APPROVED
at the Shareholders' Meeting of
SIA "Valsts aizsardzības korporācija" / State Defence Corporation Ltd.
on 26 August 2024
(Minutes No. PROT-50, Decision No. 3)

Limited Liability Company "State Defence Corporation"
Letter of Expectations from the State Capital Shareholder

By this letter, the Ministry of Defence, as the holder of the State's capital shares in the limited liability company "State Defence Corporation", sets out its expectations regarding the areas of activity, priorities and targets to be achieved by the private limited company "State Defence Corporation" (hereinafter – the Corporation) for the medium-term operational strategy period from 2024 to 2028.

The Company's overall strategic objective	On 16 July 2024, the Cabinet of Ministers adopted Order No. 601, "Amendments to the Order of the Cabinet of Ministers No. 799 of 23 November 2023 "On the Establishment of the Limited Liability Company "State Defence Corporation""" (hereinafter – the Order), by which the Corporation's overall strategic objective was supplemented as follows: **"The overall strategic objective of the company is to manage investments in the national defence industry and to coordinate processes related to the development of military goods manufacturing, ensuring the establishment of production facilities and manufacturing, as well as promoting the development of the national defence industry and the continuity of its supply chains."** The Corporation's activities are closely linked to the National Defence Concept approved by the Saeima (the Parliament) on 5 October 2023 and to the tasks assigned therein to the defence industry in the field of national defence. The Corporation will become an integral part of the National Armed Forces (hereinafter – the NAF) supply system in both peacetime and wartime, and in its operations, it must plan for continuity of activity under wartime conditions. In view of the overall geopolitical situation, the Corporation is being established to strengthen the security of supply for the NAF in respect of supply classes critical to wartime sustainment and logistics, in the production and maintenance of ammunition and its components, critical armaments, and other military equipment. In making investments in commercial activities, the Corporation shall engage solely in the production of military and dual-use goods and the provision of related services. The Corporation's strategic objective is also to promote the development of the military industry ecosystem, which is to be achieved through the establishment of joint ventures with Latvian commercial undertakings that have developed military or dual-use products meeting the needs of the NAF but lack sufficient resources for their mass production, as well as through the integration of components manufactured by various Latvia's undertakings into a single product and their production.

	Where a need has been identified by the NAF, the Corporation must be capable, by engaging researchers and commercial undertakings in accordance with their fields of specialisation, of developing applied research projects for specific products in order to provide solutions required by the NAF that are not available on the market, and to facilitate the development of such products in line with security of supply requirements. The commencement and development of operations, as well as the securing of orders, shall primarily be directed towards areas that are critically necessary for the needs of the NAF. Commercial activity in external markets and for external orders is permissible and desirable, but only after the primary needs of the NAF have been met. For the implementation of these objectives, the Corporation shall carry out analyses, develop business plans, and establish joint ventures with foreign and Latvia's undertakings to produce specific goods or the provision of services. The Corporation shall be responsible for ensuring the economic justification of such projects and safeguarding the strategic interests of the State in the newly established undertakings, as well as for achieving the Corporation's strategic objectives in accordance with the financial and non-financial targets set out in this Letter of Expectations. The Corporation is to be developed as a holding-type company that ensures production, the establishment of production facilities, and the achievement of its objectives through the establishment of joint ventures or the acquisition of equity stakes in existing undertakings. The Corporation shall not expand into areas where existing market participants already provide, or are capable of providing, for the needs of the NAF. Where shortcomings or deficiencies are identified in the ability of existing market participants to adequately meet the needs of the NAF, the Corporation, subject to an economic justification and an assessment of market failures, may consider establishing a joint venture or acquiring equity stakes in an existing market participant with the aim of strengthening the relevant production activity and aligning it with the needs of the NAF. Given that the Corporation's activities will involve restricted-access or classified information, it must ensure an appropriate operating regime, including security clearances for personnel, as well as premises and operational security in accordance with the regulatory framework governing classified information, including the rules and guidelines of the Ministry of Defence, and certification of the Corporation in accordance with the National Security Law, the Law on the Circulation of Strategic Goods, the Weapons Circulation Law, and the procedures laid down by the Cabinet of Ministers for the issuance or refusal of licences for strategic goods and other documents related to the circulation of such goods.

Supervisory Board of the Company	At present, the establishment of a Supervisory Board for the Corporation is not envisaged. The Management Board is planned to consist of a single member.
The Company's principal activities	**The Corporation's principal activities:** 1. To analyse existing gaps in the supply of the NAF and in NATO member states' markets, and to propose solutions to strengthen security of supply and ensure NAF provisioning, primarily with supply classes critical in wartime. For these purposes, to prepare business plans and identify the most effective solutions. 2. To establish and further manage joint ventures with foreign and Latvian commercial undertakings to strengthen security of supply and promote the development and independence of Latvia's military industry. 3. To establish and further manage companies that integrate components and raw materials produced in Latvia into the manufacturing of military goods. 4. To develop capabilities and implement research and development projects to meet the needs of the NAF. 5. To develop capabilities and implement classified projects.
Classification of the Company (commercial, state-dependent with commercial activity, or non-commercial)	The Corporation is classified as a state-dependent commercial company. Although, for the commencement of operations and initial investment activities, the Corporation will attract funding from the Ministry of Defence through increases in share capital, its activities must be conducted in such a way that subsequent investments in the development of specific products are economically justified and generate profit, ensuring sufficient reinvestment capacity and the ability to attract external financing in order to achieve its objectives on a self-sustaining basis. In the long term, the Corporation is not intended to remain dependent on the Ministry of Defence, unless this is required for the implementation of a strategically significant project for the Ministry. In accordance with the Corporation's overall strategic objective, its primary client shall be the Ministry of Defence and the NAF. At the same time, potential orders shall be based on market research and cost comparisons within the market, thereby developing production in Latvia with elements of supply chain security. The supply security component in future projects shall be assessed separately in each case, and its impact shall largely depend on the critical consumption of the product and its necessity for ensuring the NAF's wartime operational requirements.
The Company's stage of development or maturity (newly established, in development phase, maturity phase, or decline phase with	The Corporation is a newly established company, with many of its areas of activity to be implemented for the first time in Latvia. It is envisaged that, within the period covered by this Letter of Expectations, the Corporation will transition into a development phase, making its first investments, recruiting staff, and commencing production.

restructuring or liquidation)	
Expected development of the Company – financial objectives, major investment projects, and activity in domestic and international markets	The shareholder sets the following key performance indicators for the period covered by this Letter of Expectations: 1. The Corporation shall participate in a joint project with foreign ammunition manufacturers for the establishment of a plant for the assembly of artillery ammunition components in Latvia no later than 2027. To achieve this objective, a joint venture may be established, with a controlling 51% stake for the Corporation being preferable. 2. To assess and prepare a business plan for the establishment of a production facility for other ammunition components and, if there is sufficient economic justification, to initiate activities related to the construction of such a plant. 3. To conduct an analysis of the production possibilities for other critical ammunition and supply categories in Latvia, ensuring security of supply. 4. To establish at least one collaboration with Latvian commercial undertakings for the joint development and production of a developed product. 5. To initiate at least one research and development project, involving Latvian researchers and commercial undertakings. 6. Based on these objectives, to develop the Corporation's medium-term operational strategy for the period 2025–2028.
Financial expectations of the shareholder (profit-oriented or budget-constrained operations, return on capital, dividend level, use of new financial instruments (e.g. shares, bonds) for financing investment projects, capital structure)	The results of the Corporation's operations are to be planned with a view to promoting long-term value growth of the capital company, while simultaneously ensuring the fulfilment of its strategic objectives. **Dividend policy** Given the Corporation's development phase and the intensive investment period associated with the establishment of an artillery ammunition component assembly plant in Latvia, as well as potential investments in new joint ventures or acquisitions of equity stakes in existing companies, and the fact that the Corporation is expected to receive capital increases to finance these investments, no dividend payments are envisaged during the period covered by this Letter of Expectations. **Capital structure** Given the Corporation's development phase and intensive investment period, the achievement of an optimal capital structure is not envisaged within the scope of this Letter of Expectations. This is explained by the dependence on share capital increases and insufficient conditions (e.g. the absence of full production capacity) for the Corporation to be able to attract debt financing on favourable terms without significantly increasing financial risk. **Financing instruments** Financing of investment projects shall be carried out from the state budget, European Union financial instruments, the company's own

	generated profit, and borrowed capital, with the most appropriate financing method being assessed in each specific case, including consideration of financial and security risks, end-user interests, and compliance with the principles of responsible fiscal policy. In addition, in accordance with point 5 of the Order of the Cabinet of Ministers No. 618 of 15 September 2022 “On the Necessary Changes to the Policy on Management of Capital Companies of Public Persons and Shares of Public Persons in Capital Companies”, the company must ensure that: - prior to consideration by the Cabinet of Ministers of financing matters for investment projects of a state-owned capital company that meet the threshold specified in Section 26(6) of the Law on Governance of Capital Shares and Capital Companies of a Public Person – 15% of the company’s total assets – and that are not included in the medium-term operational strategy, an assessment of alternative financial instruments and their economic analysis is prepared, including the potential issuance of bonds; - when preparing matters for consideration regarding the attraction of financing for innovative solution projects, the potential for establishing subsidiaries shall be assessed, including the attraction of private capital.
Strategic non-financial objectives	In relation to the Corporation’s future development direction, it is essential to ensure sustainable and efficient security of supply and the further development of the defence industry ecosystem in the interests of national security. During the period covered by this Letter of Expectations, the following non-financial objectives are set for the Corporation: 1. To establish the company and its governance system in accordance with good corporate governance principles. 2. To implement effective supply chain security requirements by developing cooperation with Latvian and foreign undertakings. 3. To introduce internal control systems for the protection and efficient use of the State’s investment, in particular to ensure the prevention of corruption, conflicts of interest, and risks of political influence in the Corporation’s operations. 4. To ensure the implementation of all necessary security requirements both within the Corporation itself and in its subsidiaries. 5. By 2027, to ensure the establishment of at least one production facility. 6. To conduct analysis and assess the economic justification for the production of several critical components and material-technical resources, and by 2027 to commence implementation of at least one project. 7. To participate in joint projects with domestic defence industry companies, with a view to launching at least one joint project for the production of a product meeting the needs of the National Armed Forces by 2027.

	8. By 2027, to initiate at least one joint research and development project involving Latvian researchers and companies.
Other horizontally applicable policy objectives from sectoral policy documents for the capital company (environmental, sustainability, corporate governance, social responsibility, research and development, etc.)	**Sustainability and innovation** In accordance with point 8 of the minutes of the Cabinet of Ministers meeting of 16 November 2021, No. 75, §39 "Informative Report 'On Promoting Innovation and Setting Research and Development Targets in State-Owned Enterprises'", it must be ensured that the company's strategy includes appropriate research and development or innovative solution implementation objectives related to the management of state real estate assets (including provision for investment volumes and performance indicators). In addition, account must be taken of the National Defence Concept and the needs of the NAF. This process shall be implemented in cooperation with the Ministry of Defence and the Defence and Technology Centre of the National Defence Academy. **Corporate governance and social responsibility** In its operations, the Corporation must comply with the principles of good corporate governance set out in the guidelines of the Organisation for Economic Co-operation and Development (OECD). Compliance with the Corporate Governance Code, the Law on Governance of Capital Shares of a Public Person and Capital Companies, and other applicable regulatory enactments must be ensured. To improve overall efficiency and enhance processes, the Corporation must implement and embed a "LEAN" (lean management) culture within the organisation. Furthermore, a responsible employer policy must be implemented, including ensuring compliance with all safety requirements related to information security, infrastructure security, and product safety. **Information disclosure** During the medium-term operational strategy period, the Corporation must ensure the disclosure of information as required under the Law on Governance of Capital Shares of a Public Person and Capital Companies on the websites of the Ministry of Defence and the Corporation, in accordance with the procedures specified in the aforementioned law.

Representative of the shareholder of
"State Defence Corporation" Ltd. –
State Secretary of the Ministry of Defence Aivars Puriņš