Fouriertransform

Corporate Governance Report 2011

March, 2012

Chairman's comments

"Capital from the Government is needed as an alternative and can guarantee the desired plurality in a market economy."

What is venture capital?
Over the past year the venture capital sector has been covered with uncommon frequency in the media, with plenty of input, proposals and opinions from the political sphere (Håkan Juholt, Maud Olofsson, Lars Johansson etc.) as well as from private debaters (Swedish Private Equity & Venture Capital Association, Royal Swedish Academy of Engineering Sciences - IVA, Innovation Management Forum etc.).

In my opinion, the debate has been problematic and filled with everything from terminology and concept confusion to a total lack of insight into the important differences between various types of business, and above all the particular difficulties associated with the venture capital business. The state-owned company I represent as chairman – Fourier-transform AB – is a company that operates according to the same investment criteria as a traditional venture capital company.

What, then, is venture capital (VC)? The answer to this question requires a look back in history.

The sector originated in the United States in the late 1950s when wealthy families like the Rockefellers started to gather their small unlisted holdings under one administration and make more systematic new investments in growth companies.

During the 1960s a number of private VC companies were formed by entrepreneurial financiers who succeeded in attracting capital primarily from pension funds and insurance companies. The pioneers included Peter A. Brooke, Bill Hambrecht, Alan Patricof, Charles Lea and Tom Perkins.

In Sweden, where regulations largely steered the economy at the time, there were some similar attempts. The Wallenberg family and Stockholms Enskilda Bank formed Incentive, and a number of commercial banks had their "development companies" such as Tulwe (Sundsvallsbanken), Sponsor (Götabanken) and Navigator (PK-banken). These initiatives in the US and Sweden had in common that they were, as a rule, relatively unsuccessful. The main reason for this was the simple fact that it is a particularly complex line of business that require special skills and takes a long time to build up.

At the end of the 1960s the Swedish Minister for Industry, Krister Wickman, entered the arena with a government approach to industry – a new, bold economic policy involving the creation of state-owned enterprises such as Statsföretag, a state-owned "high-risk bank", Sveriges Investeringsbank AB, Svenska Industrietablerings AB (SVETAB) and the "VC company" Svenska Utvecklings AB. Without delving deeper into the causes, in hindsight we can conclude that none of these initiatives achieved their objectives.

The US VC sector during the same period was languishing. It was seen as relatively unprofitable until the late 1970s when the early VC companies were able to harvest large unexpected profits in the digital revolution, with holdings in comet-like companies such as Wang, Tanden Computers etc. Interest in new technology combined with concern about incipient industry crises in classic industries such as the textiles, steel etc. created an enormous influx of capital at the beginning of the 1980s into the VC sector. New funds were started while the size of funds grew from USD 15–25 million to USD 50–100 million.

It is important to remember that the VC industry's investment policy was in no way focused only on high technology. A constant process of risk minimization was under way through investments according to a matrix where, during the first few years, investments were made in early stages and later in more mature stages as well as in a variety of sectors. In other words, a VC portfolio could consist of a number of high-tech start-ups, some growth enterprises in provisions, media and manufacturing, as well as mature companies in areas such as automobile spare parts, chipboard, rubber, plastics etc. Thus, VC was and is thus **not** a collective term for investment in new, start-up, high-tech companies, but an investment method involving systematically investing in unlisted growth companies managed by their founders or large shareholders and with the objective of refining the company for a 5–8 year period and later sell it or launch it on the market.

In Sweden in the 1980s a significant number – around 40 – of new VC companies were formed. Most of them had equity that was too limited and management with insufficient experience. The result was that almost all of them failed during the real estate and financial crises at the beginning of the 1990s.

In 1988, something happened that would be highly significant for the entire industry. Kohlberg Kravis Roberts (KKR) in the US made a huge purchase of the listed giant Nabisco. The deal created so much interest in big buy-outs, i.e. buy-outs with a high level of borrowing, that many in the VC sector abandoned VC to focus solely on buy-outs. These new buy-out funds that quickly grew globally and attracted huge amounts of capital. This affected the VC sector, whose share of the capital market was reduced considerably.

I would like to mention a few fundamental differences between buy-out funds (or private equity companies as they are often called) and VC companies.

Private equity often involves purchasing entire, mature companies through a holding company ("Newco") with considerable acquisition borrowing. Private equity companies appoint a CEO and a board of directors and go about the task of changing the company according to their own plan. The timeframe is 3–6 years. VC companies, on the other hand, base their investment on business owners who usually are also the principal owners and often serve as the CEO as well. The VC company's invested capital goes straight onto the portfolio company's balance sheet thereby strengthening the company without acquisition borrowing. The engine in this growth activity is still the business owner, the CEO, although the VC company's management may assist with advice, bank contacts and possible networks.

It is clear that an entirely different skill set is needed to work for a VC company, which has an entire palette of minority-owned companies in different sectors and at different stages of maturity, than for a private equity firm. The timeframe for VC is also significantly longer, 10–12 years.

During the 1990s an attempt to refine the VC business came in the form of so-called focused funds. Instead of traditional VC companies (balanced funds), funds were formed that only focused on certain growth industries such as IT, life science and bio tech. Funds that were only for early stages were also formed – so-called seed capital funds or early-stage funds.

In my opinion, as history shows, working with these types of funds, where the objective is to invest only in early-stage enterprises, is among the most difficult journeys one can embark upon. The days are filled with a constant stream of negative news, setbacks, capital shortages and shattered illusions, interrupted by the occasional ray of hope. Very few people are capable of sustainably and successfully running this type of operation.

I will briefly address the issue of profitability in the VC industry.

Historically Government initiatives relating to industry and labour market policy have, as mentioned before, not achieved their objectives. Some of the worst examples are regional initiatives focusing on crisis industries, such as "Landskrona Finans", "Uddevalla Invest", "Karlskoga Invest", etc.

In the private sector, the average profitability in the VC industry as a whole, measured over ten-year periods since the 1980s, has not been impressive – in the US a return of between 5% and 10% annually on the total capital invested. The spread is naturally broad within the industry, ranging from funds that are highly profitable, mediocre or outright unprofitable. In Sweden the yield was probably lower, but there are no reliable statistics on the exact rates of return. The conclusion that should be drawn is that the main reason for the mediocre profitability in the sector is a general lack of capable business owners seeking external venture capital and of capable investment managers at the VC companies. There is, in other words, no actual shortage of venture capital in general. Instead the problem is the lack of professional capital and capable entrepreneurs.

The reflections above will perhaps give the reader the impression that I have a negative opinion of state initiatives in the VC area. But that is not the case; on the contrary, I believe that the state-run investment bank, Statliga Investeringsbanken, did a lot of good in the 1970s as a lender of last resort and Stiftelsen Industrifonden has managed to do quite well. Private capital can misjudge interesting projects. Capital from the state is needed as an alternative and can guarantee the desired plurality in a market economy. These kinds of government initiatives should, however, include paying attention to historical experiences.

Fouriertransform, to take one example, has built up a small, nimble organization where the employees and the Board have broad industry experience. The company also has an adequate capital base, SEK 3,000,000,000. The company was built using historical experiences in the VC sector as a model and can provide some guidance to all state VC initiatives. This is even more important if the state wants to allocate billions to funds intended for investment in early stage enterprises, which requires a commitment of at least ten years from a very experienced and tough management that normally also wants a share of the profit. A fitting model involves first identifying and bringing in a unique management team before allocating the billions.

Assessing the future of the industry with reference to Fouriertransform

VC is important, especially with respect to its investments in growth companies. Unfortunately the, sector seems to be shrinking, mainly because there is no inflow of new private initiatives. In Sweden there are not enough large private VC environments that can generate new talent with a desire to start VC companies of their own. There are several reasons for this; for example, investors and employees have drifted over to private equity, investors are not interested due to the long time perspective and lack of liquidity in the holdings, it is a very complex, high-risk business, and a long-term and challenging commitment is required from all involved.

We cannot therefore predict that more VC companies will enter the market and that more capital will go into the economy. If the state sees this as a problem and wants to contribute venture capital, historical experiences should be taken into account when doing so. Fouriertransform's Board of Directors and management have adopted a number of guiding principles. They include the following:

- Investment managers should be recruited in the spirit of a long-term commitment reminiscent of private business ownership. They should also have a natural talent for the profession and gain personal satisfaction from helping companies develop.
- The Board's work should be focused on providing quick responses to companies applying for investment and frequent contacts between the CEO and Board for quick decision-making. This is absolutely essential in order to maintain a good reputation in the market.
- The organization should be small and lean and everyone should essentially be able to handle all tasks, thereby minimizing the risk in the portfolio.
- An effective selection process where a minimum of money and time is spent on investment proposals with little potential, and vice versa.
- A cost-effective organization where people do much of the work themselves and do not use consultants unnecessarily.
- Extensive efforts to ensure that the composition of the boards of the portfolio companies is adequate and that ongoing assistance is provided to the boards in their strategic decision-making, etc.
- Conservative evaluation when investing in portfolio companies.
- Active investment follow-up and early planning for exits.
- Creative process for crisis management and reconstruction.
- Constant focus on both short-term and long-term profitability.

I could easily add 25 or 30 additional professional observations, but in conclusion I should mention that luck and a fluctuating economy play a significant role in our industry's end results as well.

Lars-Olof Gustavsson
Chairman of the Board

Corporate governance in 2011

Fouriertransform AB (corporate ID number 556771-5700) is a Swedish limited liability company that is wholly owned by the Swedish state. The company's registered office is in Stockholm. The ownership role is exercised by the Government with a mandate from the Swedish parliament to actively manage state assets in such a way as to optimize long-term value creation.

Corporate governance within Fouriertransform

Corporate governance within Fouriertransform is based on the Swedish Code of Corporate Governance (the Code, www.bolagsstyrning.se), which forms part of the Government's framework for management by enterprise owners. The company's governance is also regulated by the state's guidelines, Swedish legislation, policy documents established by the Board, and by internal regulations and documents.

Wholly-owned state enterprises apply their own principles, in place of the Code, when preparing for decisions concerning the nomination of board members and auditors (www.regeringen.se).

The most important regulations and policy documents are shown in the tables below.

Annual General Meeting 2011

The Annual General Meeting (AGM) was held in Stockholm on April 18, 2011. Resolutions:

- Dividend. The AGM decided that no dividend be paid out and that the unappropriated earnings of SEK 12,781,920 be carried forward.
- Discharge from liability. The AGM discharged the board members and the Chief Executive Officer from liability for the 2010 financial year.
- Remuneration and employment terms. The AGM resolved, based on the Board's proposal, to clarify the guidelines in place for remuneration and other employment terms for the senior executives. The principles are described below under the heading "Remuneration to senior executives."
- Board members. The Board is to consist of seven members with no alternates. All board members were re-elected: Lars-Olof Gustavsson (also re-elected as Chairman), Cecilia Schelin Seidegård, Hasse Johansson, Karin Kronstam, Lars-Göran Moberg, Ulla-Britt Fräjdin-Hellqvist and Lars Erik Fredriksson.
- Fees. The AGM resolved to set the annual fee for the Chairman of the Board at SEK 300,000 and an annual fee of SEK 150,000 for the board members not employed by the Government Offices.
- Amendment to the Articles of Association. The AGM resolved to amend the Articles of Association with respect to the rules regarding providing notice to attend meetings in § 7 in accordance with the Board's proposal

(www.fouriertransform.se/fouriertransform/bolagsstyrning/bolagsordning).

Nomination process

The nomination process is conducted and coordinated by the division for state-owned enterprises within the Ministry of Finance. A working group analyzes the competence requirements based on the company's activities, and recruitment is conducted on the basis of this analysis. Board members are selected from a broad recruitment base to achieve a balance of expertise, background, age and gender.

The Board of Directors

According to the Articles of Association, Fouriertransform's Board of Directors is to consist of at least three and no more

EXTERNAL REGULATORY FRAMEWORKS

- Swedish Companies Act
- Swedish Code of Corporate Governance (the Code)
- The Government's guidelines for external reporting for state-owned companies
- Guidelines for employment terms for senior executives in state-owned companies
- The Rule Book for Issuers, NASDAQ OMX Stockholm (based on)
- Accounting legislation (incl. Annual Accounts Act, Swedish Accounting Act – BFL)

INTERNAL REGULATORY FRAMEWORKS

- Articles of Association
- Rules of Procedure for the Board and Instructions for the CEO
- Order of authority
- Investment processes
- Financial handbook
- Employee handbook
- Crisis preparedness manual
- Policy documents established by the Board of Directors

POLICY DOCUMENTS ESTABLISHED BY THE BOARD OF DIRECTORS

- Financial policy
- Ownership policy
- Code of Conduct including: Sustainability policy
- Equality and diversity policy
- Communication policy
- IT policy

than eight members with no alternates. In 2011 the Board consisted of seven AGM-elected members. The Government considers it important to separate the roles of the board members and the CEO, and the CEO is therefore not a member of the board of a state-owned company.

Independence

According to section 4.5 of the Code, at least two board members must be independent of the company's major shareholders. The main reason for the independence rule is to protect minority shareholders. Where a company is wholly owned by the state, there is no reason for it to account for its independence in relation to the state. In view of this, Fouriertransform does not report such information.

Board members

Member	Attendance at the Board's eight meetings in 2011
Lars-Olof Gustavsson, Chairman	8 (8)
Cecilia Schelin Seidegård	7 (8)
Hasse Johansson	8 (8)
Karin Kronstam	6 (8)
Lars-Göran Moberg	8 (8)
Ulla-Britt Fräjdin-Hellqvist	8 (8)
Lars Erik Fredriksson	7 (8)

Work of the Board of Directors

The Board of Directors has established written instructions and rules of procedure for the Board and the Chief Executive Officer. The purpose is to document the work procedures of the company's Board, the distribution of responsibilities among the board members and between the Board and the CEO, and the required financial reporting to the Board. The document is subject to an annual review by the Board of Directors.

The Board is to hold at least six meetings a year, one of which should preferably be held in the offices of one of the portfolio companies. One meeting a year is to be devoted to strategy issues and the company's risk exposure. One meeting is to address HR issues and include a review to ensure that the employment terms for senior executives and comparable positions follow established guidelines. According to new guidelines adopted at the Annual General Meeting, an account of these issues is to be provided in a special report from the company's auditor.

The Rules of Procedure also stipulate that board members must be provided with adequate information materials well in advance of meetings for all matters to be put before the Board for informative purposes or decisions. The Chairman of the Board and the CEO are jointly responsible for convening meetings, meeting agendas and the necessary documentation relating to all items to be addressed.

During the 2011 financial year the Board held seven regular meetings and one statutory meeting. See the table above for member attendance.

When taking decisions on investments in companies where a board member is considered to have a possible conflict of interest, that member has not participated in the procedure or the decision on the investment in question, and a note to this effect has been included in the minutes of the board meeting.

In 2011, the Board paid particular attention to conducting in-depth analysis of the external business environment and attempted to assess the potential effects of it on Fouriertransform.

In consultation with executive management, the Board, during the course of its ongoing work, has called for changes in the strategy and business focus of several of the early-stage portfolio companies. At the same time, the Board initiated business focus work to achieve a balanced portfolio which involves, among other things, investing in more mature companies. A well-balanced portfolio is absolutely essential in order to achieve an acceptable level of profitability. It also allows existing human resources to be used more efficiently through an appropriate mix of tasks such as working with new investments, developing companies and making preparations for future exits.

At the end of September 2011, the Board of Directors went on a field trip to California to obtain a deeper understanding of the US automotive industry and developments in the automotive market. A meeting between the Board and consumer research company Panoramix Global provided in-depth insights and information on changes in consumer values, purchasing behavior and environmental awareness. During a visit to the research and analysis company RAND, the Board was given a detailed presentation of the US energy policy and the new energy technology initiatives that are under way. A visit to venture capital company Venrock provided an insight into how a successful VC company selects investment objects and makes its financing decisions.

Committees

The Board of Fouriertransform has decided not to set up any committees. Instead, the entire Board will handle the issues that would otherwise be delegated to committees.

Evaluation of the work of the Board

Chairman of the Board Lars-Olof Gustavsson is responsible for ensuring that the work of the Board is evaluated. The Chairman has decided that an annual evaluation should take place of the Board's work where the members are given the opportunity to express their views on work procedures and board materials, their efforts and those of other members, and the scope of their mandate.

The relevant parts of this evaluation are to be reported to the nominating committee. In spring of 2012 one such evaluation took place with assistance from an external consultant.

Auditor

The task of the auditor is to conduct independent reviews on behalf of the owner of the Board's and the CEO's management of the company as well as the annual accounts and accounting records. Responsibility for the election of an auditor always rests with the owner and is decided on at the Annual General Meeting. Authorized Public Accountant Hans Andersson of Deloitte AB has been elected as the auditor.

Senior executives

The Chief Executive Officer is appointed by the Board and is responsible for the day-to-day management of the company within the framework established by the Board. Due to the company's small number of employees, the Board has decided that the CEO alone is to be regarded as the senior executive for the company. The Board is to evaluate the work of the CEO on an ongoing basis and is to pay particular attention to this issue at least once a year.

Fouriertransform's internal operations

Twice a month the CEO holds a meeting with the investment managers and the CFO. The following are standing items on the agenda of these meetings: a review of investment proposals, market development and the company's financial development.

The investment managers are responsible for reviewing and analyzing investment proposals according to an established evaluation model and Fouriertransform's investment criteria. In the case of companies and projects that are deemed of particular interest and that meet the investment criteria, meetings are held with executive management and external specialists before an investment proposal is put before Fouriertransform's Board of Directors.

Remuneration to senior executives

Fouriertransform's Annual General Meeting on April 18, 2011 decided on principles for employment terms and remuneration for the CEO and senior management, which involves Fouriertransform applying the guidelines established by the Government in 2009 regarding employment terms for individuals holding senior positions in state-owned companies. Remuneration to senior executives should be competitive without being market-leading. This is ensured by Fouriertransform's practice of constantly obtaining information on market rates of pay. Based on the Board's proposal for clarification, Fouriertransform's 2011 Annual General Meeting decided that, prior to a recruitment decision, a written document should be prepared indicating the company's total costs for the position. The AGM also resolved that the company's auditor should verify that the established remuneration levels and other employment terms are not exceeded. The auditor is to prepare a special report annually to describe his observations for the Board's meeting that coincides with the year-end accounts.

There is to be no incentive scheme for executive management.

For further information on remuneration to the Chief Executive Officer and other senior executives as well as the board members, see Fouriertransform's Annual Report.

Financial reporting

Fouriertransform's financial reporting follows the Guidelines for external reporting by state-owned companies and the Annual accounts act, and is based on the OMX NASDAQ Stockholm's rule book for issuers. Fouriertransform's information and communication paths are aimed at promoting completeness and accuracy in the company's financial reporting. The finance department is manned and organized based on the need to ensure that the company maintains a high standard of accounting and complies with the relevant regulations and guidelines. The finance department consists of a CFO and an accounting manager with many years of experience of financial reporting, financial control and accounting issues.

Internal control

According to the Companies act the Board must ensure that the company is organized in such a way that its accounting records, management of funds and overall financial circumstances are subject to satisfactory internal control. The CEO is responsible for ensuring that the Board's guidelines are adhered to and complied with within the company. The Board meets the company's auditor at least once a year without the presence of the CEO or any other person from company management.

Fouriertransform's Board has decided not to establish an audit committee. Issues regarding financial reporting and internal control are instead addressed by the Board in its entirety. The CEO is not a member of the Board.

The company's internal control has been adapted in line with the company's operations and the structure of the organization. Authority and responsibilities are regulated in internal control documents such as:

- Rules of Procedure for the Board and Instructions for the CEO
- Order of authority
- Investment processes
- Financial handbook
- Financial policy

This corporate governance report is part of the Directors' Report in Fouriertransform's 2011 Annual Report and has therefore been signed by the Board of Directors and reviewed by the company's.

Board of Directors

❶ **Cecilia Schelin Seidegård,** Board Member

Born 1954.

County Governor of Gotland.
Chairman of the Board: Systembolaget AB, CliniTrials Skåne AB and Vårdalstiftelsen.

❷ **Ulla-Britt Fräjdin-Hellqvist**, Board Member

Born 1954.

Chairman of the Board: Kongsberg Automotive Holding ASA, SinterCast AB and Swedish Foundation for Strategic Research.
Board Member: Castellum AB, e-man AB, Data Respons ASA, Stockholm Environment Institute, Svenska Rymdaktiebolaget and Tällberg Foundation.

❸ **Lars Erik Fredriksson**, Board Member

Born 1964.

Chairman of the Board: Sundsvalls Mätcenter AB.
Board Member and audit committee member:
RISE Research Institutes of Sweden Holding AB.
Board Member: Green Cargo AB.
Responsible for ownership issues: Apoteksgruppen Holding AB.
First Secretary at the Ministry of Enterprise, Energy and Communications.

❹ **Lars-Göran Moberg**, Board Member

Born 1943.

Formerly President of Volvo Powertrain.
Chairman of the Board: Deutz AG.
Board Member: Cross Control System AB.

❺ **Lars-Olof Gustavsson**, Chairman of the Board

Born 1943.

Chairman of the Board: Four Seasons Venture Capital AB and Boule Diagnostics AB.
Board Member: SJ AB, Industrifonden, Siem Capital AB, TA Associates AB and Mikroponent Intressenter AB.

❻ **Hasse Johansson**, Board Member

Born 1949.

Formerly Head of R&D at Scania AB.
Chairman of the Board: Lindholmen Science Park Aktiebolag, Vinnova AB, Dynamate Industrial Services AB and Alelion Batteries AB.
Board Member: AB Electrolux, Skyllbergs Bruk AB and C-Garden AB, Calix Group AB, LeanNova Engineering AB.

❼ **Karin Kronstam**, Board Member

Born 1950.

Board Member: Praktikertjänst AB, Rabbalshede Kraft AB and MPT Intressenter AB.
Associate Board Member: Volvoresultat Försäkringsförening.

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