



Company analysis and earnings projection

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Summary

Primoco UAV, a Czech manufacturer of unmanned aircraft, has undergone significant changes in the external business environment over the past year. In spring 2021, the company had a revenue target in hundreds of millions CZK by the end of the year but ended the year with revenues at a fraction of this estimate (revenues of CZ 17.8m). Following the deterioration of relations between the Czech Republic and Russia, Primoco was unable to carry out aerial work for a Russian customer, and, moreover, the Covid-19 pandemic led to the postponement of some planned contracts for new aircraft. The management's targets proved to be too optimistic.

However, we believe that Russia's invasion of Ukraine in February 2022 has completely changed the business environment in which Primoco operates. First of all, European countries decided to increase defence spending with unprecedented speed. For example, Germany, after years of low military spending, approved a massive EUR 100bn plan to strengthen its army, with a third of the amount to go to the air force. Secondly, the course of the war in Ukraine has shown the importance of unmanned aerial vehicles. Primoco does not manufacture military unmanned aircraft with weapon systems; nevertheless, armies also need unmanned aircraft as a tactical surveillance tool. In addition, Primoco's aircraft are capable of carrying multiple sensors at once. The distinction between military and civilian unmanned aircraft is thus, in our view, slightly blurred.

Therefore, we see two positive implications for Primoco UAV:

1. **The emergence of a new clientele from among the armed forces**, which originally was not intended to be the main source of income.
2. **The shift of the centre of revenues to Europe**, whereas previously Primoco expected most demand to come from the Middle East and Asia. In our view, the advantage of having European customers from the public sector consists in greater political stability and thus predictability of revenues.

We consider it likely that unmanned aircraft will be included in the new military spending in Europe. Primoco's advantage as a bidder in such contracts is, in our view, its competitive pricing (lower than in the case of US and Israeli competitors) and the fact that it is a domestic European manufacturer. The disadvantage is the youth of the company and a small volume of contracts to date, and thus a small number of references to potential customers.

In June 2022, Primoco announced that it had sold 6 aircraft to a European buyer for about CZK 82m. With 1Q sales, we believe that Primoco has already exceeded 100m in revenues this year (vs. CZK 17.8m last year). **Thus, this year could be a breakthrough year and a path to tangible profits.** The increase in demand in Europe following the events in Ukraine could be a major catalyst for Primoco, but we believe that estimates of the impact on revenues in coming years still carry a high degree of uncertainty.

In this document, we provide basic information on the company, summarise the change in the external business environment, present earnings projections, show relative valuations to peers and outline the key opportunities and risks. **The future earnings trajectory is associated with a high degree of uncertainty and we therefore do not provide company valuation or investment recommendation.** Nonetheless, we believe that this year's events and the ongoing jump in revenues could mark a turning point in Primoco UAV's earnings performance.

Primoco UAV SE



Basic Information

Primoco UAV SE is a Czech manufacturer of medium-size unmanned aerial vehicles. Primoco has developed the One 150 model, with a maximum take-off weight of 150 kg and a fly-time of 15 hours. This vehicle is most often used in protecting state or sea borders, monitoring state strategic infrastructure or calibrating airport radio beacons. The company has clients in Europe, the Middle East, Asia and Africa. The company manufactures aircraft in Prague-Radotin and performs test flights at the airport in Krasovice near Pisek acquired in 2019. It plans to build new production facilities there in future.

Primoco obtained an EASA light UAS operator certificate (LUC) in 2022 and now it is undergoing military standard certification according to NATO STANAG.

The company's shares are traded on the Start market of the Prague Stock Exchange, where the company had an initial public offering (IPO) in 2018 and a secondary offering (SPO) in 2021. Ladislav Semetkovsky, CEO, is also one of the two founders and the largest shareholder.

Basic Information

Price of last trade on the stock exchange	CZK 252
Number of shares	4,708,910
Market capitalization	CZK 1.2bn
Key shareholder:	L. Semetkovsky (59.6%)
Free float	14.3%

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1. Primoco: Company's market, production and ownership

Primoco in unmanned aircraft market

Unmanned Aerial Vehicles (UAV's) are currently a rapidly growing field with both military and civilian applications. So far, military UAVs have seen the biggest development and they are already produced by most of the major US arms companies (Lockheed Martin, Northrop Grunman, Boeing, etc.). By contrast, civilian unmanned aircraft have been developed for a shorter time and their manufacturing is more likely to be undertaken by medium-sized and smaller companies. Within civilian aircraft, a distinction can be made between consumer UAVs (small unmanned aerial vehicles or drones mainly for capturing videos), which are available to the general public, and commercial UAVs, which are mainly purchased by companies or the public sector. Primoco operates in the latter category.

It is not known how many companies currently conduct business in each category. In total, it is estimated that there are between 450 and 1,000 companies worldwide engaged in the production of UAVs for military and civilian purposes. In the field of civilian commercial UAVs for businesses and the public sector, we believe it is more like tens of companies. Primoco identifies nine companies globally as its main competitors.

According to Teal Group's estimates, global spending on commercial UAVs should grow from USD 5.6bn at present (on an annual basis) to USD 18.9bn in 2030. This implies an average annual market growth of about 14.5%. Given Primoco's low initial basis of production and deliveries, its growth could be well above the market dynamics. We believe that military UAVs will see even faster growth, especially after the outbreak of war in Ukraine this year. Please also note that a rise in inflation could significantly increase the nominal spending estimated by Teal Group, and so we consider the numbers to be only indicative.

Primoco: Sources of revenues

Primoco generates revenues from two main sources:

- (1) **The sales of the One 150 model.** The standard delivery is three units for a total price of approx. CZK 50m, including sensors, control station and pilot training.
- (2) **The sale of spare parts** to clients who have already purchased the aircraft.

Until last year, the company also counted on revenues from the so-called aerial work planned to be carried out in the Russian Federation. Clients were to pay for surveillance flights without owning the aircraft. This source of revenue will not materialise due to the closure of the company's operations in Russia in January 2022.

The sale of aircraft is the main source of revenues. The sale of a large number of aircraft is usually accompanied with a contract for the subsequent sale of spare parts, which means that aircraft purchase contracts carry a certain inertia of revenues going forward.

Company's production capacity and current outlook

Primoco published several production and management assumptions in its investor presentations (4/2021 and 5/2022):

- **Current capacity of 50 – 100 aircraft, 250 aircraft per year in the long-term.** The current production facility in Prague-Radotin has a capacity of 50 – 100 aircraft per year. To increase the capacity, the management plans to build a new facility in Krasovice near Pisek, next to an airfield owned by Primoco. We expect the construction to take place in 2025 at the earliest, depending on the size of contracts. The construction would be financed mainly from operating cash flow. (We are conservative in our projections below and expect deliveries of no more than tens of aircraft per year until 2026, i.e., the execution of orders is not conditional on the construction of the new facility in our model.)
- **In 2022, Primoco expects to sell a total of 40 aircraft to various clients for a total of approx. CZK 500m, with a 40% EBITDA margin.** We believe that this is only an indicative outlook and that actual revenues may vary significantly because a major contract or the absence of one may sharply skew the revenue level. We are cautious in our projection and expect revenues of CZK 223.1m this year (see details in section 3, especially Table 2).

Aircraft and production: selected specifics

We consider the following information on Primoco's production and sales important:

- **Product:** Primoco has developed One 150, a medium-sized unmanned aircraft, where the number indicates the maximum take-off weight in kg. The aircraft has a maximum flight distance of approximately 2,000 km, a flight time of 15 hours and a cruise speed of 100 – 150 km/h. Take-off and landing require a runway of 300 m.
- **Use:** The two main purposes of a non-military unmanned aircraft are: (1) monitoring of product pipelines (oil and gas pipelines) and early identification of faults, hazards, etc. and

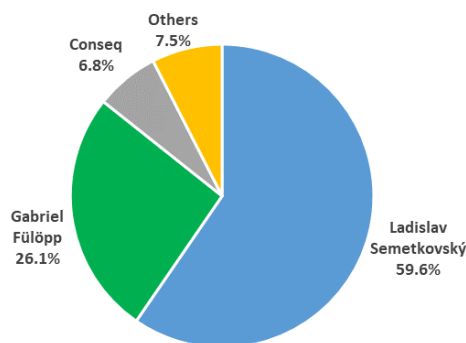
(2) monitoring and surveillance of borders and water corridors. Therefore, the company’s customers include both private companies and the public sector (police, border guards, armed forces). To a lesser extent, aircraft are used to map mines, construction projects, natural systems, etc. However, we think that after the outbreak of war in Ukraine, the sharp distinction between military and civilian UAVs will be partially blurred. This is because civilian aircraft can be used by armies to monitor and target enemy coordinates or movement of equipment, even though they are not equipped with weapons. This could be the key factor for Primoco.

- **Geographical distribution of demand:** Until 2021, the company had expected the largest sales in the Middle East and Asia, with Africa and Europe seen as secondary markets. The limitation of sales to Europe stemmed from the strict regulation of civilian unmanned aircraft, not allowing intensive operation of these aircraft by private operators in the EU. Since the start of the war in Ukraine, the situation has fundamentally changed – Primoco now expects strong demand in Europe from the public sector, which is expected to account for 50% of sales in the future. The Middle East and Asia are expected to account for around 25%, with Africa and South America sharing the rest.
- **Competitive advantage:** The work performed by a UAV can be performed by a manned helicopter or in some cases a satellite. The disadvantage of a satellite is a significant inaccuracy while a helicopter has much higher operating costs (fuel consumption, repairs) and the crew is at risk of a potential crash. According to Primoco, its One 150 model enables a 50-90% reduction in operating costs compared to a helicopter.
- **Production capacity:** Primoco is able to produce 50 – 100 aircraft per year in its current production facility in Prague-Radotin. Our model assumes deliveries of tens of aircraft per year until 2026 and this capacity should be sufficient for this volume by a margin.
- **Certification.** Since 2019, Primoco, has held a Czech licence for trade in military equipment through its subsidiary Primoco UAV Defence. Primoco’s aircraft itself is not a military product but certain sensors, electronics and software used by the aircraft are considered military material. Primoco was recognised as an approved production and development organisation in October 2020 by the Department of Military Aviation Authority of the Ministry of Defence. From a revenue perspective, we believe this means the company may have a better chance of succeeding in tenders with customers who prefer or require such certifications. Additionally, Primoco received the EASA LUC (Light Unmanned Certificate) certificate from the Civil Aviation Authority in 2022. The certificate allows flight operations to be carried out with an internal approval at company level without a further approval by national aviation authorities in the EU. Primoco took advantage of this in April 2022, when it carried out flights with the LUC certificate in the Bundeswehr’s military airspace in Ingolstadt-Manching. Further, Primoco intends to obtain certification according to the NATO STANAG 4703 standard in the future. In our view, all of these certifications and test flights are important steps for winning European contracts.

Shareholder structure

Primoco had 4,708,910 shares outstanding as at 17 June 2022. CEO Ladislav Semetkovsky remains the majority shareholder with a 59.6% stake (see Figure 1) and with the company’s other founder Gabriel Fülöpp, they hold approximately 85.7% of the company’s shares. The remaining 14.3% of the shares are free float, which includes a shareholding of the investment company Conseq (6.8%).

Figure 1: Shareholder structure as at 17 June 2022



Source: Primoco UAV, J&T Banka

Free float increased significantly (from 6.2% previously) following the secondary share offering (SPO) in May 2021, when the company issued new shares to fund further growth and repay a shareholder loan. In the SPO, 364,200 new shares were subscribed in two rounds at prices of CZK 240 and CZK 260 per share. The IPO proceeds amounted to CZK 90.5 million.

In the long term, we believe that the company would find it advantageous if a major aerospace or arms industry company bought a partial stake, which would open the way to larger contracts. However, we are currently not aware of any such specific bidder.

2. External environment: Boom in military spending with impact on unmanned aircraft

War in Ukraine led to historical revision of military spending

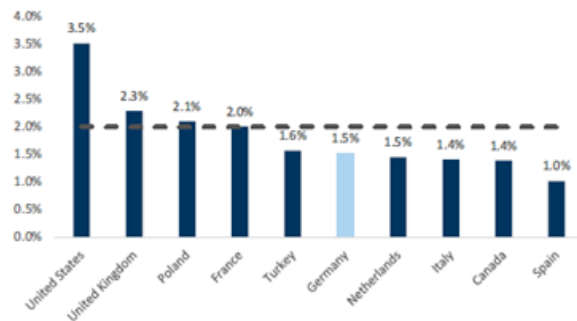
Russia’s invasion of Ukraine in February 2022 caused an unprecedented revision of military spending in European countries in just a few days. Increases in military spending can be expected in virtually all European members of NATO and EU members, but they will be most significant, in our view, in countries that have not yet complied with the 2%-of-GDP defence spending recommended by the NATO Charter. These include large countries such as Germany, Italy and Spain (see the right graph in Figure 2). Given the spending to date, achieving the 2% target for these countries means a sharp increase in spending, by 30 – 100%.

Figure 2: Military spending in Europe

Exhibit 1: We estimate a step up to 2% of GDP would see the budget rise to c.€70bn
German defence spend in €bn, as % GDP



Exhibit 3: However, Germany previously has not met the NATO commitment to spending 2% of GDP on Defence
Defence spend in Europe as % GDP



Source: Goldman Sachs

Germany in lead with huge EUR 100bn defence fund

By far the biggest spending revision was presented by Germany in spring 2022. Not only does Germany plan to fast-track the 2%-of-GDP spending target (see the left graph in Figure 2), but it also introduced a special arms fund totalling EUR 100 billion. The fund will be outside the standard budget and it will not be subject to the debt brake, so that it cannot be jeopardised in any way by any savings in German public finances. This fund, with the approval process completed on 10 June 2022, should enable Germany to build „the largest conventional army in Europe“, according to Chancellor Olaf Scholz. A third of the 100 billion fund is to be used for the air force. In our opinion, this will include unmanned aerial vehicles, both combat from suppliers such as Aerovironment or Elbit Systems, as well as for monitoring, such as those produced by Primoco.

Potential contract with Bundeswehr would not be the only one

In our view, the successful testing of Primoco’s aircraft in the Bundeswehr’s military space in April 2022 (see above) suggests that the company has a chance to supply unmanned aircraft to Germany, for the Bundeswehr’s own needs as well as for delivery to Ukraine. If the company wins a contract for the German army, the chances of supplying larger numbers of aircraft to other European countries will increase significantly. Contracts with European countries already amount to units of aircraft (see

section 3 below) this year, but a possible contract for the Bundeswehr would have the potential to take the volumes to a new level.

The dramatic turnaround in military spending by the Czech Republic’s largest neighbour and Europe’s largest NATO member is, in our view, significantly positive news for Primoco for the following years.

3. Earnings performance: Jump in revenues in 2022, but high degree of uncertainty in future

General characteristics:
Low fixed costs and moderate competition could lead to high profitability

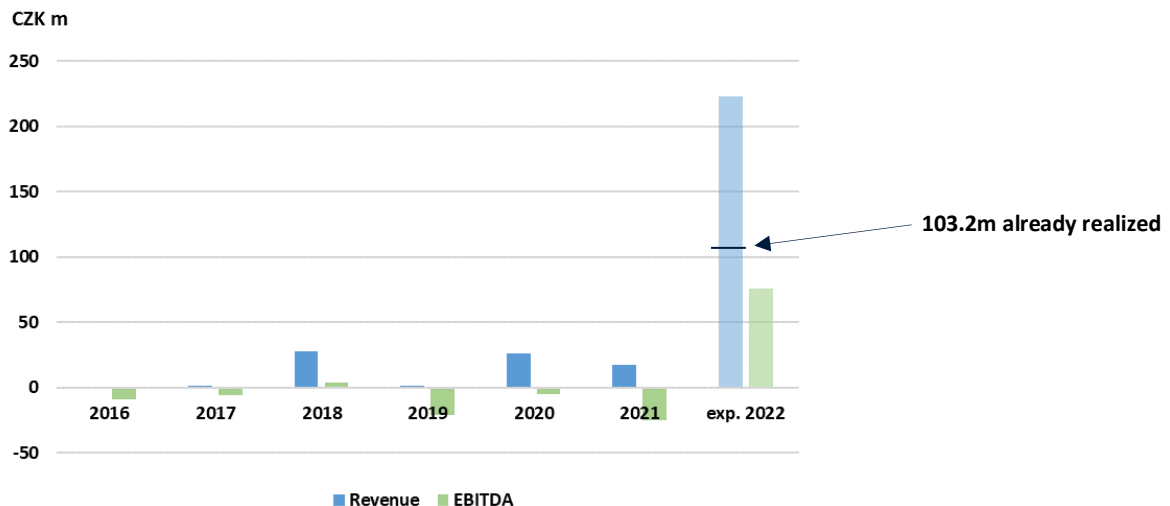
From an investor’s point of view, Primoco has a relatively transparent production model. The company produces its own components such as the body frame, engine and control station. Autopilots and datalinks (communication between the aircraft and the ground station) are sourced from foreign suppliers and the aircraft is assembled by Primoco. Approximately 70% of the aircraft production cost goes towards electronics, which the company purchases according to the size of a contract. This means that it is not burdened with large fixed costs. At the same time, there are currently only a few companies in the world operating in the 100 – 250 kg aircraft segment, which means that there is not yet much pressure on prices and the company can operate with a significant margin. In our opinion, Primoco offers one of the least expensive products in this category. The management expects the EBITDA margin of around 40% in the long term.

Table 1: Contracts and revenues of Primoco in 2022: realized and expected by management

	Quantity	Value in EUR m	Value in CZK m	Status
Realized				
Customer #1 (= 1Q22)	1	-	21.7	Delivered in 1Q
Customer #2	6	3.3	81.5	Delivered in 2Q
Realized revenues			103.2	
Expected in near future				
Customer #3	4	2.7	66.7	Expected
Revenues incl. expected contract			169.9	

Source: J&T Banka, Primoco UAV

Figure 3: Revenues and EBITDA – history and our estimate for this year



Source: Primoco UAV, J&T Banka

2022: Breakthrough in revenues driven by situation in Europe

Until 2021, Primoco had reported low and fluctuating revenues not exceeding CZK 30m annually (see Figure 3). These revenues did not allow for tangible profit generation as the company simultaneously invested in internal systems and aircraft certifications.

The developments in 2022 bring a major change in terms of revenues. Before the end of 2Q 2022, the company announced that it had sold six One 150 aircraft to a European customer. The sale price is EUR 3.3m, or approximately CZK 82m. This is by far the largest contract of the company to date. Primoco reported 1Q revenues of CZK 21.7m and with this newly announced contract, this year's revenues have already exceeded CZK 100m. (For comparison, last year, they were just CZK 17.8m). Moreover, Primoco's CEO Ladislav Semetkovsky said in the announcement that the company anticipated the signing of a contract for the sale of four more aircraft worth EUR 2.7m, i.e. about CZK 67m. This information means that Primoco's revenues for this year will certainly be higher than the cumulative revenues in the company's history so far and that this year, the company may achieve revenues in hundreds of millions CZK for the first time (see Table 1 and Figure 3).

**Projection until 2026:
We expect growing revenues and earnings, not ruling out high fluctuations**

Our projection is for five years until 2026 (Table 2). Our estimate of this year's revenues is based on performance for the first half of the year, and we expect the company to secure further sales in the remainder of the year. Our estimate for this year's revenues of CZK 223.1m is very conservative considering the company's outlook (revenues of CZK 500m). We believe caution is justified with respect to repeated delays in contracts in the previous years. Nevertheless, we expect this year's jump in revenues to carry over into future years. The increased demand for unmanned aircraft in response to the war in Ukraine will continue and, moreover, we expect that the already won contracts in Europe will serve as references for other customers, which will help Primoco generate further revenues. We therefore expect revenue growth in coming years. However, please note that the actual revenue development may significantly differ either way. It is not possible to estimate revenues accurately at the company's current phase.

We project an EBITDA margin of 30 – 40% in the next few years. Again, we are more cautious than the management (40%) as it is possible that the components purchased for Primoco's aircraft from abroad will become significantly more expensive. On the other hand, a higher revenue volume can easily help margins. Therefore, we stress again the difficulty of making projections and the possibility that EBITDA margins may deviate in either direction. The company has zero debt and so we expect net profit to be closely related to operating profit, with only the tax paid accounting for the difference.

Table 2: Earnings projection and market multiples at CZK 268/share

CAS, CZK m	2018	2019	2020	2021	e 2022	e 2023	e 2024	e 2025	e 2026
Revenues	27.5	1.4	26.0	17.8	223.1	280.1	313.7	338.8	362.5
EBITDA	4.1	-20.9	-5.0	-24.6	75.9	96.9	110.4	122.0	132.0
EBITDA margin	14.8%	-1544.6%	-19.1%	-138.5%	34.0%	34.6%	35.2%	36.0%	36.4%
Operating result	2.0	-23.4	-7.0	-27.5	72.9	93.7	106.6	118.1	127.7
Financial result	-1.7	-0.5	-2.5	-0.5	0.0	0.0	0.0	0.0	0.0
Net profit	0.4	-24.0	-9.4	-28.0	57.6	74.0	84.2	93.3	100.9
Net profit margin	1.4%	-1,767.4%	-36.2%	-157.3%	25.8%	26.4%	26.8%	27.5%	27.8%
EPS (CZK)	0.1	-5.5	-2.2	-6.1	12.2	15.7	17.9	19.8	21.4
Free cash flow	-14.6	6.7	-1.4	-58.7	51.3	69.3	75.7	92.6	100.8
P/E					21.9	17.0	15.0	13.5	12.5
EV/EBITDA					15.6	11.5	9.5	7.8	6.6
P/Sales					5.7	4.5	4.0	3.7	3.5

Source: J&T Banka, Primoco; free cash flow is operating cash flow minus sustaining capital expenditures

Low CAPEX enable high conversion of earnings into cash

In our opinion, the current production facility in Prague-Radotin is sufficient to cover the production rate in coming years (we estimate tens of new aircraft vs. Radotin's capacity of 50 – 100 aircraft per year). Moreover, the company does not need to make any significant investments in equipment or production. The test airfield in Krasovice near Pisek has already been acquired as well. As a result, the company will be able to convert a large part of EBITDA into free cash flow (see Table 2). We define free cash flow as operating cash flow minus sustaining capital expenditures, and this measure indicates how much cash flow the company is able to generate either for investments or acquisitions or for distribution to shareholders. The only significant capital expenditure we project in the near term is the investment in obtaining the important STANAG certification used by NATO member countries. We estimate this investment at CZK 5m in 2022–23. However, this capital expenditure is very small relative to the EBITDA the company is able to generate from revenues.

The company plans to start the construction of a new production facility in Krasovice near Pisek within a few years. We do not expect capital expenditures for this project until 2025, given that the company has yet to apply for a building permit. In our view, the construction will be primarily financed from operating cash flow and we do not expect debt financing. However, the project is not urgent for the company now due to the sufficient capacity of the Radotin facility and, therefore, neither the timing nor the cost of the project is yet known. We see the project itself as dependent on the volume of contracts and note that the current production capacity is sufficient to generate revenues in higher hundreds of millions CZK.

No debt burden

Additionally, our earnings projection does not assume long-term interest payments since the company does not have or plan to have debt to banks or other external creditors. The previous shareholder loan (CZK 28m at the end of 2020) was repaid from last year's SPO. We are also not aware of any other significant liabilities of the company.

Dividend not yet projected owing to performance level

Primoco's management stated at the IPO in 2018 that it expected the payment of dividend as an important company policy as soon as the level of performance allows. The current revenue and earnings level did not allow the company to pay a dividend and there is no dividend policy. Therefore, we do not consider it yet in our projections.

Valuation multiples decline thanks to earnings growth

Table 2 also shows that if our projections for this year's performance are roughly correct, the company's shares priced at CZK 268/share are at P/E of about 22, based on this year's expected earnings, and at EV/EBITDA of about 16. These multiples decline in subsequent years due to earnings growth. However, any major contracts above our estimate and the related realization of earnings could bring down the multiples significantly.

4. Relative valuation to publicly traded companies

Selection of companies for comparison

Due to the high uncertainty in estimating earnings, we do not provide a fundamental valuation of the company. As an alternative method, we offer a comparison with similar companies based on market multiples. We compared the P/E and EV/EBITDA multiples of Primoco with those of publicly traded UAV manufacturers (Table 3). Net profit and EBITDA estimates for Primoco come from our model while in the case of the other companies, we use Bloomberg market consensus estimates. Primoco's multiples are calculated at the market price of CZK 268/share. Please note that the list of companies is short and for some of the companies, there are not many earnings estimates available. The table should therefore be seen as indicative.

We consider AeroVironment (USA) and Elbit Systems (Israel) the closest peers. Their main business (or one of their main businesses) is the production of unmanned aircraft. Strictly speaking, only these two companies are well suited for comparison with Primoco. (That said, please note that AeroVironment and Elbit make unmanned military aircraft while Primoco produces monitoring aircraft without weapon systems.) Further, we included Airbus (Germany, France), Leonardo (Italy) and Textron (USA), which have UAV products, but these do not represent a significant part of their revenues. And we completely excluded some giant US arms companies producing UAVs which only account for a negligible part of their revenues. Their multiples would have virtually no information value with respect to Primoco.

Table 3: Relative valuation (in descending order) – as at 17 June 2022

Company	exp. P/E 2022-24	Company	exp. EV/EBITDA 2022-24
AeroVironment	40.9	AeroVironment	21.3
Elbit Systems	20.7	Elbit Systems	14.8
Airbus	14.7	Textron	7.7
Textron	12.5	Airbus	7.1
Leonardo	6.9	Leonardo	4.8
Average	19.2	Average	11.1
Median	14.7	Median	7.7
Primoco	18.0	Primoco	12.2

Source: Bloomberg, J&T Banka; Primoco's estimates according to J&T Banka, otherwise according to Bloomberg

Primoco not priced high relative to peers

The table shows that Primoco is now valued near the average for both P/E and EV/EBITDA within the selected set of companies. However, the set shows significant dispersion. According to both multiples, AeroVironment and Elbit, which specialise in unmanned technologies, come out as significantly more expensive companies. This is due to the fact that these companies are expected to have significant earnings growth and new growth opportunities and, thus, investors are willing to pay higher multiples than in the case of large, diversified companies in the rest of the set. And it is the business of AeroVironment and Elbit that is very close to that of Primoco. Therefore, if we compare Primoco's multiples to those of the two companies, Primoco would come out as relatively cheap at current prices.

However, we also need to take into account that AeroVironment and Elbit are incomparably larger than Primoco (both have revenues in billions to tens of billions in CZK terms while we expect Primoco's revenues only in hundreds of millions per year in coming years). Therefore, in our view, a certain valuation discount of Primoco makes sense due to its early stage of development and low market penetration of its products.

Comparison of Primoco with peers will fundamentally depend on earnings development this year

Overall, however, we may conclude that Primoco does not appear to be priced high relative to its closest peers or a broader set of arms companies. We also note that our earnings estimates are much more conservative than the management's outlook for this year. (Our revenue estimate is CZK 223m vs. company's outlook of CZK 500m for this year.) If the management's outlook materialised, we would regard Primoco's valuation as significantly cheap relative to the market.

5. Conclusion

Favourable external environment poses extraordinary opportunity for Primoco

From the investor's perspective, 2022 brought two significant and interconnected events. The war in Ukraine has increased defence spending of European countries and their interest in weapon systems at an unprecedented rate. While unmanned aircraft remain an emerging branch, the ongoing war shows beyond doubt their growing importance. This is true both in the sense of combat unmanned aircraft and unmanned aircraft monitoring the movement of people or equipment.

This rapid change has already had an impact on Primoco's earnings. While the company was not able to achieve significant revenues in previous years, this year, it has already surpassed CZK 100m in revenue from European customers and it expects further contracts. This puts it on course to make operating (and net) profit in tens of millions CZK. In our view, this year may predetermine Primoco's earnings performance for a long time ahead. It is absolutely crucial that the company take advantage of the increased interest of European governments in surveillance unmanned aircraft and get contracts that will start long-lasting business relationships and serve as references for other customers.

We think that the jump in defence spending in Europe this year is not just short-term. Several governments, led by Germany, have publicly acknowledged that their armies would be essentially powerless against a large adversary and this deficit will drive spending in the years ahead, in our view. This creates an extraordinary opportunity for Primoco.

Projections associated with high uncertainty, but this year indicates first major successes

Our earnings projection assumes a jump in revenues from CZK 17.8m last year to 223.1m this year, which is supported by the revenues already achieved, and a smoother pace of growth in the following years. This projection is considerably more conservative than the management's outlook, but we believe it is justified given the delays in obtaining contracts in the past years. At the same time, please note that any projection of Primoco's earnings currently is associated with a high degree of uncertainty. The company could get a major contract, as indicated by the test flights for the Bundeswehr, and then our projections would be too cautious. At the same time, however, aircraft testing with individual customers and awarding of contracts can drag on for months or quarters, and then caution is in order. Therefore, the estimates should be taken with this in mind.

For these reasons, we did not perform a fundamental valuation of the company based on discounted cash flow. We believe that such a valuation will make more sense once it becomes clearer to what extent Primoco can take advantage of the current opportunities and in what interval its revenues will range. According to an alternative method – a relative comparison with publicly traded companies – we show that Primoco's valuation is not high at the current market price, assuming our earnings projections are roughly met.

Overall, we believe that the current environment poses a unique opportunity for Primoco to gain market share in the European market. This year's developments so far show that the company has at least partially seized this opportunity.

Opportunities

- A rapidly growing UAV field globally, with many applications.
- Sharp increase in defence spending in Europe following Russia's invasion of Ukraine, including expected higher spending on monitoring unmanned systems.
- In 2022, the company expects to sell about 40 aircraft and generate revenues of about CZK 500m. It has already realized revenues of approx. CZK 100m.
- The advantage of the product compared to helicopters in terms of operating costs, and compared to competitors' aircraft in terms of purchase price.
- Relatively high profitability starting at low production volumes, owing to low fixed costs and currently limited competition in the world market (i.e. no significant pressure on the product price).
- Obtaining European EMAR 21 certification for military aircraft manufacturers, EASA LUC certification and ongoing certification according to NATO STANAG 4703.
- Possible partnership with a major aerospace and arms company may bring new contracts.
- Zero liabilities to banks or other external creditors.
- The main shareholders L. Semetkovsky and Gabriel Fülöpp pledged that their combined shareholding would not fall below 75% within 5 years of the IPO in 2018.
- The CEO is also the largest shareholder – motivation to maximise profits and dividends in the long term.

Risks

- The so-far short life of the company and its small volume of deliveries may create uncertainty among potential major customers (i.e. natural preference of large and established firms as a guarantee of reliability).
- Personnel risk – dependence of the company's success on the key person of the founder and CEO Ladislav Semetkovsky.
- Political instability in some customer countries (Middle East) and the resulting uncertainty in the size and timing of orders.
- Early stage of the business – low visibility of revenues and changes in target customers from the investor's perspective.
- Imitability of the product, i.e. potential competitors may build and offer similar unmanned aircraft in the future.
- Increase in prices of components sourced from abroad.
- Regulation of civilian UAV flights in Europe and the US (ban on civilian UAVs outside the pilot's visual line of sight) and possible spread of regulation to other countries.
- UAVs are a dual-use product in the Czech Republic, requiring the approval of the Ministry of Industry and Trade for export (geopolitical risk of export).
- Lack of qualified persons to fly UAVs in developing countries.
- Possible depreciation of the euro against the Czech koruna (contracts are priced in euros).
- Limited liquidity of Primoco's shares on the Start market of the Prague Stock Exchange.

Appendix

Profit and Loss

CAS, CZK m	2018	2019	2020	2021	exp. 2022	exp. 2023	exp. 2024	exp. 2025	exp. 2026
Revenues	27.5	1.4	26.0	17.8	223.1	280.1	313.7	338.8	362.5
EBITDA	4.1	-20.9	-5.0	-24.6	75.9	96.9	110.4	122.0	132.0
<i>EBITDA margin</i>	14.8%	-1544.6%	-19.1%	-138.5%	34.0%	34.6%	35.2%	36.0%	36.4%
Operating result	2.0	-23.4	-7.0	-27.5	72.9	93.7	106.6	118.1	127.7
Financial result	-1.7	-0.5	-2.5	-0.5	0.0	0.0	0.0	0.0	0.0
Net profit	0.4	-24.0	-9.4	-28.0	57.6	74.0	84.2	93.3	100.9
<i>Net profit margin</i>	1.4%	-1767.4%	-36.2%	-157.3%	25.8%	26.4%	26.8%	27.5%	27.8%
Earnings per share (CZK)	0.1	-5.5	-2.2	-6.1	12.2	15.7	17.9	19.8	21.4

Balance Sheet

CAS, CZK m	2018	2019	2020	2021	exp. 2022	exp. 2023	exp. 2024	exp. 2025	exp. 2026
Total assets	56.1	52.1	50.5	84.7	164.4	251.1	338.0	434.3	538.1
Fixed assets	8.1	32.9	30.2	32.4	32.2	31.7	31.9	35.1	52.9
Current assets	47.9	19.1	20.2	52.3	132.3	219.4	306.1	399.2	485.2
of which cash	23.5	2.4	0.7	28.2	77.0	143.8	217.5	305.1	385.9
Total liabilities	56.1	52.1	50.5	84.7	164.4	251.1	338.0	434.3	538.1
Equity	55.8	31.3	21.8	84.4	142.0	216.1	300.3	393.6	494.5
Provisions	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Liabilities	0.2	20.7	28.6	0.2	22.3	35.0	37.6	40.7	43.5
Long-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term liabilities	0.2	20.7	28.6	0.2	22.3	35.0	37.6	40.7	43.5

Cash flow

CAS, CZK m	2018	2019	2020	2021	exp. 2022	exp. 2023	exp. 2024	exp. 2025	exp. 2026
Operating cash flow	-14.6	6.7	-1.4	-58.7	51.5	69.6	77.7	94.6	102.8
Investment cash flow	-1.1	-27.8	-0.2	-4.4	-2.7	-2.8	-4.0	-7.0	-22.0
Financial cash flow	34.2	0.0	0.0	90.5	0.0	0.0	0.0	0.0	0.0
of which dividends	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net cash flow	18.5	-21.2	-1.6	27.4	48.8	66.8	73.7	87.6	80.8
Free cash flow for shareholders	18.5	-21.2	-1.6	27.4	48.8	66.8	73.7	87.6	80.8

Source: Primoco UAV, J&T Banka

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Overview of recommendations and relationships with issuers

	Avast	CEZ	Colt CZ Group	Erste	Kofola	KB	Moneta Money Bank	Philip Morris CR	VIG
Recommendation	Not rated	Buy	Buy	Buy	Pending	Buy	Buy	Hold	Hold
Target price	Not rated	CZK 1,623	CZK 865	EUR 52	Pending	CZK 1,021	CZK 105	Pending	EUR 24.5
Market price on recommendation issuance day	GBP 626	CZK 800	CZK 618	EUR 45	CZK 204	CZK 930	CZK 88	0	EUR 18.1
Date	11-II-2022	26-V-2022	30-III-2022	10-II-2022	20-III-2020	23-II-2022	31-V-2022	21-IX-2017	12-V-2017
Analyst	Pavel Ryska	Milan Lávička	Pavel Ryska	Milan Lavicka	Pavel Ryska	Milan Lávička	Milan Lávička	Milan Vaniček	Milan Lávička
Overview of recommendations for selected stocks in the previous 12 months (quarterly basis).									
Recommendation	Buy	Buy	.	Pending	Buy	Hold	Hold	Hold	.
Target price	GBP 430	CZK 104	.	Pending	CZK 435	CZK 991	CZK 105	CZK 12705	.
Date	5-IX-2019	10-V-2021	.	18-II-2021	17-VII-2019	16-XI-2021	21-XII-2021	24-VIII-2016	.
Recommendation	Buy	Buy	.	Buy	Hold	Buy	Buy	.	.
Target price	GBP 330	CZK 721	.	EUR 40,	CZK 426	CZK 836	CZK 105	.	.
Date	27-VI-2018	14-IV-2021	.	31-VIII-2018	9-I-2016	25-XI-2020	10-IX-2021	.	.
Recommendation	.	Buy	.	Hold	.	Hold	Buy	.	.
Target price	.	CZK 708	.	EUR 34	.	CZK 940	CZK 106	.	.
Date	.	14-IV-2021	.	21-VIII-2017	.	11-III-2018	18-II-2019	.	.
Recommendation	.	.	.	.	.	.	Buy	.	.
Target price	.	.	.	.	.	.	CZK 104	.	.
Date	.	.	.	.	.	.	13-XI-2017	.	.
Valuation method	DFCF	DFCF	DFCF	DDM	DFCF	DDM	DDM	DDM	DDM
Frequency of recommendations	.	.	.	.	.	.	.	.	.
The issuer has a direct or indirect share of over 5% in J&T Banka's share capital.	No	No	No	No	No	No	No	No	No
J&T Banka has a direct or indirect share of over 0.5% in the issuer's share capital.	No	No	No	No	No	No	No	No	No
Other material financial interests of J&T Banka and/or its related parties in relation to the issuer.	No	No	No	No	No	No	No	No	No
The author of the document has a direct or indirect share of over 0.5% in the share capital of the issuer.	No	No	No	No	No	No	No	No	No
Other material financial interests of the author in relation to the issuer.	No	No	No	No	No	No	No	No	No
Relationships of J&T Banka with issuers									
Management or co-management of the issue of the security in the past 12 months.	no	no	no	no	no	no	no	no	no
Contractual relationship between J&T Banka and the respective issuer concerning the provision of investment services.	J&T Banka may have agreements with issuers on the providing of selected banking and investment services; such information is subject to bank secrecy and may not be disclosed.								
An agreement between J&T Banka and the respective issuer on the dissemination of investment recommendations.	no	no	no	no	no	no	no	no	no
J&T Banka's market making in the stock of the respective issuer.	Yes	Yes	no	Yes	Yes	Yes	Yes	Yes	Yes

Note: DFCF – Discounted free cash flow model, DDM – Dividend discount model, ERM – Excess return model

Source: J&T Banka

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- The analyst who prepared this report holds Primoco UAV SE’s shares, which were bought on 12 March 2021 at CZK 256/share.

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