclose all material facts to the Fund. An employee can be requested to sign a separate form of revealing information that might give rise to a conflict.

Monitoring Compliance

To avoid accidental situations of conflict of interest, the Management Board of the Fund should identify persons whose individual activity may pose a risk of conflict of interest (e.g., close relatives of members of the Management Board or Supervisory Board and their family members, former members of the Management Board) and carry out

appropriate risk management.²⁶⁹ As a general principle, no member of the Management Board or Supervisory Board should take part in decision-making on matters in which the interests of the Fund are contrary to the interests of the persons concerned. According to the principles of good corporate governance, persons may be subject to conflict of interest shall regularly participate in trainings on the course of action to be taken in conflict of interest situations.²⁷⁰

9.8.1.3 *Sanction Policy*

Policy Purpose

According to Article 2(2) of the Law on International Sanctions and National Sanctions of the Republic of Latvia, the law applies to all persons, and they have an obligation to comply with and enforce the international and national sanctions.²⁷¹ If the Fund will be registered in Latvia it will need to comply with UN, EU, US, UK, and other applicable national sanctions and, in certain cases, with the Sanctions of other NATO member states. Violation of any sanctions regime may not only pose a reputational risk to the Fund but may also interfere with ensuring peace, security and the rule of law in accordance with international obligations and other applicable national interests. Hence, the policy's purpose is to eliminate the risk of involvement by the Fund in circumvention or violation of any international or other applicable national sanctions regime and to make sure that adequate resources and training are available to employees of the Fund.

Risk Assessment

In order to develop an efficient sanctions policy, the Fund should conduct initial sanctions risk assessment. The risk assessment would have to identify the main sanctions risks relevant to the Fund. In carrying out sanctions risk assessment and evaluating the risks connected with sanctions, the Fund should take into account the scope and nature of its activities and the geographic regions where its services are provided. Moreover, the risk assessment should be conducted at least once every 18 months and updated in a manner aligned to the current level of the sanctions risks to which the Fund is exposed. In addition, the risk assessment should be conducted before the Fund intends to make changes to its operational processes, management structure and services it provides or geographical areas of operation.

Management Commitment

Customarily, the responsibility for sanctions compliance rests with the Management Board. Whenever the Fund refuses to execute the transaction by or terminates the relationship with a business partner who is subject to international or applicable national sanctions or is suspected to be the subject of international or applicable national sanctions, no legal liability, including civil liability, would arise for the Fund. Any failure by an employee to comply with a sanctions policy is usually treated as a severe violation

²⁶⁹ Corporate Governance Advisory Council, Corporate Governance Code. Good Corporate governance recommendations for companies in Latvia, 4th and 13th Principle, 2020

²⁷⁰ Corporate Governance Advisory Council, Corporate Governance Code. Good Corporate governance recommendations for companies in Latvia, 4th and 13th Principle, 2020

²⁷¹ Law on International Sanctions and National Sanctions of the Republic of Latvia Article 2(2)

of the employment contract or other contract and may result in disciplinary action or imposition of civil, criminal, or administrative penalty.

Internal Controls

The Fund should refrain from deliberately violating international or other applicable national sanctions and participating in activities object or effect to circumvent the restrictions imposed under any applicable sanctions' regime. Should the Fund identify, at any time, that any of its business partners is the subject of sanctions, the Fund would have to, immediately and without prior notice, deny the business partner access to financial means and financial instruments. Suppose that an employee, officer, or representative of the Fund has suspicions regarding the Fund's binding obligation, potential non-compliance or violation of the applicable sanctions policy. In such a case, the employee, officer, or representative should immediately notify the person responsible for sanctions compliance. In addition, the Management Board may also have to be informed. Irrespective of the course of action taken, in the event of circumvention, attempted circumvention, or violation of the applicable sanctions' regime, the Fund should also notify the competent authority under the applicable law.²⁷²

Training

There shall be conducted adequate training of employees of the Fund on a regular basis, taking into account the scope of authority and nature of duties and responsibilities of employees. Attendance of the training should be made mandatory.

Auditing

The sanctions compliance policy should be subject to regular reviews and updates to be conducted at least once in every 18 months. The changing political situation on which sanctions are based requires close and hands-on monitoring of the situation. The changes should be reflected in the sanctions policy as early as practicable.

9.8.1.4 Risk Assessment and Management Policy

Policy Purpose

The purpose of this policy is to lay down general and uniform requirements for risk management and the division of risk management responsibilities within the Fund in accordance with internationally recognised standards, best practices of corporate governance and applicable laws and regulations. The main objective of the policy is to make it easier for the Fund and its employees to conduct risk management activities and, at the same time, promote adequate monitoring of employees at a different level, to enhance reputation for the Fund, efficient risk management, to enable continued operation of the Fund in distress situations, and contribute to successful operation of the Fund.

²⁷² The Wolfsberg Group, Wolfsberg Guidance on Sanctions Screening, 2019

Risk Categories

In determining the types and nature of risks relevant to the Fund, risks are divided into the following categories:

Table 60 Risk Categories

Risk category	Example
Strategic	Strategy and development decisions, decisions on innovation, delegation of responsibilities and procurement
Operational	Human resource management, technology activities, security measures
Legal and liability	Compliance with regulatory requirements, contractual control
External environmental	Conflicts, political impact, changes in laws and regulations, natural disasters, terrorism, meteorological conditions
Corruption	Handling of financial means and property, decision making
Financial	Market risk, credit risk, liquidity and cash flow risk

Source: KPMG

Governance

Risks are governed and managed by responsible entities, namely, responsibility of the Supervisory Board (if applicable), Management Board, and other employees shall be specified in the Risk Management policy. The main principles such as transparency, compliance and prevention shall form part of the policy. It is advisable to include in the Risk Management policy the following elements such as risk identification, risk assessment, decision-making on the type of response, risk recording, identification of risk mitigation measures and the procedures for risk mitigation, and monitoring of risks.

Audit

It is advisable that at least once a year, the existing risk identification and mitigation procedures be evaluated by the Supervisory Board or Management Board of the Fund.²⁷³ The evaluation serves as an efficient risk management tool tailored to the most relevant threats faced by the Fund.

9.8.1.5 Corporate Governance/Other Policies

As illustrated above, good corporate governance could help the Fund manage any reputational risks, balance the various stakeholders' needs, and be compliant with the applicable regulations. Good corporate governance often involves carrying out due diligence of business partners, resolving conflicts of interest between the various stakeholders, and ensuring that the organisation is managed well - meaning that the

²⁷³ Corporate Governance Advisory Council, Corporate Governance Code. Good Corporate governance recommendations for companies in Latvia Principle No.3, 2020

processes, procedures, and policies are implemented according to the principles of transparency and accountability.²⁷⁴

Policies illustrated above are those which are mandatory for the Fund to have. In comparison, the policies indicated below are meant as recommendations that successfully implemented would promote transparent and fair management of the Fund and allocate its resources more effectively.

Table 61 Internal Audit Policies

Internal audit policy	Assessment and development of the effectiveness of risk management, internal control and management processes
Whistleblowing policy	To reduce and prevent reputation, security and other risks, so that infringements are reported in the Fund's interest.
Information disclosure and confidentiality policy	Categorising information and determining the arrangements for handling information, transparency of the business, including in order to ensure better supervision of the Fund for investors.
Personal data protection policy	Establish procedures in compliance with the requirements of the General Data Protection Regulation (EU) 2016/679 for the processing of personal data, including, but not limited to, the collection, organisation, storage, viewing, use, disclosure, deletion, dispatches, dissemination, dissemination or other making available of personal data.
Equality, diversity and inclusion policy	Promoting an inclusive working environment and attitudes to ensure diversity and guarantee equal opportunities for all in the working environment.
Source: KPMG	

²⁷⁴ OECD, G20/OECD Principles of Corporate Governance. Principle No.1, 2015

10 CMDAF Baltic SME IPO Fund Listing Potential and Time Horizon

The CMDAF Baltic SME IPO Fund can become a potentially unique vehicle to be listed on the stock exchange at some point in time. This is because it would represent a consistently themed (via the investment strategy) and professionally managed exposure to Baltic SMEs showing promising long-term return potential.

However, as many details have not yet been finalised, it is difficult to establish when such a step could be considered. Some initial considerations include:

- It is difficult for a new fund with an untested investment strategy (based on a market gap) to immediately gain investor support due to the lack of a relevant track record, even with an experienced management team with otherwise good track record. Fortunately, as the lion's share (if not all) of the investments will be made into soon-to-be-listed or listed companies, then a tangible investment track record based on mark to market, as opposed to less tangible fair-value bookings in regular PE funds, should materialise already after several years, as opposed to market standard two-fund cycle in the VC&PE industry. To be noted, this statement concerns only the differing speed in which the track record numbers will become visible because of mechanics of mark-to-market method as opposed to slower fair-value method. No forward-looking position is taken on expected positivity or not of such faster track-record.
- EU state aid considerations should the fund be listed too early on in the process because founding investors partially/fully represent Baltic state-related public entities.
- Larger institutional fund managers from the Baltic area who do not have sufficient resources to analyse smaller companies may use this as a proxy for creating a diversified portfolio of SMEs. A particular focus here would be on pension funds, which typically have greater constraints on liquidity and specific company characteristics due to regulatory considerations. Listing helps to resolve this.

Listing provides additional funding opportunities (expanding the AUM) as well as facilitating easier full/partial exits for initial investors rather than having to dispose of a portfolio of less liquid assets under timing duress due to a general liquidation of the fund. Moreover, as the stakes in the companies would have limited influence in the underlying investments (by and large passive in nature), this initially limits the potential audience to whom such positions could be sold to in case of individual disposals. Further discussions will be held to determine whether it would be more practical to have an evergreen structure capability (without a fixed term) already from the fund's inception.

One factor to be considered is that most investment funds typically trade at a -discount to their net asset value (NAV), which may limit investor appetite unless the outperformance is consistently strong relative to the respective benchmark. Absolute

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performance would be a better way to evaluate the returns than a relative performance benchmark due to diverging trends vs. large cap stocks and large cap markets.

The total costs of listing the fund, together with ongoing reporting/compliance requirements are still required to be made should the listing possibility be considered. This further implies the need for a commercially-focused fund to be created from inception, with acceptable industry-based performance compensation levels. Furthermore, the AUM has to be high enough to make it feasible from an economies of scale perspective.

Based on the current target to achieve the initial CMDAF Baltic SME IPO Fund investor funding decisions by mid-2021 and first closing of the CMDAF Baltic SME IPO Fund in H2 2021, considering that it takes 6-12 months from the first closing to get to the first fund investment, and considering that it could take at least 24-36 months to build out the majority of the fund portfolio, the earliest there could be enough clarity and data to consider the CMDAF Baltic SME IPO Fund listing is 2024-2025.

A Tax, Accounting and Reporting Matters

The following sections outline taxation, accounting and reporting framework of Latvia, Estonia and Lithuania that is relevant to the Fund's activity, income taxation at the level of the Fund and at the level of its partners or shareholders, depending on the legal form of the Fund, with focus on legal forms that permit granting of AIF status, as well as taxation principles applicable to the Funds Manager. The aim of the comparative analysis is to analyse tax transparency of the Fund and determine more favourable jurisdiction from the tax perspective.

A.1 Estonian Taxation, Accounting and Reporting Framework

A.1.1 Income Tax Application to the Fund Depending on its Legal Form

A.1.1.1 *Taxation of Income of a Limited Partnership Fund*

Article 2 Paragraph 1 of Income Tax Act²⁷⁵ provides that income tax is paid by natural persons, common investment funds, public limited funds and non-resident legal persons who derive taxable income. A common investment fund is a common fund established in Estonia or foreign state for the purposes of Article 4 of the Investment Funds Act²⁷⁶ and a public limited fund is a fund founded as a public limited company for the purposes of Article 6 of the Investment Funds Act. A limited partnership fund as defined in Article 8 of the Investment Funds Act is not considered as a tax payer under the Income Tax Act.

Therefore, an AIF that is a limited partnership fund under Income Tax Act is not subject to income tax in Estonia and is tax transparent. Any profit earned by the fund will be treated as the profit of the investors.

A limited partnership is relieved from the obligations of a WHT agent, therefore, it is not withholding tax from payments made to the partners. If a limited partnership earns net profit, then the distribution of dividends or making of capital repayments exceeding the amount of payments made into the company are not subject to taxation at the level of the limited partnership. The investors of a limited partnership are taxed as if they had made the relevant investment into the underlying instrument directly, i.e. not through the fund, and mainly are liable for tax payments themselves.

A limited partnership is obliged to submit a return (form INF 17) to the Tax and Customs Board regarding income received in a calendar year and regarding the investors and their respective participations at the time of receiving the income and confirming their residency. The deadline for filing this report is 1 February of the year following the year of the receipt of income.

²⁷⁵ Riigikogu, Income Tax Act (English translation), 2021

²⁷⁶ Riigikogu, Investment Funds Act (English translation), 2020

A.1.1.2 *Taxation of Income of Common Investment Funds and Public Investment Funds*

Chapter 5²⁷⁷ of the Income Tax Act describes the income types of common investment fund and public investment fund. The income of these funds is taxable in Estonia only to the extent that it is related to real estate located in the territory of Estonia. The income tax of 20% is either to be withheld at source by the income payer qualifying as a WHT agent or, if the payer does not meet this criterion, the fund needs to declare its income and pay tax on its own.

The other types of income received by the funds is taxable at the level of the investors. In addition, please note that the Estonian taxation rules specified below do not apply to

- Pension funds established in Estonia;
- Pension funds established in another European Economic Area country, which are subject to financial supervision and the prudential requirements that are at least as stringent as those established for pension fund management companies by the Estonian Investment Funds Act.

A.1.1.3 *Interest Taxation*

Income tax is charged on interest, which a common investment fund or public limited fund receives, in connection with a holding in a common investment fund or other pool of assets, of whose property, at the time of the payment of interest or during a period within 2 years prior to that, more than 50% was directly or indirectly made up of immovable property located in Estonia and in which the recipient of interest had a holding of at least 10% at the time of the payment of interest.

A.1.1.4 *Capital Gains Taxation*

Income tax is charged on gains derived from the transfer of property by a common investment fund and public limited fund, if:

1. The transferred immovable is located in Estonia, or
2. The transferred real right or right of claim is related to an immovable located in Estonia, or
3. The transferred or returned holding is a holding in a company, contractual investment fund or other pool of assets of whose property, at the time of the transfer or return or during a period within 2 years prior to that, more than 50% was directly or indirectly made up of immovable property located in Estonia and in which the transferor had a holding of at least 10% at the moment of specified transaction.
4. Gains were derived on the conditions specified in Point 3 above upon liquidation of a company, contractual investment fund or other pool of assets as specified above.

²⁷⁷ Riigikogu, Income Tax Act (English translation), 2021

A.1.1.5 Rental Income

Income tax is charged on the rental income received by a common investment fund or a public limited fund, which is derived from the membership of the fund in a building association established in Estonia, an apartment ownership located in Estonia, an immovable located in Estonia or limited real rights related thereto.

A.1.2 Taxation of Income at the Level of Partners or Shareholders

A.1.2.1 Resident Legal Entity

Similar to the Latvian CIT system, the Estonian tax system also shifts the point of corporate taxation from the moment of accrual to the moment of distribution and income is not taxed on receipt but on profit distribution.

Namely, distributed profits are generally subject to CIT of 20% of the gross amount or 20/80 of the net amount of profit distribution. Distribution of profits includes dividends, share buy-backs, capital reductions, liquidation proceeds, certain issued loans to a shareholder or a partner, or deemed profit distributions (such as transfer pricing adjustments, business non-related expenses and payments).

Furthermore, certain transactions and payments to low tax or no tax jurisdictions are treated as deemed profit distributions, which are therefore subject to CIT of 20%:

1. Acquisition of securities issued by a tax haven entity (exception for certain listed securities).
2. Acquisition of a holding in a tax haven entity.
3. Payment of fines, contractual penalties or compensation for damage to a tax haven entity, unless settled by court or arbitration.
4. Granting loans or making prepayments to a tax haven entity or otherwise acquiring a claim against a tax haven entity.

CIT at the rate of 14% of the gross amount or 14/86 of the net amount is applicable to legal entities making regular profit distributions. Namely, the amount of dividend, which is below or equal to the amount of taxed dividends paid out during the three preceding years, is subject to the lower CIT rate. In cases where the recipient of the dividends taxed at the reduced rate is either a resident or non-resident private individual, WHT of 7% will also apply unless the applicable Double Tax Treaty provides for a lower WHT rate.

All undistributed profits are tax exempt (until the moment of distribution; the Estonian CIT system is cash based). This exemption covers trading profits as well as inbound dividends, interest, royalties and other passive income. It also covers capital gains from the sale of all types of assets, including shares, securities, and immovable property. The tax regime is available to Estonian resident legal entities and Estonian PEs of non-resident legal entities.

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Thus, received dividends, interest payments and capital gains of a partner or a shareholder (i.e. an investor) of the Fund, notwithstanding its legal form, is not taxed, if the income is retained or reinvested. CIT is applied only upon further distribution of the profits by the partner or shareholder.

No additional WHT is applied to dividends or interest payments made to an investor, who is a resident legal entity.

A.1.2.2 CIT Exemptions

Under Article 50 Paragraph 1²⁷⁸ of the Income Tax Act income tax is not charged on dividends paid out if:

1. Dividends are received from Estonian, EU, European Economic Area and Swiss tax resident legal entities (except tax haven companies) in which the resident legal entity Estonian company receiving the dividends has at least a 10% shareholding or voting rights at the time of receipt of the dividends;
2. Dividends received from legal entities situated in other countries (except from tax haven jurisdictions) in which the resident legal entity has at least a 10% shareholding or voting rights at the time of receipt of the dividends, provided that a foreign income tax was withheld from the dividends upon the payment or the profit, on the account of which the dividends are distributed, have been taxed with income tax.

In addition, Article 50 Paragraph 1 stipulates that where profits are distributed by way of a bonus issue, this is also not subject to CIT.

A.1.2.3 WHT Tax Applicable to Non-Resident Legal Entity

In general, received dividends, interest payments and capital gains of a non-resident legal entity that is a partner or a shareholder of the Fund are not subject to tax in Estonia and WHT is applied only to certain payments as described below:

In practice, a non-resident partner generally has to declare income received by the limited partnership and attributed to it itself.

A.1.3 Taxation of the Funds Manager's Income

A.1.3.1 Income Taxation of the Fund's Manager

For income tax application purposes, the manager of the AIF that is registered in Estonia is a regular CIT payer and income is taxable according to the general taxation principles described in the section "Resident legal entity" above.

Payments to non-resident companies for services provided in Estonia, including management and consultancy fees, are subject to a WHT of 10% under domestic law,

²⁷⁸ Riigikogu, Income Tax Act (English translation), 2021

but may be exempt under an applicable Double Tax Treaty. Thus, whenever the Fund Manager is a non-resident, services may be subject to withholding tax.

A.1.3.2 VAT Application Principles

Article 16 Paragraph 2 Sub-Paragraph 11 of the Value Added Tax Act²⁷⁹ determines that provision of fund management services to an investment fund are considered tax exempt supplies.

A.2 Latvian Taxation and Reporting Framework

A.2.1 Establishing the Fund

According to Latvian regulations an AIF can be established using the following legal forms – aggregation of property, limited partnership or joint stock company. From the information available we understand that the decision on the particular legal form of the AIF is not yet made. However, from the available information we conclude the most likely legal form of the AIF will be a limited partnership or joint-stock company.

A.2.2 Income Tax Application to the Fund Depending on its Legal Form

A.2.2.1 AIF Income Taxation

Article 2, Paragraph 2, Sub-Paragraph 6 of the LV CIT Law²⁸⁰ states that an AIF is not a CIT payer. Article 2, Paragraph 3, of the LV CIT Law foresees that CIT or PIT will be paid by the investor where relevant.

The LV CIT Law does not specify that the aforesaid regulation applies only to a specific legal form of the AIF. Therefore, it may be assumed that AIF, irrespectively of its legal form, is transparent for income or corporate tax purposes and income is not taxed at the AIF level, but at the level of its partners, shareholders or investors.

Due to lack of any official explanations by the SRS or Ministry of Finance, prior to deciding on the legal form of the AIF, it is advisable to request an official confirmation by the State Authorities that an AIF is not a CIT payer, irrespective of its legal form. For example, clearly confirming that the Fund would still not be considered as a CIT payer in situations when profit is distributed among the AIF's shareholders or partners nor among investors in relation to their investment made.

Considering that an AIF itself is not a CIT payer and does not pay CIT on profit distribution or withhold PIT on interest payments or capital gains, the manager of an AIF is responsible for all tax obligations and withholdings, where applicable, as well as for accounting and reporting.

²⁷⁹ Riigikogu, Value-Added Tax Act (English translation), 2020

²⁸⁰ Saeima, Enterprise Income Tax Law (English translation), 2019

An AIF's profits can be distributed to investors in respect of the investments made and investment certificates issued. The tax consequences of the income in the hands of the recipients may differ depending on the form of the participation.

A.2.2.2 General Taxation Principles of a Regular Capital Company and a Partnership

Capital companies and partnerships that are not AIFs are regular CIT payers and general taxation principles apply.

Starting from 1 January 2018 CIT at 20% (calculated as 0.2/0.8 from net dividend or distribution) is payable not when the profit is made, but rather upon dividend distribution. In addition to dividend distribution there are other types of transactions that are subject to CIT – dividends in kind, deemed profit distribution (i.e. expenditure not related to economic activity, increased interest payments, debt write-offs, etc).

A.2.3 Taxation of Income at the Level of Partners, Shareholders or Investors

A.2.3.1 Resident Legal Entity

Gains from the sale of the Fund certificates (investment) would be taxable under general principles, i.e. upon profit distribution.

A.2.3.2 CIT Exemptions Applicable to a Resident Legal Entity

Distribution of profits is not subject to CIT if made up from dividends received by the capital company or partnership from its shareholding in companies that are CIT payers or have withheld CIT or similar tax at source. The exemption also applies when dividends are received from an AIF that itself is not a CIT payer, but has further distributed dividends received from its shareholding in a company that is a CIT payer in its country of residence or has withheld tax at source. In this case it is the obligation of the manager to submit all relevant information to the SRS about the payments made by the Latvian AIF. The aforesaid exemptions however do not apply to dividends received from a low tax or no tax jurisdictions, which is not likely to be the case with the CMDAF EU Baltic SME IPO Fund.

A.2.3.3 WHT Applicable to a Non-Resident Legal Entity

Whenever a non-resident legal entity receives income that is subject to WHT as described in this section as partner, shareholder or investor in an AIF, the respective funds manager making the payment shall withhold the tax.

A.2.3.4 A Non-Resident Legal Entity Established, Registered, Located in a Low Tax or no Tax Jurisdictions

Any payment that is made by a Latvian resident to a non-resident legal entity that is registered, located or established in a low tax or no tax jurisdiction, including payments to the legal entity's representatives or to a bank account of a third party, is subject to WHT of 20% is applied. Such payments include dividends, interest payments and payments for the disposal of shares or holding in the Fund.

A.2.4 Taxation of the Fund's Manager Income and Income of the Shareholders of the Fund's Manager

A.2.4.1 *Income Taxation of the Funds Manager*

For income tax application purposes The manager of an AIF that is registered in Latvia is a regular CIT payer and it's income is taxable according to the general taxation principles. Nevertheless, the manager of an AIF is subject to additional reporting obligations for any payments made to the partners, shareholders or investors of the Fund that is established in Latvia.

If the manager of the Fund is a non-resident legal entity, the Fund might be obliged to withhold tax of 20% for management and consultancy fees paid to the manager, unless the manager of the Fund is located in a State with which Latvia has concluded a Double Tax Treaty.

A.2.4.2 *VAT*

Article 52, Paragraph 1, Sub-Paragraph 22 of the Value Added Tax Law²⁸¹ states that management of investment funds, State funded pension scheme investments, closed and open pension funds, risk capital funds, as well as insurance companies and other investment portfolios, which are collective investments or are established on the basis of the requirements laid down by such funds (including technical reserves and guarantee funds), is treated as a non-taxable supply of services if the management is related to lawful or actual decision-making powers.

At a later stage when the decision on the Fund manager and its activities is decided, management activities should be analysed to assess whether this VAT exemption would indeed apply for fund management services.

A.2.5 Reporting Requirements

A.2.5.1 *Reporting for the Payments*

Article 16, Paragraph 3 of the CIT Law provides that the managers of an AIF have an obligation to submit to the SRS information regarding any payments made to the investors in the fund that is established in Latvia.

The Manager of the AIF must submit detailed information about the investors and the payment – name of investor, registration number, country of residence, address, type of income (interest, dividends, income from lease or rent of real estate, other income, including repurchase of investment fund certificates), date of the payment and amount of the payment.

When the fund is making dividend payments to its investors (this would apply if the Fund is registered as a joint stock company), the manager must also submit to the SRS

²⁸¹ Saeima, Value Added Tax Law (English translation), 2019

information about any dividends received by the fund as such dividends when passed through may be tax exempt at the investor level.

A.3 Lithuanian Taxation, Accounting and Reporting Framework

A.3.1 Income Tax Application to the Fund Depending on its Legal Form

Article 2 Paragraph 2 of the LT CIT Law²⁸² provides a definition of a Lithuanian taxable entity – (i) a legal person registered in accordance with the legal acts of Lithuania, (ii) a collective investment undertaking established in Lithuania without the status of a legal person. Article 3 of the LT CIT Law states that a Lithuanian taxable entity is subject to CIT in Lithuania.

Considering the aforesaid it may be concluded that the Fund irrespective of its legal form or AIF status, is a CIT payer under LT CIT Law.

A.3.1.1 AIF Income Taxation

As provided by Article 12, Paragraph 1, Sub-Paragraph 5 of the LT CIT Law, income of a Lithuanian collective investment undertaking is CIT exempt irrespective of its legal form (i.e., investment fund or investment company), except if the income is received from companies registered or otherwise organised in blacklisted jurisdictions (i.e. tax havens) or residents of such jurisdictions.

Where the management of a collective investment undertaking is transferred to a management company, the management company shall apply the procedure of taxation of profit earned and/or income received or paid out by a collective investment undertaking as prescribed by the LT CIT Law.

Thus, even though AIF is treated as CIT payer under the LT CIT Law, overall its income at the fund level based on the Lithuanian collective investment undertaking tax regulation is CIT exempt (except when income is received from the companies registered or otherwise organised in blacklisted jurisdictions or residents of such jurisdictions). Nevertheless, WHT may apply to income distributed to partners/investors and shareholders of the fund.

A.3.1.2 General Taxation Principles of a Legal Person

In contrary to the CIT application system in Latvia and Estonia, CIT in Lithuania is imposed on a tax payer's profit which includes business/trading income, passive income, capital gains and positive income of controlled foreign entities. Taxable income is calculated by adjusting general income of a certain tax period with non-deductible expenses and non-taxable income.

Article 5 of the LT CIT Law states the applicable CIT rates. The general CIT rate is 15%. A reduced rate of 5% applies to corporate profits of small companies, whose annual

²⁸² Seimas, Law on Corporate Income Tax (English translation), 2018

income does not exceed EUR 300 000 during a tax year and where the average number of employees does not exceed 10 (with exception if the shareholder of the small company is also a shareholder in other companies as described in the Article 5, Paragraph 3, of the LT CIT Law). Newly established small companies may be subject to 0% CIT rate for the first year of activity, provided certain conditions are met.

In addition to CIT paid by taxable entities on their profits, WHT may be applicable to the certain distributions of the fund to its shareholders or partners.

A.3.2 Taxation of Income at the Level of Partners or Shareholders

A.3.2.1 Resident Legal Entity

A resident legal entity pays CIT at the standard rate of 15% from its taxable income, unless a reduced CIT rate may be applied.

A.3.2.2 Dividend Taxation of a Resident Legal Entity

Dividends distributed by a resident legal entity to another resident legal entity are subject to CIT of 15%, which is withheld by a distributing legal entity. Where CIT is withheld upon distribution of dividends, the receiving legal entity may reduce its CIT payable for that period when dividends were received by the amount of CIT withheld from the received dividends. Any excess credit may be offset with other taxes payable.

A CIT withholding exemption applies to dividends distributed by a resident legal entity, if the recipient legal entity has held not less than 10% of the voting shares in the distributing legal entity for at least 12 successive months and the profit of the distributing entity is subject to CIT or similar tax (it shall be noted that aforesaid participation exemption may be applied even if the shares are held for a period shorter than 12 successive months, but the recipient intends to hold them for such or a longer period). Nevertheless, exemption may not be applied when the dividends received from a foreign legal entity were deducted from taxable profits at the distributing legal entity level or if received from blacklisted jurisdictions.

Dividends distributed by a non-resident legal entity to a Lithuanian corporate shareholder are generally subject to 15% CIT that is to be paid by the receiving resident legal entity in Lithuania, unless if the distributing foreign entity is established in the European Economic Area and its profit is subject to CIT or similar tax in its residence country.

A.3.2.3 Interest Taxation of a Resident Legal Entity

Interest income is treated as general taxable income and is subject to CIT of 15%. No additional WHT is applied for interest received by a Lithuanian entity from another Lithuanian entity.

A.3.2.4 Capital Gains Taxation of a Resident Legal Entity

Capital gains are taxed as part of the taxable income of a resident legal entity under the general provisions of income taxation.

Nevertheless, a CIT exemption applies to capital gains that are derived from the transfer of shares in a company incorporated in the European Economic Area or in a country with which Lithuania has a valid Double Tax Treaty and which is subject to CIT or similar tax in its country of residence. The exemption is applied if the resident legal entity holds more than 10% of voting shares for a continuous period of (i) at least two years or (ii) at least three years when the shares were transferred in one of the established forms of reorganisation. The exemption however shall not apply if the entity transferring the shares transfers them to the entity that has issued these shares (Article 12 Paragraph 1 Sub-Paragraph 15 of the LT CIT Law).

A.3.2.5 *Non-Resident Legal Entities*

Under Article 4 Paragraph 3 of the LT CIT Law non-resident legal entities pay CIT on their income earned in Lithuania, including income earned through a Lithuanian based PE, as well as Lithuania imposes WHT on income of a non-resident legal entity:

1. WHT of 15% from dividend income (unless the rate may be reduced under applicable Double Tax Treaty or Parent – Subsidiary Directive).
2. Nevertheless, a CIT withholding exemption applies to the dividends distributed by a resident legal entity, if the recipient legal entity has held not less than 10% of the voting shares in the distributing legal entity for at least 12 successive months and the profit of a distributing entity is subject to CIT or similar tax (it shall be noted that aforesaid participation exemption may be applied even if the shares are held for a period shorter than 12 successive months, but the recipient intends to hold them for such or a longer period). Exemption may not be applied when the dividends received from a foreign legal entity were deducted from taxable profits at the distributing legal entity level or if received from blacklisted jurisdictions.
3. WHT of 10% from interest payments from any type of debt obligations, including securities (except interest paid to non-resident legal entities established in the European Economic Area or in a country with which Lithuania has a valid Double Tax Treaty, such interest is not subject to withholding tax).
4. WHT of 15% on proceeds from the disposal or lease of immovable property located in Lithuania.

No WHT is applied to the capital gains upon the disposal of capital assets (other than immovable property).

A.3.3 *Taxation of the Fund's Manager Income*

A.3.3.1 *Income Taxation of the Fund's Manager*

The manager of an AIF which is a Lithuanian taxable entity is a regular CIT payer and income is taxable according to the general taxation principles. Nevertheless, the manager of the AIF is subject to additional reporting obligations.

A.3.3.2 *Income Taxation of the Shareholders*

Applicable taxes differ depending if the shareholders are resident/non-resident legal entities or resident/non-resident private individuals.

A.3.3.3 *VAT Application Principles*

Article 28 Paragraph 6 of the Law on Value Added Tax Law²⁸³ provides that management of assets of variable capital investment companies, closed type investment companies, investment funds and pension funds shall be exempt from VAT.

A.3.4 Accounting and Reporting Requirements**A.3.4.1 *Reporting Requirements***

The fund (or its management company) must submit the required tax returns under regular reporting deadlines.

²⁸³ Seimas, Law on Value Added Tax (English translation), 2020

B List of Meetings and Interviews

This list of meetings and interviews does not include project Steering Committee meetings and technical meetings as well as numerous internal working meetings. It also does not include a handful of meetings with public and private equity market players, institutional and other types of investors, that had agreed to participate off-the-record with their views and experience in the elaboration of this report.

Date of the Meeting	Goal of the meeting	Institution/ Company	Representative/s
05.03.2021	Discussion on possible EIF involvement in the CMDAF project	EIF	Head of Mandate Management Equity division; Senior Mandate Manager; Private Equity Mandate Officer
02.03.2021	Discussion on the position of the EstVCA and LVCA regarding the project	EstVCA LVCA	Member of the Board of the EstVCA; Chairwoman of the Board of the LVCA
23.02.2021	CMDAF Baltic SME IPO Fund initiative follow-up	Ministry of Economic Affairs and Communications of Estonia Ministry of Finance of Estonia	Senior Expert at Economic Development Department Director and Senior Expert of Financial Market Policy; Department
11.02.2021.	Project technical call mainly addressing funding synchronisation across the three countries	Ministry of Finance of Estonia; Ministry of Finance of Latvia; Ministry of Economy of Latvia; Ministry of Finance of Lithuania	11 attendees
08.02.2021	Status update & draft material on regulatory impediments	Ministry of Finance of Estonia	Director and Senior Expert of Financial Market Policy Department
05.02.2021	Status update & draft material on regulatory impediments	Ministry of Finance of Lithuania	Director; Deputy Director; Chief Specialist; Senior Specialist of Financial Markets Policy Department

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04.02.2021	Discussion among Financial sector regulators, institutions, associations and ministries regarding funding for the CMDAF Baltic SME IPO Fund	Ministry of Finance of Latvia; Ministry of Economy of Latvia, Central Bank of Latvia; Finance Latvia Association; Nasdaq Riga; Latvian FCMC; Central Finance and Contracting Agency	35 attendees
02.02.2021.	Presentation of CMDAF	Chancery of the President of Latvia	Economic Policy Adviser Smart Technology Adviser
11.01.2021.	Presentation of CMDAF and discussion on potential involvement	Council of Europe Development Bank	Country Manager for Finland, Latvia and Lithuania
07.01.2021	Case study interview	MADARA Cosmetics	Managing Director and Shareholder
06.01.2021	Case study interview	NEO Finance	Chairman of the Board
14.12.2020	Case study interview	Linda Nektar	Chairman of the Supervisory Board and Majority Co-owner
13.11.2020. and 11.11.2020.	CMDAF Investment strategy and structure discussion	EBRD	Associate Director and Head of DCM; Head of Venture Capital Funds; Principal, Local Currency & Capital Markets Development Equity Funds Associate
20.10.2020	CMDAF Presentation & discussion of market gaps and strategy	Ministry of Economic Affairs and Communications of Estonia	Deputy Secretary General; Senior Expert at Economic Development Department
08.10.2020	Market gap discussion & CMDAF strategy discussion	Ministry of the Economy and Innovation of Lithuania (MoE)	Vice Minister, MoE; EU Investment Coordination Department, Director, MoE; EU Investment Coordination Department, Financial Instruments Division, Head, MoE;

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			EU Investment Coordination Department, Financial Instruments Division, Chief Specialist, MoE; CEO, Invega; Deputy CEO, Invega; Project Management Division, Senior Project Manager, Invega
07.10.2020	CMDAF presentation/ Market gap discussion & CMDAF strategy discussion	DG FISMA	Head of Capital Markets Union Unit; Deputy Head of Unit; Policy Officer ; Principal, Local Currency & Capital Markets Development, EBRD; CMDAF Project Manager from DG REFORM
06.10.2020	CMDAF presentation to Baltic ESOs	Multiple European Commission Directorates General	Representatives from EU Representations in the Baltics; Representative of DG ECFIN; Representative of SG RECOVER; Principal, Local Currency & Capital Markets Development, EBRD
05.10.2020.	Briefing on CMDAF Project progress and further steps	EBRD DG REFORM	Associate Director and Head of DCM; Principal, Local Currency & Capital Markets Development Equity Funds Associate; CMDAF Project Manager from DG REFORM
30.09.2020	Case study interview	Franklin Templeton (Fondul Proprietatea)	Vice President/Investment Analyst; Vice President/Investment Analyst
29.09.2020	Case study interview	EIF (BIF I and BIF II)	Senior Mandate Manager; Private Equity Mandate Officer
25.09.2020	Market gap discussion & CMDAF strategy discussion	Central Bank of Latvia	Head of Monetary Policy Administration; Head of Financial Stability Department;

			Head of Financial Stability Division; Senior Economist of Monetary Policy; Administration; Analyst of Monetary Policy Administration
22.09.2020	Case study interview	K-Growth	Senior Manager at K-Growth; Banker at Korea Development Bank; Team Leader of Fund Management Team at K-Growth
11.09.2020.	Market gap discussion & CMDAF strategy discussion	Nasdaq in Lithuania	CEO Nasdaq Vilnius
11.09.2020.	Market gap discussion & CMDAF strategy discussion	LitVCA	Chairman of the LitVCA Board, Managing Partner at Contrarian Ventures; Managing Director Founding Partner of Livonia Partners; Founding Partner at Iron Wolf Capital; Director at Swedbank Investment Management; Partner at LitCapital; CFO at Practica Capital; Several other key LitVCA members
11.09.2020.	Market gap discussion & CMDAF strategy discussion	Invega	CEO; Deputy CEO; Senior Specialist
11.09.2020.	Market gap discussion & CMDAF strategy discussion	Ministry of Finance of Lithuania	Director; Senior Advisor; Senior Specialist of Financial Markets Policy Department
10.09.2020.	Market gap discussion & CMDAF strategy discussion	INVL Asset Management (Invalda) (Latvia)	Chairman of the Board
09.09.2020	Market gap discussion & CMDAF strategy discussion	Nasdaq Riga	CEO of Nasdaq Riga
08.09.2020	Market gap discussion & CMDAF strategy discussion	Finance Latvia Association	Chairwoman of the Board; Member of the Board;

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			Economic Advisor
08.09.2020.	Market gap discussion & CMDAF strategy discussion	LVCA	Executive Director of LVCA; Founding Partner of Livonia Partners; Partner and Chairman of Board of ZGI Capital
08.09.2020.	Market gap discussion & CMDAF strategy discussion	Ministry of Finance of Estonia Ministry of Economics of Estonia	Director and Senior Expert of Financial Market Policy; Department of Ministry of Finance Director of Department of Competitiveness of Businesses of Ministry of Economics
07.09.2020.	Market gap discussion & CMDAF strategy discussion	Finance Estonia Nasdaq Tallinn Banking Association	CEO of Finora Capital; CEO of Nasdaq Tallinn; CEO of LHV Pank
07.09.2020.	Market gap discussion & CMDAF strategy discussion	EstVCA	Managing Director of EstVCA; Founding Partner at Karma Ventures; Partner at BaltCap; Several other active EstVCA members
07.09.2020.	Market gap discussion & CMDAF strategy discussion	Central Bank Finantsinspeksioon	Member of the Board of Central Bank; Analyst of Finantsinspeksioon
07.09.2020.	Market gap discussion & CMDAF strategy discussion	Ministry of Finance of Estonia SmartCap (on behalf of KredEx)	Head, Deputy Head and Advisor of Financial Markets Policy; Department of Ministry of Finance; Member of the Board of SmartCap
01.09.2020.	Market gap discussion & CMDAF strategy discussion	Altum	Chairman of the Board; Head of Financial Intermediaries
28.08.2020	Market gap discussion & CMDAF strategy discussion	Swedbank Investment Management in Latvia	CEO; Fund Manager
25.08.2020	Discussing results of FCMC survey	Latvian FCMC	Senior Supervisory Officer; Chief Supervisory Officer

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18.08.2020	Market gap discussion & CMDAF strategy discussion &	Latvian FCMC	Member of Council; Member of Council; Senior Supervisory Officer
07.08.2020	Case study interview	TESI (Finland)	Development Director; Director, Growth & Industrial Investments
06.08.2020	Market gap discussion & CMDAF strategy discussion	INVL Asset Management (Invalda) (Lithuania)	Member of the Board
31.07.2020	Market gap discussion & CMDAF strategy discussion	BaltCap	Managing Partner; Partner
30.07.2020	Market gap discussion & CMDAF strategy discussion	LitVCA	Chairman of the Board

C Interview Questions

This annex shows part of the working material used by the project experts when carrying out project interviews with different stakeholders, as explained below.

C.1.1 Questions for the Case Studies

C.1.1.1 *The Baltic Innovation Fund*

We understand that the European Investment Fund is managing 2 fund-of-funds active in our target geography – the Baltic Innovation Fund I and Baltic Innovation Fund II, as well you have significant exposure, experience and expertise in this subject in Europe in general.

Questions about EIF experience with these two funds-of-funds:

- Could you give a brief update on the BIF I and BIF II implementation status?
 - The number of PE&VC funds invested in by BIF I/BIF II?
 - The number of investee companies under BIF I/BIF II?
- Has there been any IPOs or other types of listings under BIF I/BIF II? How many? Roughly how many exits have there been in total?
- Is listing companies on the Baltic stock exchanges mentioned among BIF I/BIF II objectives? Are there any plans to do something specific in this direction?
- Any general observations about the listing climate in the Baltics?
- Can BIF II invest in funds with less than 50% of private investors at fund level? Can BIF II invest in funds investing in listed companies?

Questions not directly related to BIF I/BIF II, but related to the CMDAF focus area:

- Can EIF in general invest in funds with no private investors at fund level? Can EIF in general invest in funds investing in listed companies?
- Does EIF have any existing or planned instruments focusing on facilitating public capital markets, either by listing companies on stock exchanges or other mechanisms?
- Is EIF familiar with the EU SME IPO Fund initiative?

C.1.1.2 TESI

From TESI response to recent EVFIN survey for EU SME IPO Fund: “We indeed have a concept which we call IPO Underwriting. It means that we participate in IPOs as an anchor investor or just an investor. The focus is on SME IPOs. So far we have completed a couple of cases in this category”. Following questions are about practicalities of these “IPO Underwritings”.

- Why is TESI doing these “IPO Underwritings”? Is it an identified market gap in Finland?
- Since when has TESI been doing these “IPO Underwritings”? How many cases are there up until now? How big is the total financing amount TESI invested this way?
- Is it targeting official list (Nasdaq Helsinki Main Market) or less regulated growth market (First North), or both? What is the average / median / min and max in terms of pre- or post-market capitalizations applicable?
- Procedure - is there a formal application procedure for companies approaching TESI (standard package of documents needed to apply, formal information on TESI website etc) or is it on ad hoc basis?
- Deal terms - is there a formal program / standard term sheet for such transactions, or are terms decided case by case?
 - Is there a particular minimum demand level to be generated from third parties for this IPO underwriting to become binding?
 - Is the anchor investor / underwriting facility stated publicly? If so, at what stage? Is it at the commencement of book building or earlier or later? Is the financial advisor running the potential transaction informed prior to going live on the deal about the facility's possibility to be used (and exact terms)?
 - Are there parallel requirements which are included in such deal terms. Potential inclusions might be certain levels of analytical research coverage and market-making facilities by at least one market participant (particularly if the alternative market is involved)?
 - Does the financial advisor acting as the Global Coordinator for the transaction typically collect fees for the demand you provide, or, this is decided by the corporate client themselves?
- In terms of EU state aid rules, is this on state aid-free/pari passu basis, or it involves state aid? Is there a formal state aid scheme?
- What funding TESI uses – own funds, state budgetary resources, EU funds?
- How does TESI arrive at equity valuation / stock pricing, especially in anchor investor cases? Is it an internal TESI analysis or some external proxy value is used?

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- Is there a limit to how large proportion of the deal TESI can take (say 25%/50%/70% of total new listing)? Are there any requirements regarding private co-investors?
 - Are there post-listing ownership limits?
- What is the typical holding period? Is it predefined in each case?
- How and when TESI exits these investments?
 - Does this include ABBs (accelerated book builds), or, can be a variety of approaches, including random blocks placed by a broker?
- Are these investments done from TESI legal entity, or is there a separate dedicated legal vehicle/fund for this under TESI?
- When an investment is made, do you take an entirely passive role, or, depending on the ownership level exercise participation in management of the company via e.g. supervisory council? If so, at what levels does this commence?
- In addition to 'IPO Underwritings' do you also get involved in other similar transaction structures such as private placement and admission to trading and/or direct listings (i.e. technical listings). Here there may also be FPOs (follow-on public offering) or SPOs (secondary public offering) taking place later down the road?

From TESI response to recent EVFIN survey for EU SME IPO Fund: "We have also few cases where we have been onboard already before the IPO and that way participated in the IPO process". Following questions are about practicalities of these other "few cases".

- Do these few cases refer to regular TESI activity, where TESI invests in risk capital funds/ private companies, and those companies sometimes get IPO'd?
- From these cases, how many were TESI direct investments in companies, and how many indirect (TESI invested in a fund, and fund invested in the company, which later IPO'd)?
- How many total IPO cases have TESI had until now? Out of how many total companies TESI has directly or indirectly (via risk capital funds) invested in?
- Were those cases a financial success (TESI got back more than it invested)?

C.1.1.3 K-Growth

We understand K-Growth is managing 2 funds similar to our planned initiative - KONEX Vitalization Fund (KONEX exchange focused fund) and KOSDAQ Scale-up Fund (KOSDAQ exchange focused fund). Following questions are about technical details and K-Growth experience with these two funds.

- Why did K-Growth launch these funds? Is it an identified market gap in Korea?

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- When they were launched? Are they still operational/investing? How big are these Funds?
- How many investments per fund have happened till now? How big is the total financing amount K-Growth invested so far per fund?
- Do these funds have other investors at fund level, apart from K-Growth? How much?
- Who is managing these funds on day-to-day basis, is there a dedicated team? How this team was selected?
- What is the average, min and max in terms of pre- or post-market capitalizations applicable for target companies these funds invest in?
- Procedure - is there a formal application procedure for companies approaching K-Growth (standard package of documents needed to apply, formal information on K-Growth website etc.) or is it on ad hoc basis?
- Deal terms - is there a formal program / standard term sheet for such transactions, or are terms decided case by case?
- Is there a particular minimum demand level to be generated from third party investors for these K-Growth funds to invest?
- Is the anchor investor / underwriting facility stated publicly? If so, at what stage? Is it at the commencement of book building or earlier or later? Is the financial advisor running the potential transaction informed prior to going live on the deal about the facility's possibility to be used (and exact terms)?
- Are there parallel requirements which are included in such deal terms? Potential inclusions might be certain levels of analytical research coverage and market-making facilities by at least one market participant (particularly if the alternative market is involved)?
- Is this on pure market/commercial terms, or is there some state aid/subsidy element?
- How does K-Growth arrive at equity valuation / stock pricing, especially in anchor investor cases? Is it an internal K-Growth analysis or some external proxy value is used?
- Is there a limit to how large proportion of the deal K-Growth can take (say 25%/50%/70% of total new listing)? Are there any requirements regarding private co-investors? Are there post-listing ownership limits?
- What is the typical holding period for investments? Is it predefined in each case? How and when K-Growth exits these investments?

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- When an investment is made, do you take an entirely passive role, or, depending on the ownership level exercise participation in management of the company via e.g. supervisory council? If so, at what levels does this commence?
- Do these funds also get involved in other similar transaction structures such as private placement and admission to trading and/or direct listings (i.e. technical listings).
- What has been the fund commercial return to date? Were those funds a financial success (K-Growth got back more than invested)?
- What is K-Growth overall assessment of success of these funds, their contribution to development of KONEX and KOSDAQ stock exchanges?

C.1.2 Fondul Proprietatea

We understand Franklin Templeton is managing Fondul Proprietatea on behalf of Romanian government.

Questions about your experience with this activity:

- Could you briefly describe Fondul Proprietatea:
 - Origins, business model and current status?
 - Total assets under management, number of companies in the portfolio, types of companies in the portfolio?
 - Future plans?

Fondul Proprietatea is a listed vehicle.

- Was listing it the original Romanian government plan, or was it proposed by Franklin Templeton?
- Listing in Bucharest stock exchange vs listing in Warsaw vs listing in London
- Share price of listed vehicle vs NAV of underlying portfolio

Fondul Proprietatea portfolio of companies.

- Taking companies from private to listed status.
- Selling companies only via stock exchange?
- Have there been any cases of listed portfolio companies taken private, de-listed?

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- Is listing companies on Romanian stock exchanges included among Fondul Proprietatea formal objectives?
- Any general observations about listing climate in Romania?
- Is there any collaboration or coordination between Fondul Proprietatea and European Investment Fund-managed Romania activities (JEREMIE, EU Structural fund fund-of-fund)

C.1.2.1 Questions for the Baltic Equity Issuers

Questions were intended for the representatives of Linda Nektar, MADARA Cosmetics and NEO Finance

- Was this stock exchange listing the first external equity fundraising for the company?
- How much money was raised in any previous rounds, how much money via listing?
- What was the rationale for choosing listing as opposed to private fundraising?
- Did the actual real life process and results match the expectations at the moment when the listing decision was made?
- Main positives of listing, as opposed to private fundraising route?
- Any negative experiences?
- What was the cost of listing? How it breaks down into cost categories? What are the maintenance costs of the listed status?
- Will the company raise funds via the stock market again, or will consider private fundraising?
- Any additional comments?

C.1.3 Interview Questions for Private Equity Market Players

C.1.3.1 Questions for Baltic Private Equity Fund Managers

General

Are there observable market gaps (potential good-quality Baltic deal flow not sufficiently served by existing market players/investors) in the Baltic risk capital market:

- In terms of segment (seed/start-up/expansion/buyout/mezzanine)?
- In terms of investment deal sizes (are existing market players/investors sufficiently serving all deal size segments)?

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— In terms of industry focus?

Per each identified market gap:

- What is preventing the private investors & new market players/funds from emerging in these market gap segments? / what incentives could the government/EBRD as a limited partner investing in the particular fund provide to attract greater private investor interest towards such a fund?;
- What would be the minimum size of such a fund, ability to raise private capital, required management fee, plus any other comments on instrument details?
- Regarding bad-quality deal flow (the investment proposals that get rejected by risk capital funds) what are the main reasons for rejections in your experience? Which reasons can be solved/remedied and which are just set in stone? Are there any systemic issues that should be solved on the government/regulatory level?
- Any views on latent demand (companies, for which it would make business sense to use risk capital, but which either knowingly decide against using it or not even consider using it due to lack of understanding, lack of ambition or other reasons).

Peer comparison and industry awareness:

- The typical sizes of risk capital investment cases on an enterprise value basis at time of exit are typically/somewhat/far smaller than the standard norm encountered in other neighbouring markets (the idea here is whether the typical company size itself in the Baltics is considered a challenge for listing due to absolute size). If so, is there an adequate reflection of the size factor in the valuation expectations vis a vis other perceived valuation expectation 'benchmarks'?
- How would you judge the overall knowledge and industry awareness of the following exchange-based (public equity) factors in the Baltics vs. elsewhere: (i) true costs of listing (initial and ongoing) in the regulated market vs the alternative market? (ii) variety of listing mechanisms possible (IPO / private placement / direct listing) (iii) potential consideration of multiple-stage exits (including ABB [accelerated bookbuild]) via public route rather than single transaction (iv) level of enquiries made for the aforementioned by yourselves and other industry players when considering an exit strategy for the various public / private equity, strategic, MBO etc. options.

About the CMDAF

Theory says that the stock market is often a natural next step for a company funded by PE/VC funds. Facts on the ground in Baltics don't support this theory yet. The companies and PE/VC fund managers historically seem to prefer the private capital route, with a few exceptions.

- What have been your fund /portfolio company's historical experience with new equity listings and other traded securities instruments on Baltic stock exchanges? Outside Baltics?

- What is your fund's/portfolio companies' current future outlook on the same question (ignoring the COVID-19 impact)?
- Your general observations about Baltic stock exchanges as a fund exit route or a company funding (both equity and debt) source?

Let's do a thought experiment. Say we build a specialist investment fund "Bridge-funder & Market-maker Fund", with 1-3 year investment holding period time-horizon and investment strategy of investing in pre-IPO [or 'listing'] private placements and possibly even immediate post-IPO [or 'listing'] liquidity support in cases where fundamentals indicate decent upside potential for later disposal. Additionally, both in the pre-listing (IPO, private placement/direct listing) or post-listing environment company shareholders are not held back by drag along/ tag along limitations on their participation, hence partial exit allows an alternative liquidity event to take place (even in the event of a lock-up process being in place post-listing). This can therefore be a helpful way of increasing the free float of the enterprise without forcing the hand of other stakeholders/negatively impacting the market price.

Let's discuss this business model idea vs Baltic reality, as well as any pivots/improvements needed to this hypothetical CMDAF business model.

- Would the CMDAF bring additional value/a specific angle to the financing landscape in the Baltics?
- What particular characteristics should the CMDAF possess to be of interest to private capital from early on?
- Would the potential future listing of the CMDAF positively impact your view of the CMDAF in terms of the possibility of attracting private capital to the CMDAF?
- Any other ideas of how to facilitate private companies using more public capital via both equity and debt (via various formats of new equity listings and other traded securities instruments on Baltic stock exchanges)?
- Assuming that the CMDAF project goes forward, could your fund management company be interested in participating in the tender to run the CMDAF? What would be the main questions you as a fund manager would look at, when considering this opportunity? Do you as a fund manager see any major impediments (inter alia legal) in potentially running the CMDAF?

C.1.3.2 Questions for Swedbank Latvia

A short introduction of the CMDAF project.

- How many times has the Swedbank pension fund and asset management invested in companies listed on Nasdaq Baltic, both bonds and equity? Experience from investing in the listing of HansaMatrix etc.

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- Any immediate observations and ideas regarding the potential CMDAF investment strategy?
- Would Swedbank consider investing in the CMDAF?
- Would Swedbank consider investing in IPOs as a co-investor with the CMDAF?
- Would Swedbank consider investing in the shares of the listed companies after the IPO?
- Swedbank's approach to stock valuation, is it cheap or expensive?
- Any general observations about the Baltic stock exchanges as company funding source (both equity and debt)?
- Any other instrument ideas that could facilitate the capital market development?
- Is Swedbank investing in the new Altum fund?

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D Latvian Financial Industry Stakeholder Organisations Joint Letter Addressed to the Government of Latvia (In Latvian)

2021. gada 14. janvārī

**Ekonomikas ministrijai
Finanšu ministrijai**

Informācijai:
**Eiropas Rekonstrukcijas un attīstības bankai
Attīstības finanšu institūcijai "Altum"
Latvijas Bankai
Eiropas Komisijas pārstāvniecībai Latvijā**

Par Latvijas kapitāla tirgus attīstības veicināšanu
ar Eiropas Atveseļošanas un noturības mehānisma
finansējumu

Latvijas Finanšu nozares asociācija, Latvijas Privātā un riska kapitāla asociācija, Finanšu un kapitāla tirgus komisija un AS Nasdaq Riga (turpmāk - Birža) ir iepazinusies ar Kapitāla tirgus attīstības akcelerācijas fonda (turpmāk – CMDAF²⁸⁴) Baltijas mazo un vidējo komersantu (turpmāk - MVK) sākotnējā publiskā piedāvājuma (turpmāk – IPO²⁸⁵) fonda projekta aprakstu (pielikumā), ko pēc Baltijas valstu valdību lūguma Eiropas Rekonstrukcijas un attīstības bankas vadībā izstrādā ārējā ekspertu komanda, un uzskatām, ka šī projekta ieviešana būtiski veicinās Latvijas (un Baltijas) kapitāla tirgus attīstību, kā arī Latvijas uzņēmumu pieeju kapitālam un Latvijas ekonomikas izaugsmi pēc-COVID-19 pandēmijas periodā. Valstis, kurās ir attīstīts kapitāla tirgus, spēj operatīvāk un efektīvāk pārvarēt krīzes.²⁸⁶

Šobrīd tikai niecīgs skaits Latvijas uzņēmumu finansē savu darbību, izmantojot Biržas sniegtās iespējas un priekšrocības. CMDAF Baltijas MVK IPO fonda iniciatīva paredz 8-10 Latvijas uzņēmumu ienākšanu biržā tuvāko piecu gadu laikā. Plānotās aktivitātes tirgus ekosistēmas pastāvīgā pilnveidē, tās dalībnieku izglītošanā un, protams, mazākuma akcionāru tiesību aizsardzībā papildus radīs ievērojamu multiplikatora efektu, aktivizējot privāto sektoru. Minētais noteikti rezultēsies jaunu emitentu un investoru skaita pieaugumā, kā arī kopējā tirgus attīstībā un iedzīvotāju labklājības pieaugumā. Publiskā kapitāla aktivitātes pieaugums tirgū arī veicinās Biržas kā "izejas" mehānisma pievilcību Latvijā strādājošajiem izaugsmes (riskā) kapitāla fondiem, kas pozitīvi ietekmēs privātā kapitāla attīstību un aktīvu iesaisti tirgū.

Latvijas uzņēmumu piekļuve relatīvi lētākam un ilgtspējīgākam publiskajam kapitālam veicinās uzņēmumu tālāku, ilgtspējīgu izaugsmi, dodot tiem biežāk no MVK kategorijas sasniegt lielo uzņēmumu kategoriju, kas cieši saistās ar uzņēmuma augstāku produktivitāti, konkurētspēju, eksportspēju un augstāku noturību pret ievainojamību dažādos ekonomiskajos ciklos, kā arī labāku uzņēmumu pārvaldību un citām priekšrocībām. Tādējādi CMDAF Baltijas MVK IPO fonda adekvāts finansējums ir vitāli svarīgs un nozīmīgs.

Jāuzsver, ka līdzīgas IPO fondu atbalsta iniciatīvas darbojas vai tiek ieviestas virknē citu Eiropas valstu²⁸⁷. CMDAF Baltijas MVK IPO fonda projekta ieviešana nodrošinās, ka Latvijas uzņēmumiem ir pieejams tāds pats atbalsts, kā to konkurentiem citās Eiropas valstīs. Piemēram, Lietuvas valdība jau ir

²⁸⁴ Capital Markets Development Accelerator Fund

²⁸⁵ Initial public offering

²⁸⁶ Is less more? Profitability and consolidation in the European banking Sector, 2019.gada jūlijs, 11.lpp., <https://www.bankingsupervision.europa.eu/press/speeches/date/2019/html/ssm.sp190704~1f442782a.c.en.pdf>

²⁸⁷ Ungārija, Somija, Čehija, Vācija, Nīderlande

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nolēmusi Eiropas Atveseļošanas un noturības mehānisma²⁸⁸ resursus izmantot CMDAF Baltijas MVK IPO fonda izveidei un darbam. Līdzvērtīga publisko resursu atbalsta neesamība Latvijā vēl vairāk paplašinātu plaisu starp Lietuvas un Latvijas kapitāla tirgu attīstības tempu. Igaunijā arī šobrīd norit produktīvas diskusijas par fonda finansēšanas avotu. **Svarīgi, ka visas Baltijas valstis izmanto vienu finansējuma avotu CMDAF Baltijas MVK IPO fonda izveidei. Pretēji fonda izveide un darbība tiks būtiski apgrūtināta, jo finansējuma pieejamības nosacījumi katram finansējuma avotam atšķirsies, tie būs pieejami dažādos laikos, kā arī paredzēs atšķirīgus ierobežojumus. Rezultātā fonda pārvaldība tiks būtiski apgrūtināta un kļūs neefektīva un smagnēja.**

Ievērojot minēto, aicinām atbalstīt Eiropas Atveseļošanas un noturības mehānisma resursu piešķiršanu CMDAF Baltijas MVK IPO fonda izveidei un darbībai.

Pateicamies par līdzšinējo konstruktīvo sadarbību, spēju rast risinājumus situācijās, kurās būtiski panākt samērīgāko un efektīvāko rezultātu, kā arī paužam gatavību sniegt nepieciešamo atbalstu uzdevuma izpildē.

Pielikumā: CMDAF Baltijas MVK IPO Fonda projekta apraksts.

Ar cieņu

AS Nasdaq Riga valdes priekšsēdētāja
Latvijas Privātā un riska kapitāla asociācijas valdes priekšsēdētāja
Finanšu un kapitāla tirgus komisijas priekšsēdētāja
Latvijas Finanšu nozares asociācijas valdes priekšsēdētāja

**ŠIS DOKUMENTS IR ELEKTRONISKI PARAKSTĪTS AR
DROŠU ELEKTRONISKO PARAKSTU UN SATUR LAIKA ZĪMOGU**

²⁸⁸ Recovery and Resilience Facility

E CMDAF Baltic SME IPO Fund Structure Discussion Material

The material was used in discussions about the proposed fund structure of the CMDAF Baltic SME IPO Fund during the steering committee meeting held on 17 December, 2020.

Public investors	LT, LV, EE governments via their NPIs (Invega, Altum, KredEx), Preferably also IFIs, including via EU SME IPO Fund-(of-funds)	
Private investors at	Fund level	Deal level
N.B. Cumulative 50% of total Investment required to qualify for state aid- free (market economy operator) status	<ul style="list-style-type: none"> — Unproven business model at fund level, with significant non-commercial policy-driven rationale in parallel to target of risk-appropriate commercial returns; — Private investors expect governments to take the initial proof-of-concept risk. 	<ul style="list-style-type: none"> — Partially-proven business model at deal level; — Less desirable approach for IFIs investing at deal level given the rather limited ticket size per deal and lengthy approval process to trigger such investment. <p>Recommendation:</p> <ul style="list-style-type: none"> — Primarily at deal level, with possible exception of fund manager also acting as a sponsor if a large established asset manager hired to that role; — Deal level enables broad participation by professional and retail investors – this also progressively introduces and reminds via repetition the concept of the cornerstone role (regular publicity for potential future fund level investment). Also reduces any private investor concerns about commercial returns being sacrificed for policy goals.

Fund size	— EUR 80m fund with a minimum size of EUR 60m and hard cap of EUR 100m, based on a planned equal split of EUR 20m between targeted investors (LT, LV, EE, IFIs, EU SME IPO Fund).	
Investment/ Deal size	— Typically EUR 0.5-5m per investee company initial investment, with a follow-up capability, but not exceeding cumulatively 15% of the Fund size (total investor commitments) for a single investee company.	
Fund/ investment manager	Independent manager (IFI or selected via competitive procedure)	Captive manager (joint daughter company by 3 Baltic NPIs, based on Nordic examples)
	<ul style="list-style-type: none"> — Best market practice; — Avoids political influence risks; — Initial feedback from the experienced Baltic fund managers lukewarm about interest in managing this Fund; — Mitigate potential conflicts of interest arising in the decision making process as commercially driven mandate in place. 	<ul style="list-style-type: none"> — Non-standard investment strategy with significant policy-driven activities (“market gendarme” role after listing, actively policing minority shareholder rights); — No ready-made team on the market; — Captive investment manager owned by NPIs could be set up by head-hunting individuals as opposed to procuring a complete team; — Captive team easier to control and incentivise; — Joint management processes by the 3 NPIs may prove to be complicated.
Structure	Closed-end	Evergreen
	<ul style="list-style-type: none"> — Closed-end structure typically required by governments to provide intervention reassessment option, by institutional investors for liquidity/ exit reasons. <p>Recommendation:</p> <ul style="list-style-type: none"> — Fixed-term investment strategy with flexible winding-up deadline. 	<ul style="list-style-type: none"> — Is the market gap permanent, justifying evergreen approach?
Number of legal entities	Single legal entity (GP+LP)	Separate legal entities for GP and LP
	— Single entity could be cost-efficient if captive investment manager and no further funds envisaged.	— Separate entities typically used if GP expected to manage several funds and for separating financial flows (investments, management costs, carry etc);

		<ul style="list-style-type: none"> — Cross-fund liability risk; — Separate entities better suited for future listing.
Team's own commitment / alignment of interest	<ul style="list-style-type: none"> — Complicated for independent teams due to non-standard investment strategy if significant policy-driven activities/ costs not directly contributing to Fund profitability; — Not fully relevant for captive team, there alignment of interest typically achieved through bonus/ incentive schemes only; — Could be managed through performance-based remuneration/ incentive scheme. 	
National quotas	None	Based on country contribution
	<ul style="list-style-type: none"> — Fund investing geographically opportunistically on first-come first-served basis. 	<ul style="list-style-type: none"> — Fund targeting country allocations at least at country contribution level, with rest of fund (IFIs, sponsor contribution) invested opportunistically; — National quotas may lead to some good deals being rejected due to relevant national quota being fully used already; — This could both negatively impact the Fund commercial returns and make the structure less attractive for an established fund manager to run.

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