J&T BANKA

Primoco UAV SE

Leap in orders opens path to billions in revenues

12 May 2023; 2:00 p.m. CET

Summary

In an analysis released last June, we expressed a view that the year 2022 could be a turning point for Primoco UAV. This scenario has been confirmed, and Primoco's earnings continue to rise sharply this year too. Russia's invasion of Ukraine has given rise to **completely new demand from European customers** and has led to a long-awaited acceleration in revenues and profits. Nevertheless, we did not predict last year that sales to civilian customers, which constituted the original basis of Primoco's business model, would increase as well. It is likely that the start of the war in Ukraine combined with low manufacturing capacity in European countries have caused both military and civilian buyers to worry that if they hesitate, there will not be any production capacity left. This might have sped up the growth in orders in the past year.

The expectation that the European member countries of NATO would announce and begin a **dramatic increase in defence spending** materialised during 2022. The spending could increase by a third by 2027, with an emphasis on the introduction of modern systems including unmanned systems. We believe that Primoco will be one of the companies that could profit from these developments. Although Primoco is a relatively young entity on the market, its advantage consists in a **competitive price and fast progress in obtaining certifications**, which guarantee to buyers the compliance of the aircraft with international standards. Demand from armed forces brings not only higher revenues and profits but, together with civilian demand, it is also a source of **revenue diversification** between two segments that are more or less uncorrelated. If Primoco's revenues depend on private and public budgets, they will be more stable in the long term than if they depend only on one source.

In our projection, we expect Primoco to increase revenues four times this year and to exceed CZK 500m in annual revenues. This is indicated both by strong results for 1Q and the already signed contracts, to be realised this year. Additionally, our projection assumes that revenues will exceed CZK 1bn by 2025.

In this document, we provide basic information on the One 150 aircraft and the company, summarise the turnaround in defence spending in Europe, present earnings projections, show relative valuations to peers, and outline the key opportunities and risks. In our view, the future revenue trajectory still offers many growth paths and it is far from clear how high the sustainable revenue level can be in the long term. Therefore, it is difficult to carry out a valuation of the company at this time. Nonetheless, in our opinion, the changed environment from early 2022 and, in particular, the ability of Primoco's management to take advantage of this environment support further **rapid growth of the company**. This could pave **the way to exceeding CZK 1bn in revenues in the coming years**.

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 aircraft 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.

Základní údaje	
Last market price	CZK 580
Number of shares	4,708,910
Market capitalisation	CZK 2.7bn
Key shareholder	L. Semetkovsky (59.6%)
Free float	14.3%

Pavel Ryska

Analyst

ryska@jtbank.cz

1. Primoco One 150: Tactical drone for civilian and military purposes

Model One 150

Primoco has developed One 150, a medium-sized unmanned aircraft, which belongs to a category of tactical UAV (Unmanned Aerial Vehicles) or drones. Although it is primarily a non-military model that does not carry any weapons, it is marked as a "dual use" aircraft, i.e. a model that can be used both for civilian and military purposes. The two main uses of the One 150 model are:

(1) **Monitoring of product pipelines** (oil and gas pipelines) and early identification of faults and risks. To a lesser extent, aircraft are used to map mines, construction projects, natural systems, etc.

(2) **Protection of borders and water corridors and detection of enemy location** and facilities in armed conflicts.

This means that the company's customers include both private companies and the public sector (police, border guards, army). Primoco UAV initially emphasized sales of aircraft to police forces or border guards and did not foresee the use of the aircraft directly in military conflicts. The conflict in Ukraine has shown direct usability of the aircraft to monitor the location of the enemy in war, and the company now envisages sales of the aircraft to armies. In our view, the sharp distinction between civilian and military drones has started to blur since a civilian aircraft used for collecting visual data is inherently usable in a military conflict. This now proves to be key in terms of revenues for Primoco.

One 150 model, the Pisek – Krasovice airfield

Source: Primoco UAV

Aircraft and manufacturing: selected specifics

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

- **Product:** Primoco offers One 150, where the number indicates the maximum take-off weight in kg. The aircraft has a maximum flight distance of approx. 2,000 km, a flight time of 15 hours and a speed of 100 – 150 km/h. Take-off and landing require a runway of 300 m.
- **Equipment:** The One 150 aircraft is sold with Ground Control Station (GSC), sensors (mainly video camera, but also equipment for radio targeting and jamming) and spare parts. Primoco equips the aircraft with a control station of a 200 km range. If the aircraft gets beyond this range, it must connect to another control station or it returns to the original range. An autopilot enables the aircraft to return via the original route and land without any pilot intervention.
- **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. In 2022, Primoco obtained the **EASA LUC certificate** (Light Unmanned Certificate) from the

Civil Aviation Authority. It certifies the compliance of the aircraft with international requirements and allows flight operations to be carried out with an internal approval at the 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 without having to obtain approval from the German aviation authority.

Further, Primoco intends to obtain **certification according to the NATO STANAG 4703 standard** in 2023. It has already satisfied part of the certification regarding the combustion engine. In our opinion, all the mentioned certifications and test flights are important steps in obtaining European contracts. The company will have a bigger chance of succeeding in tenders where customers require such certifications.

- **Production capacity:** The current production facility in Prague-Radotin has a capacity of 50-100 aircraft per year. Given a sharp rise in orders, management plans to increase capacity by building a new facility in Krasovice near Pisek, right by an airfield already owned by Primoco. The project is now at the design stage and we expect the construction to start at earliest in 2025 (but rather 2026) after a building permit is obtained.
- **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 lower expectations for 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 1/3 of revenues in the future. The Middle East and Asia are expected to account for approx. the second third and the last third should be shared by Africa and South America.

Model One 150 – Aircraft structure

Source: Primoco UAV

Aircraft price

Primoco generates revenues from two main sources:

(1) **Sales of One 150 including equipment.** The standard delivery is 3 pieces, and we estimate the unit price at approx. EUR 800 thousand to 1.1m (see the box) or CZK 18.8 – 25.9m per unit at the current exchange rate. The delivery includes sensors, control station, aftermarket and pilot training. Due to an increase in prices of sensors, the average sale price is likely to increase.

(2) **Aftermarket** for existing customers. The estimated usual flight intensity of 400 hours per year implies that spare parts annual costs make up approx. 15%

Aircarft One 150 and delivered equipment

Aircraft	
Ground Control Station	
Sensors (mainly camera)	
Spare parts	
Training	
Unit price (On purchase of 3 pieces, J&T estimate)	EUR 0.8-1.1m

Zdroi: Primoco UAV. J&T Banka

of the aircraft price. These costs usually arise from the second year of aircraft operation.

Aircraft sales are the main sources of revenues. The sale of a larger number of aircraft is usually accompanied with an aftermarket contract, i.e. aircraft purchase contracts carry a certain inertia of revenues going forward.

2. Market characteristics

Primoco in unmanned aircraft market

Unmanned Aerial Vehicles (UAV's), also called drones, 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. Unmanned aerial vehicles are divided in 4 categories, mainly according to the flight range and purpose:

(1) **Hobby drones** – flight range of up to 25 km, recreational purpose.

(2) **Tactical drones** – flight range of over 25 km, with flight time amounting to hours, civilian and military purposes. → *Primoco One 150 belongs here.*

(3) **Strategic drones** – flight time amounting to tens of hours, military purposes.

(4) **Combat drones** – they carry a weapon and have any flight range.

Most world sales are in the category of strategic drones (estimated at 70%), mostly in the USA. Tactical drones are still a smaller emerging category.

Primoco states that aircraft comparable to its model are offered by a total of **8 manufacturers of unmanned fixed-wing aircraft**: Boeing and AeroVironment (USA), Aeronautics, Elbit and IAI (Israel), Tekever (Portugal), CAIC (China) and Quods (Iran). Further, a comparable product is offered by manufacturers of unmanned helicopters Schiebel (Austria) and UMS Skeldar (Switzerland).

Market size

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. We believe that most producers fall in the category of hobby drones since it offers broad sales potential and it does not face regulation in most countries. (Hobby drones are within the visual line of sight, which is not regulated in any way by most countries). In the field of civilian commercial UAVs for businesses and the public sector, we believe there are about tens of companies. Primoco identifies ten companies globally as its main competitors (see below).

There is no reliable statistics on the size of the total market (civilian and military UAV). According to Teal Group's estimates of 2022, global spending on *civilian* UAVs should grow from USD 7.2bn in 2022 to USD 19.8bn in 2031. This implies market growth at CAGR of about 11.1%, in nominal terms. Given Primoco's low initial basis of production and deliveries, its growth could be well above the market dynamics, which has been confirmed since last 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.

Dual market: America separated from Europe

The United States has taken a leading role in the unmanned aircraft market, with several manufacturers offering a range of mainly military drones of various sizes. However, the market between Europe and North America does not seem to be „permeable", i.e. companies from one continent do not easily find contracts on the other. For example, the US company AeroVironment, a specialist in the manufacturing of drones, does not list any European competitor in the category of medium-sized drones or mention orders in the European market. Only the US army is its key customer. It identifies US companies Boeing, Textron and L3 Harris and Israel-based Elbit Systems and IAI as its competitors.

This shows that **there is no direct and intense competition between US and European manufacturers** in the medium-sized aircraft market, where Primoco operates. In our view, this separation of markets plays to Primoco's advantage as the emerging demand in Europe is all the more likely to find European firms as suppliers, the number of such suppliers is small and Primoco gets the upper hand (see below).

We believe that drones will see even sharper growth in Europe after the outbreak of the war in Ukraine last year than is now present in the US. This is because European armies are considerably less equipped with unmanned aerial vehicles than in the USA. The Czech army can serve as an example. The battalion of unmanned systems of the Army of the CR was established only in 2020 (The 533rd Unmanned Systems Battalion in Prostejov) and it is expected to reach the full operation and staff capacity only in 2025. At present, it has only small Raven RQ-11B drones and it has no unmanned aircraft in the Primoco One 150 category or larger.

Where is potential 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 visual 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.

The other question is the position of Primoco's One 150 compared to competitors in the segment of medium-sized tactical unmanned aircraft. We see competitive advantage to Primoco's peers in two key areas:

(1) Price

Primoco: The avg. price of One 150 delivered in quantity of 3 is approx. EUR 0.8-1.1m/pc.

Competitors: USD 0.8 – 8m/pc. (According to Primoco's information of 2022.)

(2) Certification

(a) With its One 150, Primoco is the first manufacturer of fixed-wing aircraft to have received **the EASA European civilian certification** in the LUC (Light Unmanned Certificate) category. The company can now carry out flights in the EU just with internal approval and supply aircraft to EU countries for civilian purposes without the need of further approvals.

(b) **It is in the final testing stage for the NATO STANAG certification** (expected to be obtained in 2023). None of the above manufacturers has yet received this certification and some of the models do not even meet the requirements of this standard.

In tenders, particularly in European countries, certification can play a key role in shortlisting. The price can then be a decisive factor in further decision-making. According to Primoco's information, the range of the control station is 200 km and the range of the sensors (mainly video cameras) is also 200 km, which is considerably above average compared to its competitors (150 and 85 km, respectively). This may be an additional competitive advantage, although it depends on the specific requirements of a given buyer.

By contrast, what we see as Primoco's potential disadvantage in tenders is mainly its short track record and, subsequently, the lack of reviews of its aircraft, and Primoco's operation as a single-product company, which does not make it possible to deliver a wider range of products to military customers in particular. Other than that, it is difficult to determine any other potential drawbacks stemming from the technical features of the product without more reviews and tender information.

That said, the fact that the company makes only unmanned aircraft leads, in our opinion, to a better management focus on the product and the customer than in the case of large arms corporations, where unmanned aircraft are often just an ancillary product on the sideline and where top management devotes only a fraction of its time to it.

3. Shareholder structure

Two main shareholders and increase in free float …

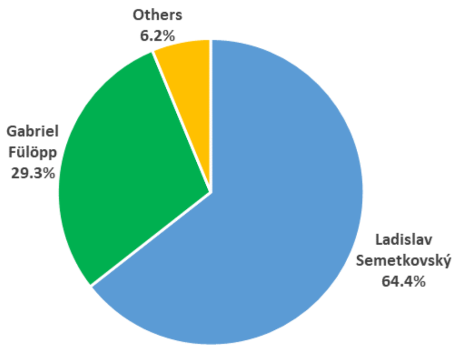
After the establishment of the company in 2014, its shares were held only by its founders – Ladislav Semetkovsky (50.41%) and Gabriel Fülöpp (49.59%). Following an IPO at CZK 240/share on the Start market of the Prague Stock Exchange in 2018, there was a relatively small free-float of 6.2% (Figure 1). It rose significantly after an SPO in May 2021, when the company issued new shares to finance further development and repay a shareholder loan. In the SPO, 364,200 new shares were subscribed (increase to 4,708,910 shares at present) in two rounds at CZK 240 and CZK 260/share. The proceeds from the SPO amounted to CZK 90.5m.

… helping trading volumes

The CEO of Primoco Ladislav Semetkovsky has remained the majority shareholder with a 59.3% share (Figure 2) and along with the other founder Gabriel Fülöpp they hold approx. 84.7% of the company's shares. The remaining 15.3% is a free float, including a shareholding of the investment company Conseq (6.8%).

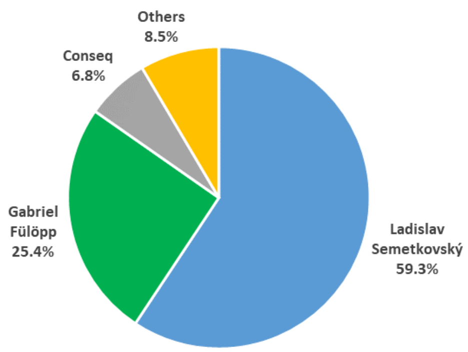
The significant increase in free float is positive for pricing and trading volumes. Thanks to a higher free float, we continue to see an increase in trading volumes: since the start of 2023, the average daily volume in Primoco's shares has been higher by approx. 80% compared to 2022.

Figure 1: Shareholder structure after IPO in 2018



Source: Primoco UAV, J&T Banka

Figure 2: Shareholder structure as at 21 April 2023



Source: Primoco UAV, J&T Banka

Despite ending lock-up period, the founders' combined shareholding will remain above 75%

The free float has slightly risen over the past year (by approx. 1pp) as both majority shareholders have mildly reduced their positions. (Namely, Gabriel Fülöpp by 0.7pps and Ladislav Semetkovsky by 0.3pps.) The majority shareholders pledged during the IPO in 2018 that their combined share would not decline below 75% for the period of five years. This lock-up period expires this year but we think that the 75% combined shareholding will remain for some time. This is owing to the rapid development of the company over the past year, which has led to the doubling of the share market price and which could result in a significant increase in the value of the founders' shareholdings. By selling a substantial part of their shareholdings in a moment when the company is freshly set for rapid growth, shareholders would risk missing the chance to participate in the value increase.

In our opinion, Primoco would consider it beneficial in the long term if a major international aerospace or arms company bought a partial stake since it would place the company in its sales channels and help increase sales. We think that there could be a partnership with one of European manufacturers of airplanes or military aviation, which are considerably lagging behind their US peers when it comes to unmanned aircraft.

4. Key developments: Growing defence expenditures in Europe

Quick operational deployment of Primoco One 150 in Ukraine

The use of the Primoco One 150 for defence purposes proved to be at least as important as its civilian use after the start of the war in Ukraine. Not only did Primoco begin to win significant contracts for armed forces after Russia's invasion of Ukraine, but thanks to purchases by Luxembourg and the Netherlands, its aircraft were operationally deployed by Ukraine's defence intelligence agency. Therefore, we see a high chance that Primoco can win further contracts from armed forces, especially from European NATO members.

Turnaround in defence spending in Europe

Therefore, we see the development of defence spending in Europe as a potentially crucial factor in Primoco's revenues. Following the start of Russia's invasion of Ukraine, a number of European governments reassessed their defence spending. Increases in defence spending can be expected in virtually all European members of NATO and the EU, but it will be most pronounced, in our view, in countries that have not yet complied with the 2% of GDP defence spending level recommended by NATO's statutes. In 2021, as many as 15 NATO countries were below this level, and 14 of them were from Europe (Fig. 3). We therefore think that the core of the increase in defence spending will be in Europe. Large countries expected to see a significant increase in defence spending include Germany, Italy and Spain (Fig. 4). Given the 2021 spending, reaching the 2% of GDP target by these countries means a sharp increase in spending of 30% to 100%.

Figure 3: Military spending in Europe as percentage of GDP

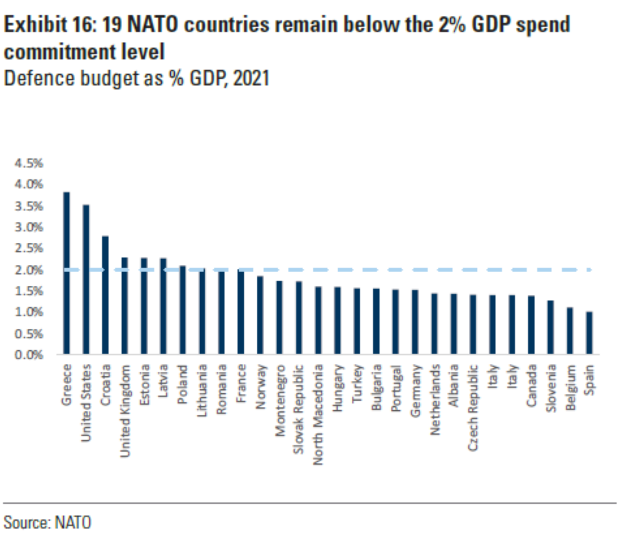
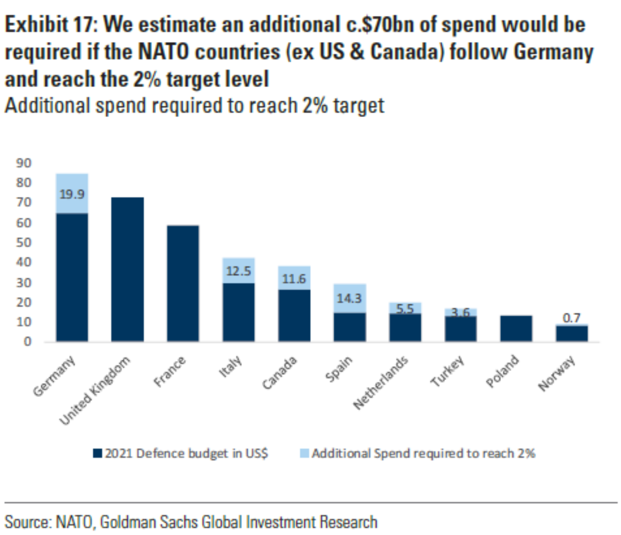


Figure 4: Spend needed to achieve 2% of GDP (NATO's recom.)



Source: Goldman Sachs

After 3 decades of declines, European defence spending expected to surge by 1/3 within 5 years

Western Europe had seen more than three decades of steady decline in defence spending as a percentage of total spending in economy (Figure 5). This process, referred to as the "peace dividend", enabled the shifting of spending elsewhere, but it is becoming increasingly clear that such decline in spending and its structure are incompatible with defence in such a large-scale conflict as the present one in Ukraine. All of the 5 largest Western European countries, and especially the UK and Germany, had seen a drop in spending (Fig. 6).

The turnaround last year should lead to an acceleration in spending growth by European NATO members by half, from 4% until 2021 to 6% annually in the 2022-2026 period, according to Goldman Sachs' estimates (Fig. 7). This means that spending should increase by more than a third within 5 years. After Poland, which, given its location, has already started massive armaments, Germany should show the highest growth of 9% per year, followed by Turkey and Spain. In addition to the growth in the standard defence budget (now EUR 60-70bn annually), Germany has announced an special fund to restore the Bundeswehr's combat capability of EUR 100bn. One third of this fund is to be focused on the air force and, although its start is slower than expected, the first major contract (over EUR 1bn) from this fund should be announced during 2Q 2023. The fund is expected to enable Germany to build "the largest conventional army in Europe", according to Chancellor Olaf Scholz.

Figure 5: Defence spending in Western Europe as % of GDP

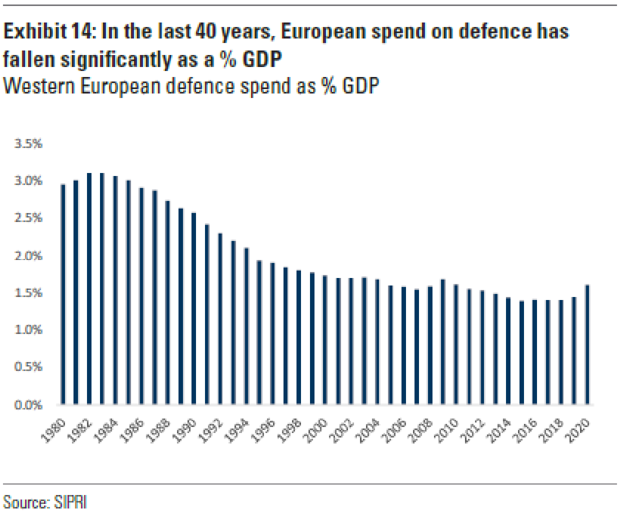
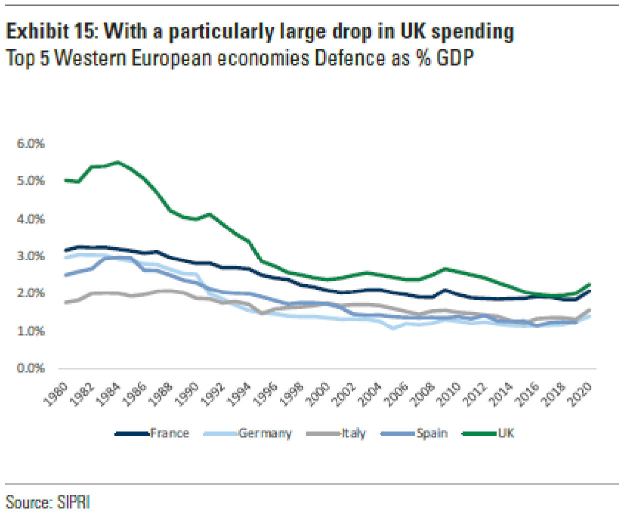


Figure 6: Drop in spending of 5 largest countries, esp. UK



Source: Goldman Sachs

Germany: Striking opportunities in airspace segment

In addition to total spending, the important thing is what proportion goes into new equipment (i.e. weapon systems) versus personnel and other spending. The share of spending going to new equipment is increasing in NATO countries (Fig. 9) and it can be expected to continue to increase.

The condition of the German army in the case of combat deployment has received considerable media attention (Fig. 10). The proportion of non-functioning or unready equipment commonly reaches 1/3 and in the case of air force, it is as high as a half, with the worst result in helicopter air force. This suggests that the greatest supply opportunities for the German army may lie in this segment. At the same time, unmanned aircraft are a cheaper and safer substitute for military helicopters in surveillance missions. Primoco successfully tested its aircraft for the German Bundeswehr in April 2022 and we believe that it has a chance to win a contract from Germany for both the Bundeswehr's own needs and for eventual delivery to Ukraine.

Figure 7: Defence spending growth in European NATO countries

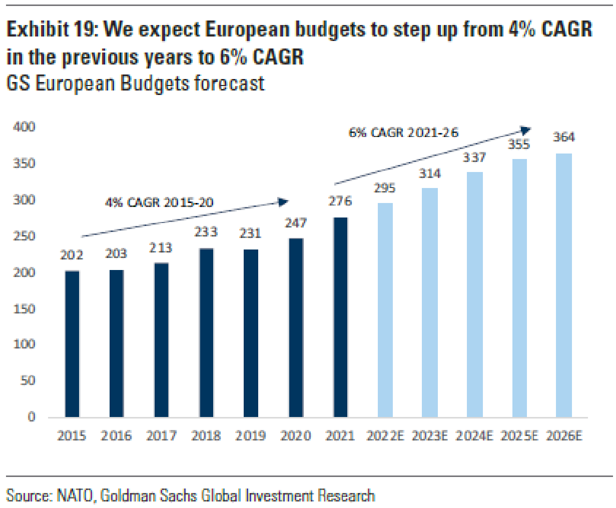
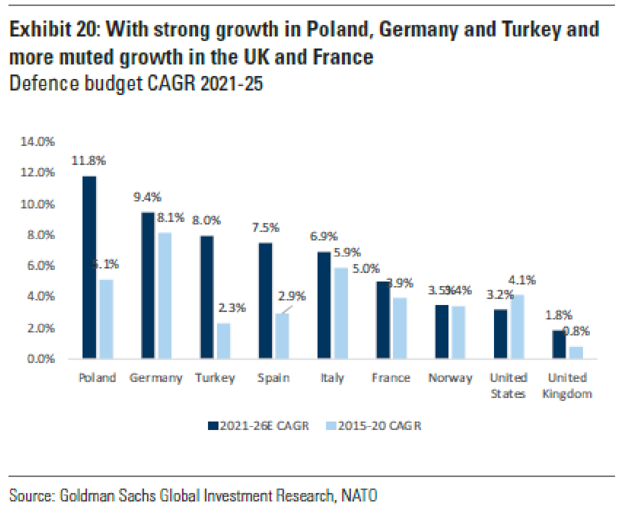


Figure 8: Defence spending growth in selected countries



Source: Goldman Sachs

Figure 9: Share of equipment spend as % of defence spend

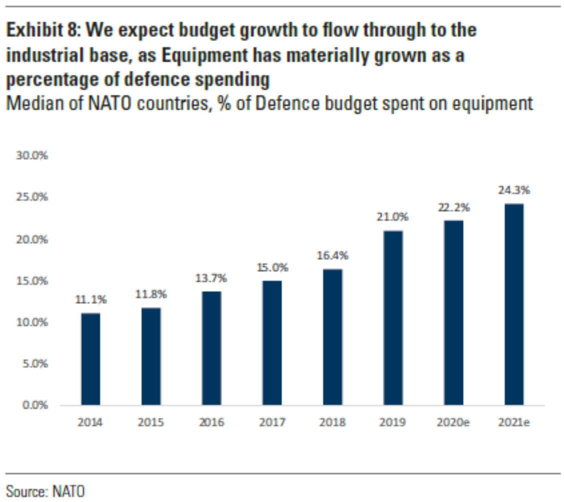
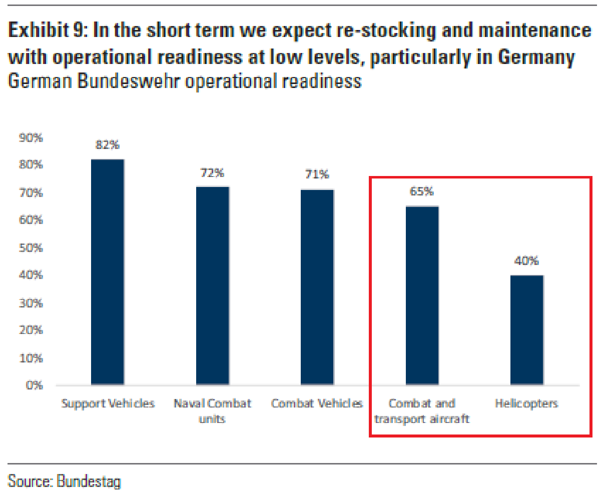


Figure 10: Share of Bundeswehr's operational readiness



Source: Goldman Sachs

5. Earnings performance: Revenue breakthrough in 2022 and strong start in 2023

EBITDA margin above 40% thanks to low fixed costs and favourable competitive environment

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 high fixed costs.

Given the separation of the UAV market in North America and Europe, there has not been any big price pressure yet and the company can operate with a substantial margin. As a result, management has a long-term EBITDA margin target of 40 – 50%.

2022: Earnings breakthrough driven by European buyers…

The year 2022 literally brought a breakthrough to Primoco's earnings. As a young and small company, it had until then had only little success in winning contracts. Russia's invasion of Ukraine convinced previously hesitant governments that equipping armies with modern equipment was becoming pressing. Primoco signed contracts to deliver its aircraft to an unnamed European customer soon after the war began (Table 1). The press later provided information that Primoco's aircraft were being used by the Ukrainian army, with the purchase being paid for by the Netherlands and Luxembourg. Primoco gradually signed contracts in 2022 for the delivery of 22 machines, of which 12 were delivered in the same year. Primoco thus generated higher revenues in 2022 than in its entire previous history.

Table 1: Primoco's contracts for 2022 and since start of 2023

	Number of aircraft	Value in EUR m	Value in CZK m	Status
2022 – delivered				
Customer #1 Europe	5	-	50.4	Delivered in 2022
Customer #2 Europe	6	-	81.1	Delivered in 2022
Customer #3	1	-	21.7	Delivered in 2022
Total	12		153.2	
2023 – signed				
Customer #1 Europe	9	7.1	166.1	5pcs delivered in 1Q, remaining 4pcs to be delivered in 2023
Customer #2 Slovakia	2	1.7	39.8	To be delivered in 1H23
Customer #3 Africa	8	6.8	159.1	To be delivered in 1H23
Customer #4 Malaysia	2	3.7	86.6	To be delivered in 2023
Total	21		451.6	

Source: J&T Banka, Primoco UAV

… joined by non-European customers in 2023

This year, Primoco continues deliveries to European buyers (Table 1), and it is possible that last year's pattern is being repeated – various European countries are financing the purchase of aircraft for the Ukrainian army. In addition, however, Primoco is also carrying out a contract for the Slovakian police force, delivering aircraft for airport equipment calibration to a private buyer in Malaysia and is set to export aircraft to a buyer in Africa this year. Primoco has already signed contracts for the delivery of 21 aircraft this year, and more could follow.

1Q23: Revenues rise 4-times, EBITDA margin exceeds outlook

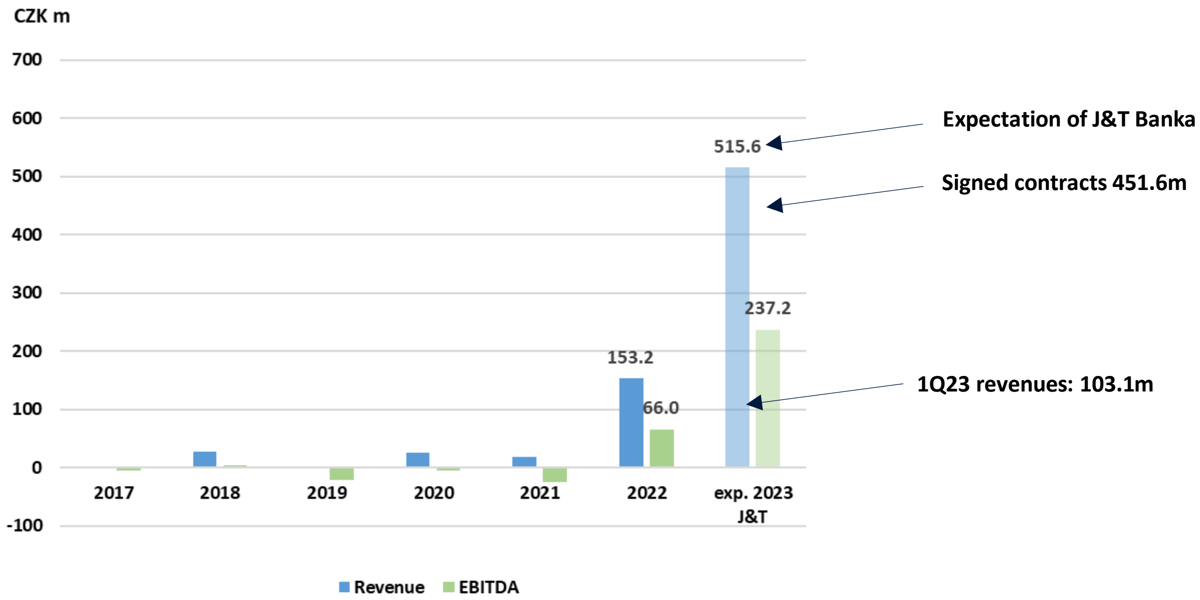
The first quarter of this year confirmed the sharp growth in Primoco's earnings performance as the company reported revenues and profit several times higher than in the same period last year (Table 2). Revenues increased almost five times year-on-year to EUR 103.1m, and the company delivered 5 aircraft from a contract for a European customer. The EBITDA margin surged to 63.9%, well above the company's long-term guidance of 40-50%, and EBITDA rose more than five times year-on-year. We believe that the exceptionally high EBITDA margin may have been due to the fact that under the contract for the European customer, Primoco first delivers the actual aircraft, where the margin is higher, while sensors, purchased from third parties, will be delivered later. This temporarily puts the EBITDA margin above the targeted level.

Table 2: Earnings results for 1Q 2023

CZK m, uncons.	1Q 2023	y/y	1Q 2022
Revenues	103.1	374.7%	21.7
EBITDA	65.9	410.1%	12.9
Margin	63.9%	+4.4pps	59.5%
Pre-tax profit	65.3	435.4%	12.2
Profit after tax	52.9	333.7%	12.2

Source: J&T Banka, Primoco UAV

Figure 11: Revenues and EBITDA – history and our estimate for this year



Source: Primoco UAV, J&T Banka

2023 – 2027 projection:

Company growth gaining firmer footing, we expect revenues to exceed CZK 1bn

Given the changed behaviour of military and civilian customers from 2022 onwards, we expect Primoco to continue to win more contracts. This will be aided by the expected sharp growth in arms spending in Europe described above as well as higher interest from civilian customers. We therefore estimate that the number of aircraft sold, and thus revenues, will continue to grow rapidly throughout the period of our detailed projection until 2027 (Table 3).

Our revenue estimate for this year is CZK 515.6m. We consider this estimate to be rather conservative because the company has already signed contracts for 21 aircraft, which, at the current exchange rate, should translate into revenues of CZK 451.6m (Figure 11). Moreover, we expect that negotiations with many other counterparties will result in more signed contracts this year. We expect an EBITDA margin of 46% this year, with the high level of 63.9% in 1Q to be gradually reduced by the delivery of a large number of sensors, which entail lower profitability.

Table 3: Earnings projection and market multiples at share price of CZK 580/share

CAS, CZK m	2019	2020	2021	2022	e 2023 J&T	e 2024 J&T	e 2025 J&T	e 2026 J&T	e 2027 J&T
Delivered aircraft	-	-	5	12	23	35	48	58	67
Revenues	1.4	26.0	17.8	153.2	515.6	877.0	1159.2	1388.5	1589.9
y/y	*-95.1%*	*1820.1%*	*-31.8%*	*762.5%*	*236.4%*	*70.1%*	*32.2%*	*19.8%*	*14.5%*
EBITDA	-20.9	-5.0	-24.6	66.0	237.2	368.3	463.7	527.6	604.2
EBITDA margin	n.m.	-19.1%	-138.5%	43.0%	46.0%	42.0%	40.0%	38.0%	38.0%
Operating result	-23.4	-7.0	-27.5	62.4	233.5	364.1	459.5	523.1	597.5
Financial result	-0.5	-2.5	-0.5	0.3	0.0	0.0	0.0	0.0	0.0
Net profit	-24.0	-9.4	-28.0	61.9	189.2	294.9	372.2	423.7	484.0
Net profit margin	-1767.4%	-36.2%	-157.3%	40.4%	36.7%	33.6%	32.1%	30.5%	30.4%
EPS (CZK)	-5.5	-2.2	-6.1	13.1	40.2	62.6	79.0	90.0	102.8
y/y	*n.m*	*n.m*	*n.m*	*n.m*	*205.8%*	*55.9%*	*26.2%*	*13.8%*	*14.2%*
Free cash flow	6.7	-1.4	-58.7	34.7	192.3	279.6	391.9	426.3	488.6
P/E					14.4	9.3	7.3	6.4	5.6
EV/EBITDA					10.4	6.0	3.9	2.7	1.6
P/Sales					5.3	3.1	2.4	2.0	1.7

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

Primoco's management has declared a goal to conclude contracts worth CZK 1bn this year. Primoco needs about 6 months from the signing date to deliver an aircraft, which means that this target should translate into at least a billion korunas in revenue next year. We are more cautious in our projection and expect revenues of 919mn next year. We expect that the billion mark will be exceeded a year later.

In terms of long-term profitability, we also take a relatively conservative assumption that the EBITDA margin will gradually decline to 38%. The reason for this assumption is a potential increase in market competition combined with a possible increase in prices of foreign components for Primoco's aircraft. The company has zero debt, and so we expect net profit to be closely aligned with operating profit, with only the tax paid being the difference between the two.

Low CAPEX enable high earnings conversion 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 3). 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 that 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 to respond to the sharp growth in demand. The company has indicated construction costs of up to CZK 500m but these could be partly covered by a subsidy from the EU. Our projection until 2027 does not assume production of more than 100 aircraft per year (see Table 3), which could be made in the existing facility in Prague-Radotin. Therefore, we do not include the cost of the new facility in our projection and we think that the final decision will be made only around 2025.

In any case, we believe that the construction would be financed from operating cash flow and we do not expect any debt financing. We see the project itself as dependent on the volume of contracts and note that the current production capacity is sufficient to generate revenues up to CZK 2bn annually.

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 the SPO. We are also not aware of any other significant liabilities of the company.

Dividend not expected given the company phase

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. Although Primoco's highly profitable performance could hypothetically enable dividend distribution, the company is in a phase of sharp growth accompanied with uncertainty regarding production facilities. Therefore, we think that management will proceed to the payment of dividend only once it is certain that the company will not have any major capital expenditures. Therefore, we do not yet consider a dividend in our projections.

P/E and EV/EBITDA multiples stay low thanks to leap in earnings

Primoco's share price on the Prague Stock Exchange has more than doubled from CZK 268 to CZK 580 since our last analysis of June 2022. We believe this increase was driven by investors' reaction to the steep growth in earnings. The increase in our estimates of Primoco's earnings for this year and for the years ahead results in P/E and EV/EBITDA where price growth is offset by earnings growth. If our earnings projections for this year are roughly met, our P/E estimate at the current price of CZK 580 is 14.4 and it falls sharply to 9.3 next year. The EV/EBITDA ratio then drops from 10.4 to 6.0. Overall, these are relatively low multiples given the pace of growth of the company's earnings.

6. Relative valuation to publicly traded companies

Two groups of companies for relative comparison

Due to the high uncertainty in estimating Primoco's earnings, we do not provide a fundamental valuation of the company on the basis of discounted cash flow. As an alternative method, we offer a comparison with similar companies based on market multiples. We selected two ranges of companies for relative comparison:

(1) **Broad group**: Leading manufacturers of aircraft and arms with any exposure to UAV.

(2) **Narrow group**: "Pure-play" UAV manufacturers, of any size.

The condition for inclusion is that the companies' shares are traded on public markets and that there are earnings estimates until 2025 available including at least one of the following items: revenue, EBITDA and net profit. From these, we then derive the P/Sales, EV/ EBITDA and P/E market multiples.

We included the P/Sales multiple because companies in the narrow group often have negative EBITDA or net profit and, therefore, the EV/EBITDA and P/E ratios cannot be used. We therefore use P/Sales as an alternative, but please note that from an investor's perspective, it is not as valuable as the EV/EBITDA or P/E multiples since it does not reveal anything about the relation of the company's share price to its earnings.

The estimates of Primoco's revenues, net profit and EBITDA come from our model while in the case of the other companies, we rely on the Bloomberg market consensus estimates. Primoco's multiples are calculated at the market price of CZK 580/share. Please note that the list of the companies in the narrow group is short and for some of them, there are not many earnings estimates available. The table should therefore be seen as indicative.

Closest peers

We consider AeroVironment (USA), which also has good market liquidity, the closest peer. It is a company that produces only unmanned aircraft, of many types from the smallest drones to large UAVs to the so-called pseudo-satellites. Even here, the comparison with Primoco is not ideal because AeroVironment has the US army as its dominant customer and it differs from Primoco in the spectrum of aircraft. Still, in our view, it is the closest to Primoco of the companies with liquid market trading. The other companies in the narrow group have less liquidity and are at a much earlier stage of development. The companies in the broad group are liquid and are at a "mature" stage, but, on the other hand, the biggest part of their revenues is generated from products other than UAVs. Therefore, both groups (broad and narrow) have advantages and disadvantages to comparison with Primoco.

Table 4: Relative comparison: Selection of large aerospace & defense companies with exposure to UAV; in descending order, as at 10 May 2023

Company	Exp. avg. P/E 2023-25
Boeing	28.0
Elbit Systems	23.6
Northrop Grumman	17.8
Airbus	17.6
Raytheon	16.8
Lockheed Martin	16.2
BAE Systems	15.5
L3Harris Technologies	14.3
Textron	11.6
Leonardo	7.3
Average	16.9
Median	16.5
Primoco	10.3

Company	Exp. avg. EV/EBITDA 2023-25
Boeing	23.0
Elbit Systems	15.4
Northrop Grumman	13.6
Lockheed Martin	12.7
Raytheon	12.6
L3Harris Technologies	12.4
BAE Systems	10.1
Airbus	8.8
Textron	8.3
Leonardo	4.9
Average	12.2
Median	12.5
Primoco	6.8

Company	Exp. avg. P/Sales 2023-25
L3Harris Technologies	1.9
Raytheon	1.8
Lockheed Martin	1.7
Northrop Grumman	1.7
Elbit Systems	1.4
Boeing	1.4
Airbus	1.3
BAE Systems	1.2
Textron	0.9
Leonardo	0.4
Average	1.4
Median	1.4
Primoco	3.6

Source: Bloomberg, J&T Banka; Estimates for Primoco by J&T Banka, otherwise according to Bloomberg

Table 4: Relative valuation: Pure-play UAV manufacturers; in descending order, as at 10 May 2023

Company	Exp. avg. P/E 2023-25
ACSL	382.8
Drone Shield	42.7
AeroVironment	39.0
Draganfly	-
Volatus Aerospace	-
Ehang Holdings	-
Average	154.8
Median	42.7
Primoco	10.3

Company	Exp. avg. EV/EBITDA 2023-25
Drone Shield	133.3
AeroVironment	19.0
Volatus Aerospace	9.1
ACSL	-
Draganfly	-
Ehang Holdings	-
Average	53.8
Median	19.0
Primoco	6.8

Company	Exp. avg. P/Sales 2023-25
Ehang Holdings	29.0
ACSL	4.3
Drone Shield	4.1
AeroVironment	4.0
Draganfly	3.3
Volatus Aerospace	0.5
Average	7.5
Median	4.0
Primoco	3.6

Source: Bloomberg, J&T Banka; Estimates for Primoco by J&T Banka, otherwise according to Bloomberg

Results: Despite jump in market price, Primoco not priced high

The results in the broad group of companies show that Primoco is now priced considerably below the average when it comes to P/E (10.3 vs. 16.9) or EV/EBITDA (6.8 vs. 12.2). Only arms manufacturer Leonardo has lower multiples; however, its multiples have long been the lowest of the big arms manufacturers due to specific problems of the company. Primoco's valuation is higher only in terms of the P/Sales multiple, but this result is not significant in light of the previous multiples: Primoco realizes higher profit margins than its peers and therefore it has lower P/E and EV/EBITDA despite the higher P/Sales.

The results in the narrow group of companies look favourable for Primoco again. The P/E, EV/EBITDA and P/Sales multiples are all below the sector average. Moreover, Primoco has significantly lower multiples than the mentioned AeroVironment, which we consider the best for comparison.

The market price of Primoco's shares has risen by about 100% over the past 12 months but the jump in expected earnings is also significant and, therefore, Primoco's market multiples have not increased. In contrast, almost the entire aerospace and defense sector has had one of the fastest price jumps, but its earnings estimates have not increased as much, pushing its market multiples up significantly. In our opinion, Primoco is thus valued favourably not only by simple comparison of multiples but also by the fact that its results are likely to grow at a higher rate than those of the companies in the broad group above. The reason for the lower multiples may be a certain discount for the low liquidity of

Primoco's shares on the stock exchange, but even when considering this discount, in our opinion, Primoco's multiples come out as very low compared to peers.

7. Conclusion

Favourable external environment presents extraordinary opportunity to Primoco

Last year, the changed security situation in Europe gave Primoco a key impetus to make its first major contracts and get the necessary references from customers. We are of the opinion that this new situation in Europe is not just a passing wave but that a longer process of 5 to 10 years has been set in motion, where the equipment of European armies will be renewed and modernised. This will be characterised among other things by the introduction of unmanned aerial systems and we believe that Primoco has an extraordinary opportunity to capitalise on this trend.

What we consider to be Primoco's key advantage is the product price, aerospace certifications and the fact that Primoco, unlike the vast majority of its competitors, is seated in the EU and, therefore, it has naturally a better chance of winning contracts in European countries. The risks include the relative immaturity of the company and the strong dependence of success on the person of the CEO. However, we expect Primoco to have a good chance to continue its rapid growth in revenues and earnings this year and in the coming years.

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.
- The advantage of the product compared to helicopters in terms of operating costs, and compared to competitors' aircraft in terms of purchase price and certifications.
- Relatively high profitability starting at low production volumes, owing to low fixed costs and currently limited competition on the European market (i.e. the absence of 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 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, Africa) 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.
- Product imitability, i.e. potential competitors may construct 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; the approval may be restricted depending on geopolitical development.
- The depreciation of the euro against the Czech koruna (contracts are in the euro).
- Expected rise in the corporate income tax in the Czech Republic from 19%to 21%.
- Limited liquidity of Primoco's shares on the Start market of the Prague Stock Exchange.

Appendix

Profit and Loss

CAS, CZK m	2019	2020	2021	2022	e 2023 J&T	e 2024 J&T	e 2025 J&T	e 2026 J&T	e 2027 J&T
Revenues	1.4	26.0	17.8	153.2	515.6	877.0	1159.2	1388.5	1589.9
EBITDA	-20.9	-5.0	-24.6	66.0	237.2	368.3	463.7	527.6	604.2
EBITDA margin	-1544.6%	-19.1%	-138.5%	43.0%	46.0%	42.0%	40.0%	38.0%	38.0%
Operating result	-23.4	-7.0	-27.5	62.4	233.5	364.1	459.5	523.1	597.5
Financial result	-0.5	-2.5	-0.5	0.3	0.0	0.0	0.0	0.0	0.0
Net profit	-24.0	-9.4	-28.0	61.9	189.2	294.9	372.2	423.7	484.0
Net profit margin	-1767.4%	-36.2%	-157.3%	40.4%	36.7%	33.6%	32.1%	30.5%	30.4%
Earnings per share (CZK)	-5.5	-2.2	-6.1	13.1	40.2	62.6	79.0	90.0	102.8

Balance Sheet

CAS, CZK m	2019	2020	2021	2022	e 2023 J&T	e 2024 J&T	e 2025 J&T	e 2026 J&T	e 2027 J&T
Total assets	**52.1**	**50.5**	**84.7**	**157.9**	**388.3**	**719.3**	**1142.9**	**1594.1**	**2102.2**
Fixed assets	32.9	30.2	32.4	36.3	35.4	35.2	38.0	55.4	85.8
Current assets	19.1	20.2	52.3	121.6	352.8	684.1	1104.9	1538.7	2016.5
of which cash	2.4	0.7	28.2	63.1	252.9	530.5	917.4	1323.6	1777.3
Total liabilities	**52.1**	**50.5**	**84.7**	**157.9**	**388.3**	**719.3**	**1142.9**	**1594.1**	**2102.2**
Equity	31.3	21.8	84.4	146.7	335.8	630.7	1002.9	1426.6	1910.6
Provisions	0.0	0.1	0.1	0.9	0.9	0.9	0.9	0.9	0.9
Liabilities	20.7	28.6	0.2	10.3	51.6	87.7	139.1	166.6	190.8
Long-term liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Short-term liabilities	20.7	28.6	0.2	10.3	51.6	87.7	139.1	166.6	190.8

Cash flow

CAS, CZK m	2019	2020	2021	2022	e 2023 J&T	e 2024 J&T	e 2025 J&T	e 2026 J&T	e 2027 J&T
Operating cash flow	6.7	-1.4	-58.7	34.7	192.6	281.6	393.9	428.3	490.6
Investing cash flow	-27.8	-0.2	-4.4	-0.2	-2.8	-4.0	-7.0	-22.0	-37.0
Financial cash flow	0.0	0.0	90.5	0.4	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	-21.2	-1.6	27.4	34.9	189.8	277.6	386.9	406.3	453.6
Free cash flow for shareholders	-21.2	-1.6	27.4	34.9	189.8	277.6	386.9	406.3	453.6

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

Contacts

Trading Equity

Jan Pavlik	Head of Equity Trading	+420 221 710 628	jpavlik@jtbank.cz
Michal Znojil	Trading - Czech and Foreign Equities	+420 221 710 131	znojil@jtbank.cz
Barbora Stieberova	Trading - Czech and Foreign Equities	+420 221 710 613	stieberova@jtbank.cz
Milan Svoboda	Trading - Czech and Foreign Equities	+420 221 710 554	msvoboda@jtbank.cz
Vratislav Vacha	Trading - Czech and Foreign Equities	+420 221 710 663	vacha@jtbank.cz
Michal Vacek	Trading - Czech and Foreign Equities	+420 221 710 662	vacek@jtbank.cz
Miroslav Nejezchleba	Trading - Foreign Equities	+420 221 710 633	nejezchleba@jtbank.cz
Marek Truchly	Trading - Foreign Equities	+420 221 710 661	truchly@jtbank.cz
Tatana Maresova	Treasury sales	+420 221 710 300	tmaresova@jtbank.cz
Jan Jandak	Treasury sales – FI & Corporates	+420 221 710 762	jandak@jtbank.cz

Portfolio Management – Client Service

Roman Hajda	Chief Investment Officer	+420 221 710 224	hajda@jtbank.cz
Katarina Scecinova	Portfolio manager	+420 221 710 498	scecinova@jtfg.com

Portfolio Management

Martin Kujal	Chief Investment Officer; bonds	+420 221 710 698	kujal@jtfg.com
Marek Janecka	Portfolio manager - equity	+420 221 710 699	janecka@jtfg.com
Michal Semotan	Portfolio manager - equity	+420 221 710 642	semotan@jtbank.cz
Marek Sevcik	Portfolio manager - bonds, equity	+420 221 710 429	msevcik@jtbank.cz

Research

Milan Vanicek	Chief Analyst; strategy, pharma, telecom		vanicek@jtbank.cz
Milan Lavicka	Banking, financials, utilities		lavicka@jtbank.cz
Pavel Ryska	Media, real estate		ryska@jtbank.cz
Petr Sklenar	Macroeconomics, fixed income		sklenar@jtbank.cz

J&T Banka, a.s.

J&T Banka, a. s.
Sokolovska 700/113a, 186 00 Prague 8
T.: +420 221 710 111
Czech Republic
www.jtbank.cz

J&T Banka, a. s., pobocka zahranicnej banky
Dvorakovo nabrezie 8
811 02 Bratislava
T.: +421 259 418 111
Slovakia
www.jt-bank.sk

J&T BANKA

Overview of recommendations and relationships with issuers

	CEZ	Colt CZ Group	Erste	Kofola	KB	Moneta Money Bank	Philip Morris CR	VIG
Recommendation	Buy	Buy	Buy	Pending	Buy	Buy	Hold	Hold
Target price	CZK 1,303	CZK 865	EUR 52	Pending	CZK 863	CZK 104	Pending	EUR 24.5
Market price on recommendation issuance day	CZK 1,050	CZK 618	EUR 45	CZK 204	CZK 670	CZK 77	-	EUR 18.1
Date	2-III-2023	30-III-2022	10-II-2022	20-III-2020	6-XII-2022	5-I-2023	21-IX-2017	12-V-2017
Analyst	Milan Lávička	Pavel Ryska	Milan Lavicka	Pavel Ryska	Milan Lávička	Milan Lávička	Milan Vaníček	Milan Lávička
Overview of recommendations for selected stocks in the previous 12 months (quarterly basis).								
Recommendation	Buy	.	Pending	Buy	Buy	Buy	Hold	.
Target price	CZK 162	.	Pending	CZK 435	CZK 1 0	CZK 109	CZK 12705	.
Date	2-III-2023	.	18-II-2021	17-VII-2019	23-II-2022	8-XII-2022	24-VIII-2016	.
Recommendation	Buy	.	Buy	Hold	Hold	Buy	.	.
Target price	CZK 104	.	EUR 40,	CZK 426	CZK 991	CZK 105	.	.
Date	10-V-2021	.	31-VIII-2018	9-I-2016	16-XI-2021	31-V-2022	.	.
Recommendation	Buy	.	Hold	.	Buy	Hold	.	.
Target price	CZK 721	.	EUR 34	.	CZK 836	CZK 105	.	.
Date	14-IV-2021	.	21-VIII-2017	.	25-XI-2020	21-XII-2021	.	.
Recommendation	.	.	.	.	.	Buy	.	.
Target price	.	.	.	.	.	CZK 104	.	.
Date	.	.	.	.	.	13-XI-2017	.	.
Valuation method	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
J&T Banka has a direct or indirect share of over 0.5% in the issuer's share capital.	No	No	No	No	No	Yes	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
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
Other material financial interests of the author in relation to the issuer.	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	yes	no	no
Contractual relationship between J&T Banka and the respective issuer concerning the provision of investment servicers.	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
J&T Banka's market making in the stock of the respective issuer.	Yes	Yes	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

Disclaimer

J & T BANKA, a. s. (hereinafter only "the Bank") is a licensed bank and a member of the Prague Stock Exchange, authorised to provide investment services as outlined in Act No. 256/2004 Sb. on Capital Market Undetakings, as amended. The Bank prepares, creates and disseminates investment recommendations in accordance with legal regulations of the Czech Republic, directly applicable EU regulations and its internal regulations. The activities of the Bank are subject to the oversight of the Czech National Bank, Na Příkopě 28, Prague 1, Postcode: 115 03 – http://www.cnb.cz/.

This document contains some important information and notice related to the creation and dissemination of investment recommendations.

The Bank issues investment recommendations created by the employees of the Bank (hereinafter also "Analysts"). Analysts who create investment recommendations bear full responsibility for the objectivity of such recommendations.

Levels of investment recommendations used

The Bank uses the following levels of investment recommendations:

- **BUY** – It is anticipated that the percentage difference between the one-year target price of the share (determined by one of the valuation methods stated below) and the current market price exceeds the minimum theoretical required return for the respective share. This required return is calculated as the sum of earnings from a risk-free asset (Czech government bonds with the longest term to maturity) and the product of the beta coefficient and a risk premium (determined individually for each company and derived from the risk premium for the Czech market).
- **HOLD** – It is anticipated that the percentage difference between the one-year target price of the share (determined by one of the valuation methods stated below) and the current market price is less than the minimum theoretical required return for the respective share but, at the same time, exceeds the return on a risk-free asset.
- **SELL** – It is anticipated that the percentage difference between the one-year target price of the share (determined by one of the valuation methods stated below) and the current market price is less than the return on a risk-free asset.

Valuation methods

To valuate companies and investment projects, the Bank uses first of all a method of discounted cash flow (FCFE or DDM). A method of relative comparison is an integral part of every valuation, but it serves more as a corroborative test for the discounting method due to the following reasons: (i) differences in accounting standards, (ii) differences in the sizes of companies, (iii) information availability, (iv) impacts of acquisitions and subsidiaries on balance sheet structures, (v) differences in dividend strategies, and (vi) differences in expectations of future profit margins. If the fundamental valuation is in principle consistent with the range of values determined on the basis of the relative comparison, this implies that the projections of cash flows and other key assumptions of the discount model are correct (especially the discount factor, growth rate for the so-called "infinite period," capital structure, etc). In the reverse case, it is necessary to identify factors which cause principal differences between the findings of the two valuation methods.

Measures preventing conflicts of interest in association with investment instruments:

The remuneration of persons who participate in producing investment recommendations depends in particular on the quality of the work performed, the results achieved and the company's overall profit. Those who participate in producing the investment recommendations have neither financial nor other motivations to issue investment recommendations of a particular level or direction. The remuneration of persons who participate in producing investment recommendation is not derived from transactions of the Bank or of a controlling or controlled legal entity or a legal entity forming a holding (hereinafter only "a related party").

In complying with the rules for prudently providing investment services and for organizing internal operations, the Bank applies procedures and rules set forth by legal regulations and its internal regulations that prevent conflicts of interest in association with investment instruments contained in the investment recommendations disseminated by the Bank, in particular by implementing a relevant internal structure including information barriers among specific divisions and regular internal control.

Simultaneously, the Bank draws attention to the fact that this document may contain information related to investment instruments or issuers of investment instruments that the investment recommendation directly or directly concerns (hereinafter only "the Issuer" with respect to which some of the entities belonging to the regulated consolidation group of the Bank may have own interest. This interest may consist in a direct or an indirect share in these entities, the performance of operations in investment instruments related to these entities or the performance of operations in investment instruments stated in this document.

Additional notice

The Bank and related parties, and persons that have a legal or actual relationship with them, including members of governing bodies, senior employees or other employees, may trade in investment instruments or make other investments or transactions related to them, and may during a decisive period buy or sell, or offer to buy or sell on regulated markets or elsewhere, whether as a broker, an intermediary, or in another legal role.

Brokers and other employees of the Bank and/or related parties may offer their clients and their own trading division oral or written market commentaries or trading strategies reflecting opinions that are at variance with the opinions expressed in investment recommendations.

In making investment decision, investors, including potential customers of the Bank (hereinafter also the "Customer/Customers"), should regard investment recommendations only as one of several factors to be considered. Investment analyses and recommendations issued and disseminated by the Bank and/or related parties have been prepared in accordance with the rules of conduct and internal regulations for managing conflicts of interest associated with investment recommendations.

An overview of changes in the level for an investment instrument in regard to which the Bank has issued an investment recommendation and its price targets during the past 12 months are published and accessible at https://www.jtbank.cz/informacni-povinnost/#povinne_uverejnovane_informace.

Issuers were not acquainted with the recommendations prior to their issuance and therefore the recommendations were not modified or adjusted in any way at the issuers' request.

It is always the Customer's responsibility to make the final investment decisions and the Customer bears full responsibility for them.

Although investment recommendations of the Bank are prepared by Analysts in good faith, in a professional and a fair manner and with due care, the Bank cannot accept responsibility and cannot guarantee that the information contained therein is complete or accurate, except for the information concerning the Bank.

The investment recommendations express the opinions of Analysts as at the date of their publication and may be changed without prior notice. Past performance of investment instruments does not guarantee future performance. This document is not a public offering for the purchase or subscription of investment instruments within Act No. 256/2004 Sb. on Capital Market Undertakings, as amended, and nor does it constitute an offer to purchase or sell any investment instruments. The individual investment instruments or strategies stated in the investment recommendations do not have to be suitable for every Customer. The opinions and recommendations stated therein do not take into account the situation of individual Customers, their financial positions, objectives or needs. The investment recommendations should serve those Customers who are anticipated to make their own investment decisions without depending unreasonably on the information stated in the investment recommendations. These Customers are obliged to make their own decisions as to the expediency of investments made in any investment instruments by appropriately considering the price, possible threats and risks, along with their own investment strategies and financial situation. The value or price of any investment may change in time and the return on the originally invested sum or the amount of potential profit is not guaranteed.

Please note a potential conflict of interest:

Additional rules for disclosing interests or conflicts of interest pursuant to EU Regulation No. 2016/958:

- J&T Banka is a market maker or a person otherwise ensuring liquidity in relation to investment instruments of Primoco UAV SE.
- The analyst who prepared this report holds Primoco UAV SE's shares, which were bought on 12 March 2021 at CZK 256/share.