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EUROPEAN ASSOCIATION OF MUTUAL GUARANTEE SOCIETIES

Growing together

**Reinforcing SME
own funds:**

**Mezzanine Finance
and guarantee solu-
tions**

May 2010



Foreword by the Chairman and the Secretary General

Dear Reader,

During the financial and economic crises, access to finance for SMEs has come under tremendous stress, and many companies have either not been able to obtain credit finance at all, or only at much more stringent conditions and often not to the full extent of the financing amount applied for.

Besides the deteriorated state of the interbank and banking retail markets, which have compressed available funding for SMEs, smaller companies have had to struggle with increasing payment delays and falling sales and export volumes.

In these times of financial pressure, the vulnerability of many SMEs due to a lack of proper capitalisation has become more evident than in the years before the crises.

The European Association of Mutual Guarantee Schemes (AECM) has reacted swiftly to the need of SMEs e.g. by providing innovative working capital guarantee products, thus answering the acute and short-term financing needs. However, in the interest of the longer term, it is also interesting to look at solution to bolster SMEs own funds, and thereby improving their ratings and overall capacity to take on more credit finance at more favourable conditions.

One solution in this direction, at least for a certain category of SMEs, is the use of mezzanine finance. However, to some extent, the mezzanine market for SMEs still suffers from a market gap in many countries across the EU. In the following, we would like to provide some examples of mezzanine products supplied by our member organisations, as stand-alone mezzanine products, as stand-alone guarantee products or both in combination with another, all featuring different characteristics.

We hope that this reading will be of interest to all parties concerned and will contribute to the debate on how to strengthen European SMEs to compete in the after-crisis environment.



José Fernando Figueiredo
AECM Chairman



Marcel Roy
Secretary General

Austria:

Austria Wirtschaftsservice (aws)

Austria wirtschaftsservice (aws) is a promotional institution that is publically owned and, among other instruments, provides a guarantee instrument for mezzanine investments called "quasi equity guarantee" for investments both by individual private investors or banks. Investment funds are excluded.



The product has the following characteristics:

Product type	Guarantee for mezzanine investments
Target group	SMEs
Type of mezzanine finance supported	Subordinated loans
Mezzanine investment range	€ 0 - € 2,5 million
Coverage rate	80% maximum, 70% average
Duration of mezzanine investment	3—10 years
Rights of mezzanine investor	No decision rights, information and reporting rights typical for a loan
Guarantee fees	Processing fee: 0,5%; Annual guarantee fee: 0,6% - 5% (variable according to risk rating of borrower)
Repayment / Exit	According to normal loan repayment schedule
Public counterguarantee	100% by Ministry of Finance
State aid regulation applicable	De minimis regulation and temporary state aid framework

Financing example:

Project: Take-over of a business field of an existing company active in the sale and repair of hydraulic presses.

Financing needs: EUR 160.000, of which:

- ⇒ Tools and existing customer base: €120.000
- ⇒ Working capital: € 40.000

Financing:

- ⇒ Own funds of company: € 20.000 (not guaranteed)
- ⇒ Investors: € 40.000 (guaranteed 70%)
- ⇒ Bank loans: € 100.000

Provision of a 70% guarantee for invested own funds in form of subordinated loans, processing fee of €200 (0,5% of € 40.000), guarantee fee of € 168 per year.

Czech Republic:

Czech-Moravian Guarantee and Development Bank (CMRZB)

The Czech-Moravian Guarantee and Development Bank (CMRZB) provides a mezzanine loan product called PROGRESS. The mezzanine loan is offered without a loan guarantee.



The product has the following characteristics:

Product type	Mezzanine stand-alone product
Target group	SMEs
Type of mezzanine product	Subordinated loan
Mezzanine investment range	€ 0 - € 750.000
Total volume of mezzanine fund	€ 160.000.000
Duration of mezzanine investment	Up to 9 years
Rights of mezzanine investor	No decision rights, information and reporting rights typical for a
Mezzanine conditions	Annual flat interest rate: 3 %; Grace period of 3 years
Repayment / Exit	According to normal loan repayment schedule
Public support	Public participation in funding of mezzanine fund
State aid regulation applicable	Block Exemption, Regulation (EC) 800/2008

Financing example:

Project: production of glass flour (fragmentation of waste glass), subject of investment: construction of premises and purchase of equipment

Beneficiary: company limited with 89 employees

Financing:

Total investment: EUR 2 million, of which:

- ⇒ Subordinated loan. EUR 0.75 million (fixed interest rate 3 % p.a, maturity: 7 years, grace period: 3 years
- ⇒ Bank loan: 0,75 million
- ⇒ Equity: EUR 0,5 million

Structure of project costs:

- ⇒ Construction of premises: EUR 0.72 million
- ⇒ Equipment: EUR 1.28 million

Waste glass collected from 390 municipalities, co- operation with 180 suppliers.
The company is certified (quality of management, environment)

Estonia:

Credit and Export Guarantee Fund KredEx (KredEx)

The Credit and Export Guarantee Fund (KredEx) is a publicly owned fund providing a mezzanine instrument using subordinated loans. The product is offered as a stand-alone, i.e. without a guarantee element, for SMEs and larger companies.



The product has the following characteristics:

Product type	Mezzanine stand-alone product
Target group	SMEs and larger companies
Type of mezzanine product	Subordinated loan, silent partnership
Mezzanine investment range	€ 64.000 - € 1.023.000
Total volume of mezzanine fund	€ 33.400.000

Duration of mezzanine investment	3 to 10 years
Rights of mezzanine investor	No decision rights, information and reporting rights, convertibility option in case of difficulties
Mezzanine conditions	Processing fee of 1% of mezzanine amount Annual variable interest rate according to risk: 9 - 18 %; Success-based fee (of profits): 2,5 - 7% Grace period of 3 - 7 years Exit fee: There is a fee if the exit is done during the first 3 years. The fee depends on the timing of the exit and on the loan amount.
Repayment / Exit	According to normal loan repayment schedule
Public support	Public participation in funding of mezzanine fund, Ministry of Economic Affairs and Communications
State aid regulation applicable	De minimis Regulation

Financing example:

Client: Provider of low cost passenger transport services in the Baltic Sea previous experience 11 years).

Main route Tallinn-Helsinki-Tallinn (operates only during ice-free period). In 2008 - 260 000 customers, revenue ca 6,4 million EUR.

Project: Purchase of the high-speed passenger ferry. New ferry will double the seat capacity and raise the number of daily trips from 6 to 10.

With the new ferry client expects to double its yearly revenue and increase the profitability as the new ship is more cost efficient.

Financial structure:

⇒ Senior bank loan:	4 300 000 EUR (78,2%)
⇒ KredEx allocated loan:	511 000 EUR (9,3%)
⇒ Borrowers own funds:	689 000 EUR (12,5%)
⇒ Total Investment	5 500 000 EUR

France:

Oséo

OSEO, as a publicly owned development agency, offers a wide range of mezzanine finance. The main product is called Contrat de Développement Participatif, and combines an OSEO loan with a specific guarantee.



Other “traditional” guarantee funds managed by OSEO (for start ups, development, innovation) can also occasionally cover banks mezzanine loans. The product is available for SMEs and larger companies (Intermediary size enterprises; with a staff up to 5000 employees).

The « Contrat de développement Participatif" has the following characteristics

Product type	Guarantee for mezzanine investments, either as stand-alone guarantee or in combination with a mezzanine product.
Target group	SMEs and larger companies
Type of mezzanine finance supported	Subordinated loans
Mezzanine investment range	€ 40.000 - € 3 million
Total volume of mezzanine fund	€ 1 billion, over 2010—2011
Total volume of guarantee funding	€ 48.000.000
Coverage rate	80% maximum, 70% average
Duration of mezzanine investment	7 years
Rights of mezzanine investor	No decision rights, information and reporting rights
Mezzanine conditions	Annual interest rate: Euribor + risk indexed margin according to Banque de France rating, 2,66% - 6,06% Success based fee: 1,20% Grace period: 2 years
Guarantee fees	Variable according to risk: 0,27% - 2,14%
Repayment / Exit	According to normal loan repayment schedule
Public support	Public funding for guarantee fund, Ministry of Finance

Financing example:

Beneficiary: 3 sPhotonics, This SME (turn over 23 M €) develops specific components in optoelectronics using laser beam technology for fiber glass internet cables and equipment.

Originally a subsidiary from ALCATEL group, bought out by the management in 2007, it keeps a high pace of growth. Yearly investments in R&D represent 15 % of turnover. Fall of activity in 2009 lead to a sharp reduction of its inventories, in order to adapt to temporary situation

Financing needs and constraints:

Existing debts from the spin off limit 3 sPhotonics' ability to raise classic loans. New working capital needs arise in 2010 as new orders demand a greater availability of inventories, as condition for sales success.

Financing solution: € 1,5 M Contrat de Développement participative. This quasi equity resource offers ideal coverage of working capital needs, as well as financing a take over operation on a Canadian company, essential for development in Northern America.

OSEO's mezzanine activity under the guarantee umbrella grows rapidly (181 M€ granted in 2008, 679 M€ in 2010, representing 21,3% of the annual lending activity), confirming the potential demand from enterprises for such "patient capital".

Germany:

Association of German Guarantee Banks

The Mittelständische Beteiligungsgesellschaften (MGB), participation companies for SMEs, provide a mezzanine product for SMES, which is in turn guaranteed by the German Guarantee Banks. The German Guarantee Banks are also shareholder of the MBG, both are private sector organisations.



The product has the following characteristics:

Product type	Mezzanine product with guarantee element
Target group	SMEs
Type of mezzanine product	Subordinated loan, silent partnership
Mezzanine investment range	€ 50.000 - € 2,5 Million
Total volume of mezzanine fund	Unlimited - evergreen
Duration of mezzanine investment	7 to 10 years

Rights of mezzanine investor	Very limited decision rights, information and reporting rights
Mezzanine conditions	Processing fee of 1% of mezzanine amount Annual interest rate according to risk: 7 - 11 %, divided in fixed and variable components; Exit fee: repayment at nominal value
Repayment / Exit	According to normal loan repayment schedule
State aid regulation applicable	De minimis Regulation, General Block Exemption Regulation

Financing example:

MTM LABORATORIES AG, HEIDELBERG

The products made by mtm laboratories AG can save lives. Every year half a million women are diagnosed with cervical cancer. More than half of them die of it. The mortality rate corresponds to the sensitivity of the tests currently available - only half of all cancer cases are found using a conventional smear test. However, with early diagnosis the chances of being cured are nearly 100 percent. "With the help of our products, the sensitivity of the test is increased to well over 90%", says Peter Pack, co-founder and chairman of the management board of mtm laboratories.

The Heidelberg-based biotech company has developed an easy-to-use procedure with which even single pre-cancerous cells as well as cancerous cells can be conspicuously marked in cervical smears and biopsies. This makes them easy to detect and to identify accurately. During this process, mtm laboratories utilises the discovery that even in pre-cancerous cells, the concentration of a particular protein marker is greatly increased.

Today, mtm laboratories is one of the leading German biotech companies and markets its products internationally. The process is patented worldwide, and the diagnostic products are now produced in-house. The company employs 24 staff members, including biologists, chemists, physicians and a patent law attorney. In 2005 a branch was opened in Boston. "The use of new methods for early cancer detection is much more widespread in the United States than in Germany," says Peter Pack. His company invests in large studies to prove the efficacy of their product here as well.

"The investment company MBG played a very important and supportive role in the work of our company," emphasises the chemist, who holds a doctorate and has been working in the biotech sector since 1993. In order to attract investors, clinical data on the test process had to be collected fast, which required capital. With these data the company was able to obtain the required financing. mtm laboratories are currently hard at work researching new products. However, their focus is presently on establishing the life-saving test procedure in the market.

Company	mtm laboratories AG, Heidelberg
Founded in:	1999
Number of employees	24
Project	Development and market introduction of cervical cancer tests

Comparison tables:

	AWS	CMZRB	KredEx	Oséo	VDB/ MBG
Product type:					
Mezzanine stand alone		x	x		
Mezzanine with guarantee				x	x
Guarantee alone for mezzanine finance	x			x	
Target group:					
SMEs alone	x	x			x
SMEs and larger companies			x	x	
Volume of guarantee admissible per company:					
Lower limit	€ 1	€ 1	€ 64.000	€ 40.000	€50.000
Upper limit	€ 2,5 mio	€ 750.000	€ 1,02 mio	€3 mio	€2,5 mio
Guarantee coverage rate					
Maximum	80 %	n.a.	n.a.	80 %	70-80 %
Average	70 %	n.a.	n.a.	70 %	
Volume of Funds					
Mezzanine fund	n.a.	€ 160 Mio	€ 33,4 mio	€ 1 bn	unlimited
Guarantee fund for mezzanine operations	n.a.	n.a.	n.a.	€ 48 mio	
Type of product mezzanine product					
Subordinated loan	x	x	x	Yes	Yes
Silent partnership			x		x

	AWS	CMZRB	KredEx	Oséo	VDB/ MBG
Rights of mezzanine investor:					
Voting rights / Decisions rights	No	No	No	No	Very limited
Information / reporting rights	Yes	Yes	Yes	Yes	Yes
Duration of investment:					
Minimum	3 yrs	3 yr	3 yrs	7 yrs	7 yrs
Maximum	10 yrs	9 yrs	10 yrs	7 yrs	10 yrs
Conditions and pricing mezzanine product:					
Processing fee: flat rate	n.a.	n.a.	n.a.	n.a.	1 %
Processing fee in proportion of mezzanine commitment Cap:	n.a.	n.a.	1 % No cap amount	n.a.	n.a.
Annual fee / Interest rate: Fixed	n.a.	3 %	n.a.	n.a.	n.a.
Annual fee / Interest rate: Variable Lower limit: Upper limit:	n.a.	n.a.	9 % 18 %	2,66 % 6,06 %	7 % 11 %
Success based fee Cap:	n.a.	n.a.	2,5 - 7 %	1,20 % n.a.	
Exit fee	n.a.	n.a.	Yes during first 3 yrs	n.a.	Nominal value
Grace period:	n.a.	3 yrs	3 - 7 yrs	2 yrs	

	AWS	CMZRB	KredEx	Oséo	VDB/ MBG
Conditions and pricing guarantee instrument:					
Processing fee: flat rate	n.a.	n.a.	n.a.	n.a.	n.a.
Processing fee in proportion of guarantee commitment: Cap:	0,5 % No	n.a.	n.a.	n.a.	n.a.
Annual fee: Fixed	n.a.	n.a.	n.a.	n.a.	n.a.
Annual fee: Variable Lower limit: Upper limit:	0,6 % 5 %	n.a.	n.a.	0,27 % 2,14 %	n.a.
Grace period:	n.a.	n.a.	n.a.	n.a.	n.a.
Exit conditions for mezzanine product:					
Regular redemption according to loan schedule:	Yes	Yes	Yes	Yes	Yes
Convertibility into shares:	No	No	Under conditions	No	No
State aid element, mezzanine product:					
Public participation in funding of mezzanine fund:	n.a.	Yes	Yes	No	No
Public co-investment in individual cases:	n.a.	No	No	No	No
Name of public authority	n.a.	Min. Industry and trade	Min. Economic affairs and communication	n.a.	n.a.

	AWS	CMZRB	KredEx	Oséo	VDB/ MBG
State aid element, guarantee instrument:					
Public funding for guarantee fund:		n.a.	n.a.	Yes	Yes
Public counter-guarantees: Coverage rate: Cap rate:	Yes 100 % n.a.	n.a.	n.a.	No	Yes 80 %
Name of public authority:	Ministry of Finance	n.a.	n.a.	Ministry of Finance	Regions, Bund
State aid regulation applying to the instruments	De minimis, Temporary Framework	Block Exmpt. EC 800/ 2008	De minimis reg.	n.a.	De minimis, , Temporary Framework, GBER

About AECM

AECM has 34 member organisations operating in 17 EU countries and Turkey. Its members are mutual, private sector guarantee schemes as well as public institutions, which are either guarantee funds or Development banks with a guarantee division.

They all have in common the mission of providing loan guarantees for SME who have an economically sound project but cannot provide sufficient bankable collateral. In 2008, AECM member organisations had a total guarantee volume in portfolio of € 57 billion and issued a total of € 23,6 billion in new guarantees.

AECM represents the political interest of its member organisations both towards the European Institutions, such as the European Commission, the European Parliament and Council, as well as towards other, multilateral bodies, among which the European Investment Bank (EIB), the European Investment Fund (EIF), the Bank for International Settlement (BIS), the World Bank, etc. It deals primarily with issues related to state aid regulation relevant for guarantee schemes within the internal market, to European support programmes and to prudential supervision.

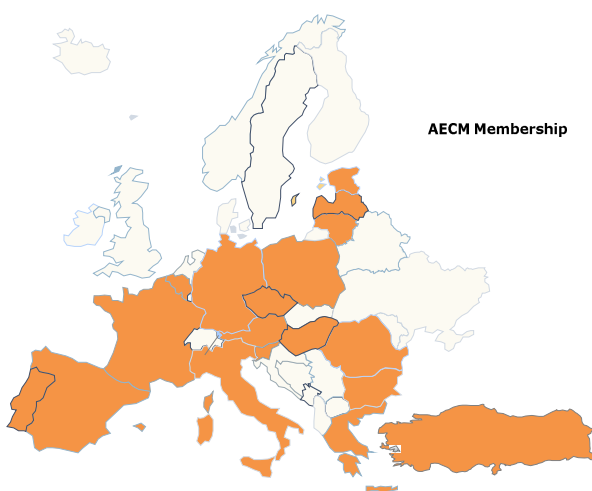
The member organisations of AECM, the European Association of Mutual Guarantee Societies, have been swift and decisive in responding together with the public authorities to the challenges stemming from the change of demand caused by the crisis. According to provisional figures the **total volume of new guarantees issued in 2009** by AECM members has risen by 55 % as compared to 2008. After a solid 8,13 % average growth rate for total guarantee volumes in portfolio over the period from 2002 to 2008, volumes have expanded by 25,20 % from 2008 to 2009, which is a considerable performance both financially and operationally. (see graph below).

Overall, in 2009, AECM members issued over 853.000 guarantees with a value of over € 33 billion. On 31st December 2009, AECM members held in their portfolios more than 2 million guarantees for a value of € 70 billion to over 1,8 million customers, which represent about 8% of all SMEs in the European Union. The vast majority of the beneficiaries are small companies.

This extraordinary increase in guarantee activity also reflects in part **the impact of the specific crisis instruments**, which have been launched by AECM member organisations towards the end of 2008 and the beginning of 2009 as new products or modified existing products.

Indeed, with a total volume of € 11,2 billion, guarantees issued under the specific crisis programmes make up about a third of the total guarantee activity in 2009. 90 % of the total volume of these specific crisis guarantees has been dedicated to short term, working capital loans.

The specific crisis guarantee instruments have provided over 117.000 SMEs with crucial access to finance and thus contributed to maintaining more than 686.000 jobs.



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