HBOR MEZZANINE FINANCING PROGRAM

CROATIA ENHANCING SME PERFORMANCE PROJECT (ESP) / PODUZETNA HRVATSKA –

JULY 2006

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Development Alternatives, Inc.

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I. Scope of Work: Delivery and Design of Mezzanine Financing Program-Phase 2

The second phase will consist of working out the details of the mezzanine financing program approved by HBOR's Board for further review and consideration. The second phase involved working with various units within HBOR to determine the role that will be played in the execution of the program.

II. Project Deliverables:

The work will result in materials describing/defining in full the product, its application, the individual transaction approval process and the roles/responsibilities of HBOR staff involved in the approval and due diligence process. As such, the Consultant will present in clear language for bankers, issues tied to structure, timing, size, maturity, price, screening/investment criteria, covenants and the like.

III. Contacts Interviewed

- **Management Board**
  - Ruzica Adamovic
- **Credit Sector**
  - Mladen Kober
  - Marija Jerkic
  - Jadranka Sabljak
  - Mira Dronjic
- **Bank Analysis Unit**
  - Nevena Savanovic
  - Zvonimir Crnogorac
- **Company Analysis Unit**
  - Mirta Fraisman
- **Technical Analysis Unit**
  - Ivan Maksan
  - Ana Simic
- **Legal Sector**
  - Branimir Berkovic
  - Branka Biscan
  - Erna Jurnjak
- **Risk Assessment**

- Marijana Cuvalo

- **Croatian Competition Agency**
  - Dr. Eberhard Kruse

- **SME Division- Bank Relationships**
  - Jadranka Mrsic- Hebrang

- **KfW**
  - Stephen Duesel

IV. Executive Summary:

a) Background

HBOR (Hrvatska Banka za Obnovu i Razvitak) is the acronym for the government owned Croatian Bank for Reconstruction and Development. Its objective is to finance the reconstruction and development of the Croatian economy. HBOR provides financing by (1) funding commercial bank loans who then on lend to the companies or (2) by direct loans to the borrowers. HBOR makes its loans with concessionary terms, conditions, and rates.

In order to assist HBOR in its objective, USAID's Croatian ESP Project ("ESP Project") agreed to provide HBOR with assistance in establishing a new financing product in the form of mezzanine or hybrid financing. The first phase of this project (completed in July 2005) provided HBOR with three hybrid or mezzanine financing structures that would enable HBOR to achieve its objectives. The structures included (a) a financing vehicle that would involve working with a partner bank that provided senior debt and HBOR providing subordinated financing with an "equity kicker"; (b) HBOR as a sole direct lender, providing a concessionary financing structure with an equity position in the company, and (c) HBOR and the commercial bank each providing separate loans. The commercial bank providing traditional senior debt at market rates for its customary tenor and HBOR providing long term financing of up to twelve (12) years at subsidized rates with its debt subordinated to the senior debt of the commercial bank. After several months of deliberation, HBOR's management board decided that they wished to explore the "C" option discussed above. Phase two of the project is the focus of this report. In this phase, HBOR with assistance from the ESP Project explores the optimal terms and conditions under which the Mezzanine Financing Program can be designed. The information will be used to prepare the Management Board for its presentation to the Supervisory Board for final program approval

b) Recommendations

Because of phase one analysis, it is believed that Croatia requires a "gap" or "mezzanine" financing facility for SME companies that have good projects; but insufficient equity capital and/or collateral to access traditional financing from commercial banks. Phase one research indicated that mezzanine financing is not currently available for the SME market in Croatia. As a result, HBOR desires to provide mezzanine financing in fulfillment of its mandate to drive economic growth and employment within Croatia. The following recommendations are presented to aid in implementing and launching the proposed Mezzanine Financing Program.

- **Implement Mezzanine Financing Program as a Pilot Program.**

HBOR should consider implementing a pilot program as the launch of its mezzanine financing program. The mezzanine financing program, that is outlined in detail below in section "c" will provide subordinated and unsecured mezzanine financing to qualified established companies and "greenfield's" projects. It will provide among other features, subsidized pricing and financing terms that will fill the gap for SME companies. The pilot program, through a small sample of transactions will give HBOR an opportunity to work on a smaller scale, which will enable HBOR to assess the merits of the program and to make changes that are warranted. In addition, through the pilot program, HBOR will also have an opportunity to make the necessary and appropriate adjustments in their analytical approach, underwriting processes, and post disbursement monitoring that will be required to maximize the successful implementation of the program.

- **Establish an Internal Maximum Exposure Limit.**

HBOR management should consider establishing an internal maximum exposure limit for the mezzanine financing program. This limit will allow management to manage the exposure risk of this type of financing. Setting the maximum exposure limit may enhance risk management's responsibility in managing the reserves for this product. The level of maximum exposure should be an amount that will allow HBOR to complete enough deals to have a good sampling of transactions for judging the viability of the program. It is recommended that the maximum exposure limit be based on a percentage of the bank's capital.

- **Appoint a "champion" or leader and establish a product launch date.**

HBOR management should appoint a project leader who is <u>empowered and responsible</u> to lead the successful launch of the mezzanine financing product by a <u>date certain</u>. The process to consider and develop a mezzanine financing product commenced in July 2005 with Phase 1 of the project with USAID. It has taken a year to move to Phase 2. There are several additional steps to consider before the product is launched and a dedicated individual with total focus on the product will be important to move the process forward successfully. The establishment of a date certain launch date will help to focus the bank's management and inertia on meeting the deadline. It is suggested that the date be set for the end of October 2006

- **Appoint a Team to Manage and Implement Mezzanine Finance**.

Mezzanine Finance has many properties that are similar to equity financing, particularly the analytical or underwriting and the monitoring process. The nuances of this type of financing will benefit from the appointment of a team that will focus its efforts on structuring, analyzing, and monitoring the loans that have been disbursed. HBOR will have direct exposure on the transaction ranging from 20-30% of each transaction without its traditional first position regarding collateral. The concentrated experience and expertise that can be generated and enhanced from a team approach cannot be emphasized enough. With experience and concentration, the team will be able to structure financings with great skill, flexibility, and timeliness that will meet the demands of the market and the credit requirements of HBOR. The proposed team should consist of a dedicated three to four individuals, a credit officer, an analyst, a lawyer and access to a technical person either within HBOR or outside. The credit officer will manage the overall process; assess management, the enterprises, and project proposals. The analyst will be involved in the underwriting process as normal. However, the analysis required will require an analyst that is very skilled in cash flow analysis and corporate finance techniques (see discussion below on analytical culture for expansion of this point). The lawyer should work closely on the team to construct legal documents and manage the legal process of closing loan transactions. The lawyer should have strong transaction skills and exhibit legal creativity. If the legal skills are not resident within HBOR, HBOR should consider outsourcing this function. The technical person will complete their normal technical analysis. The team may from time to time require technical expertise not resident in HBOR, especially if looking at a project that has a technology element. In those cases, the team should have a budget that will allow it to outsource this function.

Due to cost consideration, there might be resistance to setting up a team for one product within the current structure of HBOR. HBOR is currently reviewing its organization structure within its credit function and it is recommended that management consider establishing a unit that is broader in its focus. This might include creating a special financing unit that could include all equity and quasi equity based programs including pure equity, venture capital and mezzanine financing. The analytical approach and monitoring processes are similar enough to put the programs under the same group.

- **Early Involvement of Partner Banks**.

The Mezzanine Financing Product will require close coordination with Partner Banks. HBOR plans to consider only “A” rated banks for this financing product, which is strongly recommended. During the pilot period, it is suggested that Partner Banks that have strong credit analysis skills and underwriting skills be considered. In addition, HBOR must be comfortable and compatible with the partner bank, particularly when considering the role that the commercial bank will have in this type of transaction and HBOR’s secondary position regarding collateral. As a result, only a small group of the A rated Partner Banks are likely to qualify for this program initially. It is strongly recommended that HBOR disclose and discuss with some of its close commercial bank partners, its intent to launch the product and ask for input from the banks regarding their interest and terms they might be willing to participate. This input might prove beneficial to assure that the product can be launched without any delays or misunderstandings. Inputs from the Partner Banks might also provide insights on potential borrowers that will lead to improvements in the proposed structures.

- **Leverage KfW Relationship**.

KfW, a German government development bank similar to HBOR, launched a mezzanine financing product called the Entrepreneurial Capital mezzanine financing (ECMF) product in 2002. The KfW program has several elements that are similar to the HBOR proposed mezzanine program and HBOR could benefit from KfW’s experience regarding their program. To date, HBOR and KfW have been engaged in discussions regarding the design and structure of KfW's program. It is suggested that HBOR consider a closer working relationship with KfW including coaching or training role of HBOR personnel associated with the mezzanine financing program. It is suggested that the mezzanine financing team visit with KfW and spend time observing their process for evaluating, underwriting and monitoring companies. KfW should also be approached regarding their handling of the European Union state support and competitiveness issues that might be an issue for HBOR's mezzanine program.

- **Product Structuring Issues.**

The following recommendations are focused on the proposed mezzanine program that is discussed below.

  - **Consider Risk Based Pricing.** Risk based pricing is pricing of loan facilities based on the credit risk of the borrower. The weaker the credit risk of a facility, the higher an interest rate is charged. Risked based pricing is an important feature of subordinated mezzanine financing programs. However, HBOR's program will not contemplate risk based pricing at this time due to Croatia's recent history and devastation from the Homeland War. HBOR must consider its mandate to redevelop through concessionary programs targeted to certain areas impacted by the war. It is recommended that during the pilot program period, HBOR should continue to price this product as presented at Euribor + 3%. However, HBOR should consider exploring a form of risk based pricing when appropriate in order to help to construct a financing market that rewards competent management and good projects.

  - **Consider Additional Fees.** In addition to its usual management fees and commitment fees, HBOR should consider additional fees to incentivize its partner banks for taking additional risk and bringing good mezzanine projects. Two levels of fees should be considered. The first fee should be a Mezzanine Financing Fee or structuring fee that might be shared with the Partner Bank for bringing in transactions that HBOR can underwrite. The second fee should be a success fee that is paid to the Partner Bank after the successful mezzanine loan transaction has been repaid. This will help to reinforce the importance of finding the right transaction and continuing the spirit of cooperation.

- **Analytical Culture Necessary for Mezzanine Financing Analysis.**

Subordinated Mezzanine Financing requires great attention to the underwriting process <u>and</u> the monitoring of loans. The underwriting and structuring process should be focused on understanding the company's business and business plan assumptions. Testing the assumptions or sensitivity analysis is a key to anticipating possible areas of risk and potential problems in the credit. By understanding the company and its plans, HBOR will be able to structure covenants that address those areas as an early warning system to potential problems should the bank decide to underwrite the loan. A reliance on understanding the drivers of the company's cash flows required to repay the loans are going to be critical in loan underwriting and credit approval process. The integrity of subordinated debt will require that HBOR not depend fully on the collateral because of its secondary position. Credit analysts should have access to the companies to discuss and understand the drivers of the assumptions. On the monitoring side, it is a common believe among lenders that 80% of loans that develop problem are the result of poor monitoring of credits once the funds have been disbursed. Some adjustment to HBOR's process will be necessary to promote and insure that proper monitoring is taking place. This function should be done by the analytical member of the team in coordination with the credit officer. Frequent meetings with company management and business site visits are recommended to assure that management understands and deals with potential issues. This type of monitoring is proactive and can often enable a bank to fix problems before they become critical. This type of proactive underwriting and monitoring will be necessary to properly assess risk, but will require a change from HBOR's current analytical culture. Some training might be required to help HBOR handle this challenge.

- **Croatian State Aid Considerations**

The mezzanine financing product has implications on Croatia's compliance regarding the European Union policies regarding providing state aid to private companies. Based on discussions with advisors at the Croatian Competition Agency ("CCA"), mezzanine financing for SMEs is a complicated product that is not largely available throughout the European Union. They believed that the programs that exist have different terms and conditions that would need to be addressed. The CCA suggested that HBOR discuss with KfW the European Commission's decision regarding their mezzanine financing product and seek counsel based on what they learn from KfW. It is recommended that HBOR in addition to discussing state aid concerns with KfW, also keep the CCA informed on it progress regarding the structure of its mezzanine financing program.

c) Summary of HBOR's Mezzanine Financing Program

HBOR will make this financing program available to eligible SME companies located in Croatia. HBOR will utilize its Partner Banks (Group A) networks to access eligible companies and projects. The financing will be available to greenfield and established companies. Like other HBOR lending programs, HBOR will be willing to provide the funding of the senior debt portion of the commercial bank debt and will directly finance the mezzanine debt portion. For those Partner Banks that would prefer to use their own sources of funding for the senior debt, HBOR will provide the mezzanine debt portion. Below is a summary of the terms and conditions of HBOR's proposed Mezzanine Financing Program. (Detailed Term Sheet in Appendix 1)

Product Definition	HBOR's Mezzanine Debt Facility is long-term debt financing that is subordinate to senior commercial bank debt. This mezzanine debt instrument has been designed to address the financing needs of SME's, which lack sufficient equity capital and collateral to qualify for classical senior debt financing.
Product Implementation	HBOR's Mezzanine Financing subordinated debt program is to be implemented in cooperation with category "A" Partner Banks. The Partner Banks will provide the senior debt in conjunction with HBOR's subordinated debt

	to acceptable companies and projects. HBOR's subordinated debt will effectively provide an additional cushion of financing in order to enhance the Partner Bank's ability to provide financing to SME companies.
Type of Subordination	HBOR's Mezzanine Loan is to be completely subordinated to the Senior debt of the Commercial bank. HBOR will receive interest payments pari passu with the commercial bank debt, but its principal will not be repaid until after the senior debt of the bank has been repaid in full.
Acceptable Loan Purposes	Loans under the program will be used to finance buildings and equipment with the overall goal of developing and facilitating growth within the SME market of the Croatian economy and facilitating employment generation.
Acceptable Partner Banks	Acceptable Partner Banks are Commercial Banks in the risk group "A" category according to HBOR's method for assessing banks. Partner Banks selected for the program should be institutions that possess similar underwriting rigor and monitoring policies as HBOR. Partner banks will be required to agree with the terms to be negotiated between HBOR and the Partner Bank in its standard agreement.
Proposed Partner Bank Contract Terms	Proposed HBOR and Partner Bank terms should include: • Agreement to closely cooperate in the Mezzanine Financing with HBOR; • Full agreement and cooperation on the acceptability of the project or company to be financed, including discussion on credit review, underwriting criteria; covenants, and monitoring necessary to control the credit. • Agreement to sign an Inter-creditor Agreement between the commercial bank and HBOR outlining the extent of

	subordination of asset claims by HBOR while the senior debt is outstanding. • Agreement that HBOR is to move to the first collateral position when the commercial bank is fully paid; • HBOR and the Commercial bank to receive interest payments on their respective loans pari passu throughout the life of the loans; • HBOR to provide a grace period during the loan drawdown period and the period that the senior debt of the commercial bank is outstanding; • Agreement on loan covenants that will govern the credit. • Agreement to restrict advancing additional debt without prior agreement between the Partner Bank and HBOR. • Agreement that any shareholder loans are to be completely subordinate to HBOR's and the Partner Bank's debt including interest payments; • Partner Bank will fully disclose immediately all updates on the financial condition of the borrower; and • Agreement on proposed interest rates, fee splitting arrangements and other forms of compensation.
Acceptable Types of Borrowers	Companies involved in production or processing are ideal candidates. The following are examples of the types of companies that can be considered: • Companies with good opportunities for growth; • Exporters; • Foreign Direct Investment (FDI) Companies with known and strong foreign partners or owners; and • Greenfield companies with highly experienced management and strong business and feasibility plans.
Sectors	HBOR will consider companies in the following Sectors (This list is not comprehensive): • Value Added Wood processing and

	Furniture Production; • Food Processing (including specialty Eco food sector); • Tourism (Small Hotels and other types of tourism ventures); • Auto parts production; and • Technology
HBOR Mezzanine Loan	HBOR will provide Subordinated Loans of up to € 1.0 million each. HBOR's Maximum exposure for all subordinated loans during the pilot to be € 7.0 million.
Established Company Structure:	Companies with established track records and HBOR internal credit ratings of 1-4 will be eligible for the Subordinated Loan Program.
HBOR Individual Maximum Project Exposure	HBOR will provide up to 20% of the total project amount. (subordinated to the senior commercial bank debt provided by Partner Bank.)
Borrower Equity Requirement	The investor will provide 20% of the total project amount as cash equity from its own funds. There will be a prohibition on repayment of shareholder loan (principal and interest) until HBOR loan is paid in full.
Partner Bank Loan Amount	Partner Bank will provide 60% of the total project amount as senior debt.
Greenfield Company/Project Structure:	Companies that are start-up or near start-up will be eligible for subordinated debt financing with the following financing structure.
HBOR Individual Maximum Project Exposure	HBOR will provide up to 30% of the total project amount (subordinated to the senior debt).

Investor/Borrower Equity Requirement	The investor will provide 20% of the total project amount as cash equity. There will be a prohibition on repayment of shareholder loan (principal and interest) until HBOR loan is paid in full.
Partner Bank Loan Amount	Partner Bank will provide 50% of the total project amount as senior debt.
Additional Terms and Conditions	**The following terms will apply for both established company loans and Greenfield loans.**
Maximum Tenor of Loan	Up to twelve years, including grace period based on the projects cash flows and the ability of the company to service all debt (senior and subordinated).
Grace Period	Up to 8 years based on the tenor of the senior debt, the projects cash flows and the structure of the project.
Repayment Period	Repayment of HBOR's debt will commence following the repayment of the senior debt. Repayment to be a maximum 8 semiannual payments following the full repayment of the senior debt.
Interest Rates	3 or 6 month Euribor + 3%
Management Fee	0.80% - one time fee to be paid at closing.
Commitment Fee	0.25% p.a. based on the amount of the loan disbursed.
Mezzanine Finance Fee	Fee amount to be determined. This would be a one time upfront fee to be paid to HBOR and the commercial bank for providing

	subordinated loan structure to the borrower. This fee can be considered a structuring fee.
Other Fees	Success fee paid to Partner Bank at the end of a successful financing (loan fully repaid). This type of fee will reinforce importance of bringing successful projects to HBOR.
Acceptable Collateral	HBOR will take a secondary position to the Partner Bank on common collateral, including property (land and buildings) and equipment. After the Partner Bank is paid in full, HBOR will assume the primary position on the collateral.
Guarantees	Owners to provide a personal guarantee. FDI projects to have guarantee of the parent company through the implementation phase of the project.
Covenants	The following are the types of covenants that might be considered. Covenants should be designed that reflect an understanding of the company, its business plan, and the areas of concern that the bank and HBOR will want to monitor. These covenants are not to be considered comprehensive. • No change in principal business of the borrower without the prior written approval of HBOR • No Change of ownership without approval of HBOR • No profits/dividend payouts or management fees without HBOR and Commercial Bank approval • No shareholder loans without HBOR approval

	• No further borrowings without approval of HBOR • Negative pledge on collateral. • No sales of the company, subsidiaries or assets without HBOR approval. • Minimum Liquidity Ratio. • Maximum Debt / Equity ratios. • Minimum Free Cash Flow Coverage ratios (EBIT/interest ratio • Quarterly income statements and balance sheet from management reports(not audited) within x number of days after end of each quarter • Annual audited financial statements including income statements, balance sheet, and cash flow statements within x number of days after the end of each fiscal year

d) Steps for Execution and Launch of HBOR's Mezzanine Financing Program

1. Meetings Internally between Credit Unit, Analyst Group, Legal Unit, Technical Unit, and Management to discuss process and execution details of the product. Selection of a product launch team to oversee the launch of the program.
2. Select launch date.
3. Informal discussions with a small and select number of Partner Banks to determine interest and terms for participation.
4. Finalize products terms and conditions based on knowledge learned from KfW and Partner Bank discussions.
5. Present Mezzanine Loan Product to the Management Board for final approval.
6. Formerly select and inform Partner Banks that will be a part of the pilot program.
7. Arrange informational meetings with the Partner Banks.
8. Prepare sample documentation and promotional information
9. Training of HBOR and Partner Banks personnel involved in Mezzanine Financing.
10. Launch product.

V. Overview- Subordinated Mezzanine Financing

a. Mezzanine financing is a type of hybrid financing that has attributes of both debt and equity. It is debt-like because it has a specific amount of financing, a set interest rate, a defined tenor and a repayment schedule. It is equity like because it is subordinate to the senior debt due to its second position regarding its claims on the company's assets or collateral and its costs are second only to the cost of equity. Mezzanine financing is a common form of subordinated financing utilized for financing companies that have growth expectations with sufficient and reliable cash flows to service debt. Particularly in the U.S., this type of financing is often a form of bridge financing ranging from five to ten years to induce the senior debts holders to finance a company's capital structure that is viewed as leveraged.

   An important consideration for providing mezzanine financing is the sufficiency of cash flow from the companies operations or the project. For the subordinated debt provider, the cash flow of the company or project must be sufficient to give the debt holders confidence that all the debt (senior and subordinated) can be serviced. The subordinated debt acts as a form of "quasi equity" vis a vis the senior debt holders who usually have a secured first position on the assets of the company. In order to compensate the Mezzanine debt holders for the second position that has been taken, mezzanine financing carries higher interest rates (ranging from 200-800 basis points above the senior debt rate) and often has equity calls on the company in the form of warrants. These warrants can be valued as up to 10% of the company's equity. A key tenet of this form of financing is the acknowledged high risk position of the subordinate lender is rewarded with commensurate high returns via higher interest rates and equity kickers. Mezzanine can be used in several ways including as a form of gap financing for acquisitions, for second and third stage expansion phases of a company, as pre-IPO financing, or other strategic purposes. Mezzanine debt is issued by subordinated debt funds, pension funds, insurance and finance companies, and state and government agencies.

VI. Mezzanine Financing in Croatia

a. Phase one of this project involved assessing the Croatian market on the need and necessity for mezzanine financing particularly for SME's. In Phase one it was concluded that there was no mezzanine financing product offered by banks or other financial institutions for SME's. It was also concluded that there is a need for mezzanine type financing to fill the need of companies that are creditworthy and in need of longer term financing. This is particularly true for "Greenfield" type projects and SME's which need equity or quasi equity funding and often have little equity capital to infuse into the company for growth and insufficient collateral required from commercial banks. This funding gap has not been filled by the commercial banks or other financial institutions in Croatia. Commercial banks have ignored the gap because of their funding constraints and desire for short term financing (5-7 years). Classic bridge financing and mezzanine financing is not available in Croatia because there are few venture capitalists or investors willing to lend money while taking an equity position. Those venture capital firms that are operating in Croatia seek to provide straight equity financing. HBOR as a development bank of Croatia has recognized the need and in fulfilling its mandate has engaged in establishing the first Mezzanine financing program in Croatia.

VII. HBOR Overview

a. HBOR (Hrvatska Banka za Obnovu i Razvitak) is the acronym for the government owned Croatian Bank for Reconstruction and Development. Its objective is to finance the reconstruction and development of the Croatian economy. HBOR provides loan programs for SME's, tourism, development of the economy, and infrastructure. The bank also provides various programs to promote exports and export credit insurance.

   HBOR provides financing through (1) funding commercial bank loans who then on lend to the companies or (2) by direct loans to the borrowers. HBOR often makes its loans with concessionary terms, conditions, and rates. The bank provides financing at concessionary terms and prices in the regions that were destroyed during the Homeland War (Vukovar and Knin) and also in areas that were negatively impacted by the war although not destroyed by the war such as some of the islands off the Croatian coast that are heavily dependent on tourism.

b. HBOR's strengths are as follows:
   - Able to provide long term financing (12 years)
   - Able to provide subsidized financing rates
   - Mandated to provide financing that is unique to the market in order to promote job growth and economic development

c. HBOR's weakness are as follows:
   - Lack of a branch or office network that can enable HBOR to originate, monitor or stay in touch with its borrowers
   - Less agile loan review and approval process
   - Credit analysis process that is collateral focused rather than cash flow focused.
   - Collateral requirement that demand non-moveable collateral loan to value of 150%.

VIII. HBOR Lending Programs

a. HBOR lends to companies both indirectly and directly (See Appendix 2 with outlines of HBOR's "through on –lending banks and direct lending programs). Most of HBOR's loans are executed via the indirect model. In this model, the bank lends funds to Partner banks which are rated A, B, or C. According to HBOR's internal bank rating system ratings from 1-6 are suitable to establish business co-operation. The banks then lend these funds to the borrower directly at favorable pricing and terms through and agreement with HBOR, which makes the loans to the bank at concessionary rates. The bank is not able to charge more than 2% above HBOR's funding rate. In this model, the Partner Bank is exposed to the credit risk of the borrower and is required to complete extensive credit analysis and due diligence prior to extending the loan. If the loan fails, the bank is still obligated to repay HBOR. HBOR's risk in the indirect model is to the bank only. In HBOR's analysis group an extensive review, assessment, and ranking of the banks is done. The indirect model of lending suits HBOR due to its lack of branch and office network. By "partnering" with banks, particularly "A" rated banks, HBOR is able to rely on the bank to originate the loans, analyze the credits, disburse loans, and monitor the loans. About 90% of HBOR's loans are indirect loans with ultimate exposure to the bank. Under the direct financing model, HBOR makes loans directly to borrowers and has direct exposure and risk to the enterprises that it lends.

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IX. Appendix 1- HBOR Mezzanine Financing Program

Mezzanine Financing Program – Terms and Conditions

Product Definition	HBOR's Mezzanine Debt Facility is long-term debt financing that is subordinate to senior commercial bank debt. This mezzanine debt instrument has been designed to address the financing needs of SME's, which lack sufficient equity capital and collateral to qualify for classical senior debt financing.
Key Product Characteristics	HBOR's Mezzanine Debt Facility through its subordination feature should be considered as "quasi equity" from the perspective of the senior debt provider. HBOR will have a junior claim on the assets (collateral) of the company.
Product Implementation	HBOR's Mezzanine Financing subordinated debt program is to be implemented in cooperation with category "A" Partner Banks. The Partner Banks will provide the senior debt in conjunction with HBOR's subordinated debt to acceptable companies and projects. HBOR's subordinated debt will effectively provide an additional cushion of financing in order to enhance the Partner Bank's ability to provide financing to SME companies.
Type of Subordination	HBOR's Mezzanine Loan is to be completely subordinated to the Senior debt of the Commercial bank. HBOR will receive interest payments pari passu with the commercial bank debt, but its principal will not be repaid until after the senior debt of the bank has been repaid in full.
Acceptable Loan Purposes	Loans under the program will be used to finance buildings and equipment with the overall goal of developing and facilitating growth within the SME market of the Croatian economy and facilitating employment generation.
Acceptable Partner Banks	Acceptable Partner Banks are Commercial Banks in the risk group "A" category according to HBOR's method for assessing banks. Partner Banks selected for the program should be institutions that possess similar underwriting rigor and monitoring policies as HBOR. Partner banks will be required to agree with the terms to be negotiated between HBOR and the Partner Bank in its standard agreement.

Proposed Partner Bank Contract Terms	Proposed HBOR and Partner Bank terms should include: • Agreement to closely cooperate in the Mezzanine Financing with HBOR; • Full agreement and cooperation on the acceptability of the project or company to be financed, including discussion on credit review, underwriting criteria; covenants, and monitoring necessary to control the credit. • Agreement to sign an Inter-creditor Agreement between the commercial bank and HBOR outlining the extent of subordination of asset claims by HBOR while the senior debt is outstanding. • Agreement that HBOR is to move to the first collateral position when the commercial bank is fully paid; • HBOR and the Commercial bank to receive interest payments on their respective loans pari passu throughout the life of the loans; • HBOR to provide a grace period during the loan drawdown period and the period that the senior debt of the commercial bank is outstanding; • Agreement on loan covenants that will govern the credit. • Agreement to restrict advancing additional debt without prior agreement between the Partner Bank and HBOR. • Agreement that any shareholder loans are to be completely subordinate to HBOR's and the Partner Bank's debt including interest payments; • Partner Bank will fully disclose immediately all updates on the financial condition of the borrower; and • Agreement on proposed interest rates, fee splitting arrangements and other forms of compensation.
Acceptable Borrower Characteristics	Acceptable borrowers are SMEs that have economically viable business operations or projects that are located in the territory of the Republic of Croatia. The ideal companies should possess the following characteristics: • Experienced managers/owners; • Profitable operations; • Positive, stable and predictable free cash flows; • Products with a strong market presence; • Opportunities for growth; • Willingness to disclose information to mezzanine lender; and

	• Good internal and external reporting systems
Acceptable Types of Borrowers	Companies involved in production or processing are ideal candidates. The following are examples of the types of companies that can be considered: • Companies with good opportunities for growth; • Exporters; • Foreign Direct Investment (FDI) Companies with known and strong foreign partners or owners; and • Greenfield companies with highly experienced management and strong business and feasibility plans.
Sectors	HBOR will consider companies in the following Sectors (This list is not comprehensive): • Value Added Wood processing and Furniture Production; • Food Processing (including specialty Eco food sector); • Tourism (Small Hotels and other types of tourism ventures); • Auto parts production; and • Technology
HBOR Mezzanine Loan	HBOR will provide Subordinated Loan of up to € 1.0 million. Maximum exposure for HBOR during the pilot to be € 7.0 million.
	HBOR will provide the Subordinated Loan Financing Product to Existing Companies with a track record and to "Greenfields" companies under different capital structures
Established Company with Track Records	Companies with established track records and HBOR internal credit ratings of 1-4 will be eligible for the Subordinated Loan Program. Projects are to exhibit the following structures based on an "owned funds" basis.
HBOR Individual Maximum Loan Amount	HBOR will provide up to <u>20%</u> of the total project amount (subordinated to the senior debt).
Investor/Borrower Equity Requirement	The investor will provide <u>20%</u> of the total project amount as cash equity. There will be a prohibition on shareholder loans to the company until HBOR is repaid in full.

Partner Bank Loan Amount	Partner Bank will provide <u>60%</u> of the total project amount as senior debt.
Greenfields Company	**Companies that are start-up or near start-up will be eligible for subordinated debt financing with the following financing structure:**
HBOR Individual Maximum Loan Amount	HBOR will provide up to <u>30%</u> of the total project amount (subordinated to the senior debt).
Investor/Borrower Equity Requirement	The investor will provide <u>20%</u> of the total project amount as cash equity. There will be a prohibition on shareholder loans to the company until HBOR is repaid in full.
Partner Bank Loan Amount	Partner Bank will provide <u>50%</u> of the total project amount as senior debt.
	The following terms will apply for both established company loans and Greenfield loans.
Maximum Tenor of Loan	Up to twelve years, including grace period based on the projects cash flows and the ability of the company to service all debt (senior and subordinated).
Grace Period	Up to 8 years based on the tenor of the senior debt, the projects cash flows and the structure of the project.
Repayment Period	Repayment of HBOR's debt will commence following the repayment of the senior debt. Repayment to be a maximum 8 semi-annual payments following the full repayment of the senior debt.
Pre-Payment	Prepayment of HBOR loans is permitted after the senior debt of the bank has been repaid.
Interest Rates	3 or 6 month Euribor + 3%

Management Fee	0.80% - one time fee to be paid at closing.
Commitment Fee	0.25% p.a. based on the amount of the loan disbursed.
Mezzanine Finance Fee	Fee amount to be determined. This would be a one time up-front fee between HBOR and the commercial bank for providing subordinated loan structure to the borrower**.** This fee can be considered a structuring fee.
Other Fees	Possible success fee paid to Partner Bank at the end of a successful financing (fully repaid). This type of fee will reinforce importance of bringing successful projects to HBOR
Acceptable Collateral	HBOR will take a secondary position to the Partner Bank on common collateral, including property (land and buildings) and equipment. After the Partner Bank is paid in full, HBOR will assume the primary position on the collateral.
Guarantees	Owners to provide a personal guarantee. FDI projects to have guarantee of the parent company through the implementation phase of the project.
HBOR Underwriting Due diligence Process	Underwriting and monitoring a subordinated mezzanine financing will require rigorous credit analysis and company monitoring due to the subordinated position of HBOR. Borrowers should be required to submit: • Business Plan • Feasibility Study • Financial Projections and Assumptions • Break-even analysis • SWOT Analysis • Market Analysis • Marketing Plan • Procurement Plan • Permits • Other documents as requested by HBOR
HBOR Loan Approval Requirements	The approval process for the subordinated mezzanine financing will utilize many of the elements of the credit approval

	process in place for HBOR’s direct lending program. Emphasis to be on the company’s ability to repay loans from cash flows.
Conditions Precedent to Drawdown	• Permits in place • Proof of equity committed • Documentation satisfactory to the lender • Satisfactory due diligence • Other
Post Loan Disbursal Monitoring	Due to the nature of the subordinated position of HBOR, it is recommended that HBOR establish frequent and substantive monitoring of the company in order to be abreast of potential problems.
Covenants	The following are the types of covenant that might be considered. Covenants should be designed that reflect an understanding of the company, its business plan, and the areas of concern that the bank and HBOR will want to monitor. • No change in principal business of the borrower without the prior written approval of HBOR • No Change of ownership without approval of HBOR • No profits/dividend payouts or management fees without HBOR and Commercial Bank approval • No shareholder loans without HBOR approval • No further borrowings without approval of HBOR • Negative pledge on collateral. • No sales of the company, subsidiaries or assets without HBOR approval. • Minimum liquidity Ratio. • Maximum Debt / Equity ratios. • Minimum Free Cash Flow Coverage ratios (EBIT/interest ratio • Quarterly income statements and balance sheet from management reports (not audited), within x number of days after end of quarter. • Annual audited financial statements including income statements, balance sheet, and cash flow statements, within x number of days after the end of the fiscal year.
Value Added Tax	Value Added Taxes are to be paid by the investor and cannot be paid from HBOR direct or indirect fund.
Applicable Law	Republic of Croatia

X. Appendix 2- HBOR Lending Programs

LOAN PROGRAMME FOR THE DEVELOPMENT OF PRIVATE SMALL AND MEDIUM BUSINESSES (THROUGH ON-LENDING BANKS)

1. GOAL OF PROGRAMME

The goal of the Loan Program is to promote private entrepreneurship through long-term investment lending for the purpose of modernizing and expanding existing companies, crafts businesses and other forms of entrepreneurial activities.

2. ELIGIBILITY OF APPLICANTS

Those who may apply for a loan within this Program are domestic companies at least 51% privately-owned, currently not employing more than 250 employees (including associated companies), and entrepreneurs in the manufacturing industry, crafts business or agriculture, as well as transport, tourism and other service industry entities. The only exception shall be intermediary agencies in the real estate business.

In the case of companies involved in foreign joint ventures in the same branches of the economy, only the contribution made by Croatian partners shall be financed. Joint ventures between domestic entrepreneurs and entrepreneurs from Bavaria shall be financed in the same way.

Loan applicants without experience and newly established companies are excluded. (The precondition is a minimum of two years' work experience in the same or a similar field of activities as the investment).

Applicants are not automatically entitled to obtain a loan.

3. PURPOSE OF LOAN

Fixed assets:

- purchase of building land, manufacturing facilities and business premises
- construction costs
- nucleus breeding unit
- purchase of machinery, equipment and vehicles
- perennial plants

Current assets shall be financed by up to 30% of the loan amount at the most. In exceptional cases, this limit can be exceeded.

Not eligible for financing:

- purchase of companies and other existing entrepreneurial activities
- investments already started
- investments already financed out of other sources
- portions of investments to be used for personal purposes
- securities or other financial investments

4. LOAN AMOUNT

HBOR can finance up to 75% of the total estimated investment value at most; the maximum loan amount cannot exceed the level of HRK 8,000,000.00 per project.

5. TERMS AND CONDITIONS OF LOAN

Repayment period	up to 10 years, grace period included
Grace period	up to 2 years
Interest rate	2% for exporters having suffered direct war damage or having accommodated displaced persons or refugees 2% for exporters investing in a region of special state concern, the islands or in agriculture 4% for other exporters 4% for business entities having suffered direct war damage or having accommodated displaced persons or refugees 4% for business entities investing in a region of special state concern, the islands or in agriculture 6% for all other business entities

The interest rate for borrowers having suffered war damage may apply to a portion of the loan or to the entire amount of the loan, but this may not exceed the estimated value of the war damage.

For the purposes of interpreting the provisions of this Programme, an exporter is a business entity having generated at least 30% of its previous year income through direct exports, exports via intermediaries, or the provision of accommodation to foreign tourists.

6. INTEREST RATE

The interest rate shall be fixed for the entire lifetime of each individual loan, and shall be stipulated in a contract between HBOR and the commercial bank. The calculation and payment of interest shall be determined by the Decision on HBOR Interest Rates.

During the implementation of this Loan Programme, interest rates may vary depending on changes in the terms and conditions of borrowing abroad. The interest rate shall apply to the amounts from the start of their disbursement, i.e. from the first disbursement, until the final repayment.

Prepayment is possible only on the basis of a prepayment fee.

7. SECURITY

The usual banking collateral is accepted: Bills of Exchange, guarantees issued by other banks, guarantees issued by HAMAG or mortgages (at least 1:1.5 of the extended loan amount). The commercial bank and HBOR shall decide on the collateral submitted by the final borrower.

8. APPLICATION PROCEDURE

Within this Programme, HBOR extends loans exclusively through commercial banks that assume the entire risk for loans on-lent by them. Therefore, loan applications accompanied by the appropriate investment documentation should be submitted to the commercial banks chosen by the applicants.

Loan application forms can be obtained from the commercial banks!

The following documents relating to the final borrower shall be submitted to HBOR by the commercial banks for the purpose of processing loan applications:

- loan application form completed and signed
- excerpt from the Court Register (companies)
- excerpt from the Crafts Register (crafts businesses and free-lance professions)
- certificate issued by tax authorities (agricultural entrepreneurs)
- excerpt from the Land Register (issued not more than 6 months beforehand)
- assessment of the real estate to be offered as pledge, given by an authorized expert

For the purpose of processing a loan application, HBOR reserves the right to request additional documents.

9. DISBURSEMENT

Maximum loan disbursement period is one year. During the disbursement period, a commitment fee of 0.25% p.a. is payable on the undisguised loan amount on a three-monthly basis. In addition, commercial banks shall have the right to charge a one-off fee of 0,8% of the committed loan amount.

10. EXCEPTIONAL FINANCING OF CURRENT ASSETS ALONE

In exceptional cases, it is possible to finance permanent current assets alone for the purpose of bridging current liquidity concerns, of improving financial structure, or of expanding activities of applicants who have good operating results and favourable prospects, which shall be separately established and recommended by the commercial banks.

10.1 LOAN AMOUNT

Up to a maximum of 30% of total assets (Balance Sheet relating to the previous financial year), but not exceeding HRK 400,000.00.

10.2 LOAN PERIOD

Up to three years with grace period of up to 1 year.

For more information, please contact HBOR, Small and Medium Enterprise Department or HBOR Web Pages

LOAN PROGRAMME FOR THE DEVELOPMENT OF PRIVATE SMALL AND MEDIUM BUSINESSES (DIRECT LENDING)

1. GOAL OF PROGRAMME

The goal of the Loan Programme is to extend medium and long-term loans for the purpose of financing the development of small and medium businesses with the objective of increasing employment.

2. ELIGIBILITY OF APPLICANTS

Borrowers may be companies, craftsmen, co-operatives and natural persons, heads or members of family farms who:

- operate within the territory of the Republic of Croatia
- employ fewer than 250 employees
- are at least 51% privately-owned

Borrowers must meet the following preconditions:

- good investment project
- expert and successful management
- minimum capital of 30% on the liabilities side of the balance sheet
- total debt coverage ratio of at least 1.5:1 (net revenues as against total debt comprising existing and new obligations over the entire lifetime of the project)

Applicants are not automatically entitled to obtain a loan.

3. PURPOSE OF LOAN

investments in fixed assets (business premises, equipment and all other investments in fixed assets)

investments in current assets - up to 30% of the loan amount

refinancing of existing financial liabilities within the framework of the project, provided that the total amount utilised for financing of current assets and for refinancing purposes does not exceed 30% of the loan amount

Not eligible for financing:

- production of weapons or military equipment
- manufacture and export of tobacco products or spirits
- business entities whose sole or predominant activity is serving beverages
- casinos, gambling premises
- environmentally unacceptable projects

- investments already initiated (refinancing of payments)
- purchase of securities

4. LOAN AMOUNT

The loan amount can cover up to 70% of total investments at most. Loan borrowers' own funds must amount to 30% of the investment at least. Loans can be granted for financing projects whose total estimated investment value does not exceed the amount of EUR 1,500,000.

The highest loan amount shall not exceed EUR 1,000,000 and the lowest shall not be less than EUR 10,000.

5. TERMS AND CONDITIONS OF LOAN

Repayment period	up to 10 years, grace period included. As an exception, repayment period for borrowers in accordance with the Model of the Financing of Renewal and Modernization of the Fishing Fleet is up to 15 years (grace period included).
Grace period	up to 2 years
Interest rate	2% for exporters having suffered direct war damage or having accommodated displaced persons or refugees 2% for exporters investing in a region of special state concern, the islands or in agriculture 4% for other exporters 4% for business entities having suffered direct war damage or having accommodated displaced persons or refugees 4% for business entities investing in a region of special state concern, the islands or in agriculture 4% for business entities who invest into the production of the Slavonian paprika-flavoured salami called “kulen” 6% for all other business entities

The interest rate for borrowers having suffered war damage shall apply to a portion of the loan or to the entire amount of the loan, but this shall not exceed the estimated value of the war damage.

For the purposes of interpreting the provisions of this Program, an exporter is a business entity having generated at least 30% of its previous year income through direct exports, exports via intermediaries, or the provision of accommodation to foreign tourists.

The calculation and payment of interest shall be determined by the Decision on HBOR Interest Rates.

6. APPLICATION PROCEDURE

Loan applications shall be submitted directly to HBOR. Loan application forms and environmental protection, health and safety Polls can be obtained at HBOR.

Upon loan approval, HBOR shall enter into a loan contract with the final borrower.

7. DOCUMENTATION NEEDED FOR LOAN APPLICATION PROCESSING AT HBOR

a) loan application form completed and signed

b) environmental protection, health and safety questionnaire completed and signed

c) personal identification number certificate

d) excerpt from the register of family farms

e) photocopy of identity card

f) excerpt from the Court Register (issued not more than 30 days beforehand), or crafts license

g) notification of the classification of the business entity in accordance with NKD (national classification of business activities)

h) list of authorized signatories for disposing of the funds deposited in the account (issued not more than 30 days beforehand)

i) Balance Sheet (for medium-sized and large entrepreneurs) B/POD-V form, and Profit and Loss Account (for medium-sized and large entrepreneurs) RDO/POD-V form; or Annual Financial Statements for large, medium-sized and small entrepreneurs GFI-POD form (for the last two years)

j) auditors' report (if a company is obliged by law to have its accounts audited)

k) curricula vitae describing the professional development of the management

l) detailed investment project with calculation of its profitability

m) excerpt from the Land Register for the real estate intended to be offered as security (issued not more than 30 days beforehand)

n) assessment of the real estate value, given by an authorized court expert

o) other documents if deemed necessary by HBOR for the purpose of processing the loan application

8. DOCUMENTS TO BE CONTINUOUSLY SUBMITTED BY BORROWERS AFTER LOAN APPROVAL:

a) Annual Report for each year during the period of the loan contract validity

b) other information reasonably requested by HBOR from time to time

9. SECURITY

For the purpose of securing due loan repayment within the framework of this Loan Program, HBOR accepts collateral in accordance with the Decision on General Terms and Conditions of HBOR Lending Activities and General Terms and Conditions of Insurance of HBOR's Placements (pledge of real estate and movable property, guarantees issued by HAMAG).

10. LOAN DISBURSEMENT

Maximum loan disbursement period is 12 months.

11. FEES

Commitment fee

During the disbursement period, a commitment fee of 0.25% p.a. is payable on the undisbursed loan amount on a three-monthly basis.

Loan application fee

HBOR is entitled to charge a maximum one-off loan application fee of 0,8% of the committed loan amount.

Proper utilization of loan funds is verified by HBOR on the basis of disbursement documents and through inspection on site. In cases where loan funds have been utilised for purposes other than those specified, or where false documents have been submitted for the purpose of obtaining a loan, HBOR shall demand the repayment of the entire loan amount together with all accrued expenses.

Loan applications not complying with the criteria stipulated in the Loan Program will not be considered.

XI. Appendix 3- HBOR Credit Approval Process

The HBOR credit approval process will be used for the Mezzanine financing product , but greater focus will be given to the underwriting process

a. The Credit Approval Process in HBOR has several steps that require a review and sign off by the Credit Officer, the Analysis (Bank and/ or Company Analysis), Technical Division, Legal, the Credit Board, the Management Board, and the Supervisory Board depending on the size of the credit.

b. The Credit officer has overall responsibility for guiding the potential loan through the credit process. The Credit officer has responsibility for evaluating management and has the primary interface with the company and its management. All questions must be answered via the credit officer.

c. The analysis group is responsible for the credit and financial review of the company and its project. The analyst department has ten (10) people of which three (3) cover the banks and seven (7) cover the companies. Following the analysis review of the company, a credit rating is assessed by the department.

d. The technical division has 5 people with a civil engineering and architecture background. The technical division has a multi fold responsibility in the credit process.
   - Values the underlying collateral on the loans
   - Review of the feasibility study. Verifies the equipment costs and the inputs for building construction;
   - Reviews and confirms the permitting that will be required for any building in Croatia. In addition, the division is also required to complete environmental impact studies.
   - Monitor progress on construction of the sites during the building phase.

e. The legal department reviews the collateral from a legal perspective and drafts documents needed to “paper” the loan transaction.

f. Assuming a successful review by the group above, The credit is presented to the Credit Board by the director of SME for approval.

g. If the credit is between € 100,000 and € 5 million final approval is required from by the Management Board. Below € 100,000 final approval is completed by the Credit Board.

h. Credits above € 5 million are approved by the Supervisory Board.

XII. Appendix 4- KfW

KfW is the German government development bank that has a mandate similar to HBOR's. In 2003, KfW launched a subordinated mezzanine financing product targeted to the SME market in Germany. KfW's has three types of building block programs which will address the needs of SMEs including: start-up companies who have been in operation under two years, young companies that have been in business for more than two years but less than five, and a program for companies that have been in business for more than five years. In addition to the programs objective of providing capital to SMEs that lack equity capital, collateral, and liquidity; the program is geared to create and safe guard jobs. KfW's program supports the employment initiative of the German federal government. Since the program was instituted, KfW has made approximately € 1.35 billion of subordinated loans. Over 300 such loans were made in 2005 alone. The program, including senior debt has lent € 2.7 billion.

Eligible Borrowers

The program is eligible for all SMEs, where the private sector owns a majority share and its sales or annual turnover do not exceed € 500 million.

Eligible Sectors

All sectors are eligible to participate with the exception of transportation and weapons production.

Purpose of Loans

Financing is available for all investments that require long term investment and promise sustainable economic success and will safeguard jobs. This includes: property and buildings, construction, acquisition of machinery, equipment, furnishings and fittings and the acquisition of an existing company. Operating funds in the amount of 20% of the investment is also eligible for financing under the program.

Amount of Financing

Up to 100% of eligible costs can be financed. The maximum amount of the loan is € 4 million per project.

Structure of the Financing

The company will receive an integrated package of financing consisting of 50% senior debt from commercial banks and 50% subordinated debt from KfW. The senior and subordinated trenches must be equal in amount. KfW's subordinated tranche is provided to the company through the partner commercial bank. Tenor of Financing

Up to ten years for both tranches.

Interest Rate

Interest Rate for the subordinated debt tranche is market driven and based on developments in the capital markets and on the borrowers' credit rating. Rates are fixed for the life of the loan. Interest rate on the senior commercial bank debt is also a rate dependent on the capital markets. The rate for the program has ranged from 5.15%-8.8% for the subordinated debt and 3.8%-6.8% for the senior debt for the senior debt. The rate differential is 135 to 200 basis points.

Fees

Commitment Fee of .25% per month on the amount of the loan not disbursed.

Repayment

Senior debt: 2 year grace and 5 year repayment in equal semi annual installments

Subordinated debt: 6 equal semi annual installments after the senior debt is repaid.

Interest payments are made on both tranches of debt throughout the life of the loan.

Collateral

Senior Debt: secured by the normal collateral as negotiated between the bank and the borrower.

Subordinate: No collateral

Loan to Collateral Ratios

KfW indicated that they do not require collateral and do not have such ratio requirement. They also indicated that the banks are not governed by such ratios as well. Focus is on ability to repay loans from cash flow. Basel 2 did not appear to be a factor in structuring this loan program.

Covenants

Normal covenants as is required for long term financing

Underwriting Procedure

KfW relies on the underwriting analysis and due diligence of its partner banks. It conducts a desk type of due diligence, which takes not more than two weeks.

Default Issues

If borrower defaults, the senior debt holder will have the collateral as a source of payback but, the senior portion of the debt that is received from KfW must be repaid to KfW whether the bank recovers from the borrower or not. The subordinated portion provided by KfW is totally exposed and is not eligible for recovery via collateral. KfW has accepted that risk.

Origination of deals

Partner Banks are the originators of transactions.

Partner Bank Relationship

Partner banks were consulted early in the process of designing the mezzanine financing program. KfW presented the structure of the program when about 80% complete and asked the banks for their input to improve the product. The initial program required the subordinated loan to be paid on bullet basis. The partner banks thought that to be too onerous on the companies and the program was revised to include the 3 year (6 semi-annuals) repayment period. KfW has over 400 partner banks. The partner bank is determined by its ability to provide the financing and the bank's financial capability and standing. Partner banks enter into a "Framework Agreement" between the bank and KfW. This agreement covers all of the programs overall provisions. The banks then enter into an agreement between themselves and the borrowers. If the partner

KfW Risk Appetite

KfW operates as a market based entity. It is willing to accept the normal risks of financial transactions provided the price of the transaction is commensurate with the risk. When devising the risk premiums suitable for the SME market, KfW hired consultants to help them to calculate those risk premiums for calculating into the appropriate risk based pricing.

State Aid Issues

KfW's program appears to be highly market driven and does not run into state aid conditions. The pricing is market driven and are not concessionary, the tenor and grace periods of the loans are also market and don't appear concessionary. If a company fails or defaults, KfW has accepted that as a risk that they must bear as part of the financing package. KfW was not willing to share the opinion received from the European Union.