



HUNGARIAN WATCH

Autumn 2014



Hungarian Watch Autumn 2014

Editor: Endre Várady

Publisher: János Tamás Varga, VJT & Partners Law Firm

1126 Budapest

Kernstok Károly tér 8.

Hungary

T: +36 1 501 9900

F: +36 1 501 9901

E: office@vjt-partners.com

Hungarian Watch is a quarter yearly issued brochure. It contains comprehensive, up-to-date information about Hungary, focusing on breaking news in the fields of law, economics, business and other situations which could have a major impact on the course of Hungarian events.

Hungarian Watch is primarily prepared for those who are thinking about Hungary from an investment point of view. The investment perspective runs through this newsletter by leading the reader through the actual Hungarian business climate including current business and investment opportunities.

We hope that Hungarian Watch will keep you regularly informed on relevant Hungarian news, enabling you to know how and when to seize a business opportunity before it vanishes.

Hungarian Watch has been prepared for the use of clients, partners and staff of VJT & Partners.

Copyright © 2014 VJT & Partners

All rights reserved. No part of this brochure shall be reproduced or transmitted by any means - electronic, mechanical, photocopying, recording, or otherwise - without written permission from the publisher, except for the inclusion of brief quotations in a review.

Every effort has been made to make this brochure as complete and as accurate as possible, but no warranty of fitness is implied. The information is provided on an as-is basis. The authors and the publisher shall have neither liability nor responsibility to any person or entity with respect to any loss or damages arising from the information contained in this brochure.

Table of Contents

Summary	4
Major railway construction deals in Hungary	6
Construction of South Stream Hungary may start soon	9
Who will the lucky buyer be?	11
A new Chinese market breakthrough	13
MOL moving toward more acquisitions?	14
Tesco is about to check out from its Hungarian operations	16
Only the best will survive in Hungary	18
Hungarian automotive industry is still out in front	20
About VJT & Partners	22
The Firm	22
Practice Areas	23
How We Work	24
Our Values	24

Summary



Major railway construction deals in Hungary

Hungary plans to spend billions of EUR on developing railway infrastructure

Railway construction is a top priority in Hungary. The government intends to spend on railway infrastructural developments at least EUR 3 billion from 2014-2020 EU financial framework. In addition, the government also plans to participate in several EUR billion worth railway deals backed by Chinese loans. Switelsky, Közgép, Alstom, Bombardier, Stadler, Skoda, Pesa, and T-Systems may be involved in major projects. The future is extremely challenging, so investors should keep an eye on forthcoming tender developments.

Read more...



Construction of South Stream Hungary may start soon

Huge deal

South Stream is the major global energy project which would secure the Russian natural gas supply to Western Europe. The EC opposes the project because of antitrust concerns, but member states are resolved to implement the deal. Hungary wants to start the construction of its section in the next six months. As selection of companies involved in the construction of the Hungarian portion of the pipeline may take place in the very next months, this is the last chance for investors to step in. **Read more...**



Who will the lucky buyer be?

Citigroup sells its Hungarian consumer businesses

Due to global strategic considerations Citigroup has just announced that it will sell its very attractive Hungarian consumer business. Citibank Hungary is one of the leading players in private banking and credit/debit card business. Most of the large universal banks operating in Hungary are very interested in such businesses. Therefore, some of the main competitors, such as KBC, Raiffeisen, Erste, Unicredit, GE Capital, Intesa Sanpaolo, Sberbank and AXA could become the potential buyers. Press suggests that Citigroup has just started to look around for interested buyers, so it seems that this is the perfect time to seize this exceptional investment opportunity. **Read more...**



A new Chinese market breakthrough

RZBC to establish a citric acid plant in Hungary

After the press had reported several golden Chinese investment opportunities, another Chinese player, RZBC announced to build its citric acid plant in Hungary. The new Hungarian factory would produce 100,000 tons of citric acid annually covering 5% of the global market. The investment volume is expected to be close to EUR 100 million. The project is in the relatively early stage, so it is still not too late to catch up with this investment opportunity. **Read more...**

MOL moving toward more acquisitions?

EUR 5 billion-worth DEA, the next potential target

After concluding major transactions with U.K operators, Wintershall and Premier Oil, the Hungarian MOL is likely to continue its expansion in the field of global exploration & production. We may shortly hear MOL announcing a new acquisition.

*The newest target may be DEA, a prominent player in the field of exploration & production. If the planned deal to sell DEA to the Russian Mikhail Fridman led group of investors falls apart, MOL will most likely reopen talks about purchasing DEA. It remains to be seen how the story will end, but it is evident that MOL has a strong appetite to expand further by purchases of equities of Western exploration & production companies. **Read more...***



Tesco is about to check out from its Hungarian operations

*Tesco as one of the world's leading grocery and general merchandise retailers might consider leaving the CEE region, including Hungary in order to strengthen its UK position. This would be a major opportunity for Hungarian competitors such as Aldi, Lidl, Spar, Penny, CBA, Auchan and Metro. As analysts give close to fifty-fifty chance for this strategic decision, investors shall carefully follow the upcoming developments of Tesco. **Read more...***



Only the best will survive in Hungary

Banking industry still in turmoil

*The Hungarian banking industry is still in turmoil. Conversion of foreign exchange loans and the introduction of the bad bank will have a significant impact on the sector. There may only be room for five major banks in Hungary, noted Márton Nagy, the managing director of Central Bank of Hungary. On the other hand, the government is still resolved to purchase a new bank. Overall, it is worthwhile for investors to keep a close eye on the upcoming developments in banking. **Read more...***



Hungarian automotive industry is still out in front

New major investments expected

*The automotive industry remains as one of the great success stories of the country. The press regularly reports about production expansions, improvement of supplier networks and new greenfield investments. Audi, Patec, BorgWarner, Robert Bosch and Alumental will soon make new investments. The automotive industry definitely deserves great attention. **Read more...***



Major railway construction deals in Hungary

Hungary plans to spend billions of EUR on developing railway infrastructure

Railway construction is a top priority in Hungary. The government intends to spend on railway infrastructural developments at least EUR 3 billion from 2014-2020 EU financial framework. In addition, the government also plans to participate in several EUR billion worth railway deals backed by Chinese loans. Switelsky, Közgép, Alstom, Bombardier, Stadler, Skoda, Pesa, and T-Systems may be involved in major projects. The future is extremely challenging, so investors should keep an eye on forthcoming tender developments.



The Hungarian railway network has a total length of 8,000 kilometres, which is a huge number compared to the size of the country. This network is the second highest railway density in Europe. On the other hand, the quality of Hungarian railway is one of the lowest in Europe. Taking all of this into account, it is not surprising that railway construction is a top priority in Hungary. Hungary wants to spend billions of EUR on developing its railway infrastructure. The potential for investments is enormous. But who may be the potential key players in these projects and what kind of projects we can expect in the future?

The potential players

The Hungarian railway construction market is dominated by key players operating in various niche segments:

- The Austrian Swietelsky and the Hungarian Közgép are usually involved as the main contractors in railway construction.
- The Austrian Strabag is a big construction company primarily excelling in the building and the public road construction sectors, but also involved in railway construction projects.
- The French Alstom, the Canadian Bombardier and the German Siemens are mainly active in vehicle manufacturing and also in train control and other ancillary systems' production and installation.
- The Swiss Stadler, the Czech Skoda, and the Polish Pesa are another players of the railway vehicle market.
- The German T-System is active in establishing telecommunication systems for railway operators.

Many upcoming railway projects cover these niche segments, so several key players may be involved.

Potential players:
Switelsky, Közgép,
Strabag, Alstom,
Bombardier, Siemens, Stadler, Skoda,
Pesa and T-System

EU funded projects

Hungary will have the possibility to burn through EUR 3 billion from the EU 2014-2020 financial framework. The key segments of EU funded projects in particular include: Trans-European Transportation Network (TEN-T) development projects, suburban railway construction and also building specific telecommunication systems for railway operators.

TENT development projects - Hungary's 8000 km long railway network includes several international main lines that constitute parts of the TENT. In these cases reconstruction of the rail lines and the installation of European Train Control System level 2 (ETCS2) are the most important elements of the projects in order to make tracks capable of higher speed traffic. In order for it to enable higher speed capacity, the government plans to install ETCS2 on 513 km of the network and also to install 59 modern FLIRT trains with board unit of ETCS2.

As ETCS2 requires niche market knowledge, apart from railway construction players, companies providing electrical systems are also involved in this process. Among others, the TENT development projects will include the reconstruction of the Budapest-Vienna rail line.

Suburban railway line projects - The Hungarian railway network is Budapest-centred and the suburban railways of Budapest have enormous passenger traffic. The suburban traffic is more than a 30% share of the total railway passengers in Hungary. Therefore, this sector is especially important for the government. In this regard some of the projects enjoy high priority such as the construction of Budapest-Esztergom (building double tracks and electrification), reconstruction of the south railway bridge of Budapest, and the construction of a new railway station in Vác. A specific element of suburban railway line projects will also present the construction of 27 Park and Ride (P+R) stations in Budapest by 2020.

Building railway specific telecommunication system - Another important project is the development of GSM-R system (special telecommunication system developed for railway operators) which serves better connection of Hungarian State Railways' fleet's board communication and helps to operate locomotives and trains more cost effectively.

Chinese railway projects

Hungary will be also be involved in two big-ticket projects backed by Chinese loans. Both projects are of strategic importance to China, as under its silk road concept, they want to ensure swift transit of Chinese goods from the Greek Port of Pireus to Western Europe. Thus, both projects will help Hungary to become the central transit country of Eastern goods heading to Western Europe.

Reconstruction of the Budapest-Belgrade railway line - This project is of pivotal importance as the Budapest-Belgrade railway line constitutes the primary transit corridor to Western Europe and also part of TENT. The electrified, but outdated and one-track railway line has to be converted into a modern two-track system equipped with ETC2. The project will require EUR 3 billion in Chinese loans. The latest news is that the Chinese, Hungarian and Serbian governments will sign the agreement in December in Belgrade. This means that the implementation of this outstanding project may start in 2015.

VO railway construction - The aim of VO is to bypass the Budapest hub which also fits well within the silk road concept. The new railway is designed to be 113 kilometers long electrified double track equipped with ETCS2 and capable of operating with 160 km/h which would reduce the transit-time of goods through Hungary from the current 4-5 days to 1 day. This project will require at least EUR 1 billion in loans from the China Development Bank.

Given the high complexity (e.g. installation of ETCS2 and construction of railway bridges) both Chinese projects will involve players not just from the railway construction market but from other construction

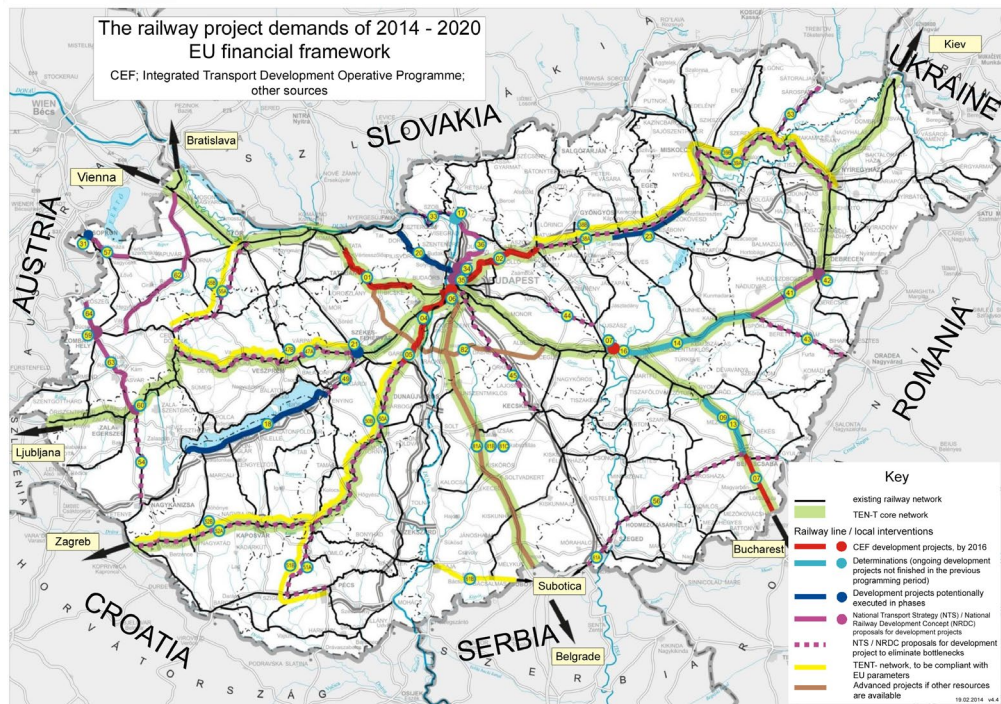
Hungary to burn through EUR 3 billion from EU funds

EUR 3 billion-worth Chinese project may start in 2015

VO another EUR billion-worth Chinese project

sectors and players specializing in railway electricity system building.

Overall, Hungary expects a significant boom in the Hungarian railway construction industry. The future is extremely challenging. Implementation of several major deals may start as early as 2015.



Map of potential railway projects
(Source: RAILHUC)

Construction of South Stream Hungary may start soon

Huge deal

South Stream is the major global energy project which would secure the Russian natural gas supply to Western Europe. The EC opposes the project because of antitrust concerns, but member states are resolved to implement the deal. Hungary wants to start the construction of its section in the next six months. As selection of companies involved in the construction of the Hungarian portion of the pipeline may take place in the very next months, this is the last chance for investors to step in.

The global significance of South Stream



South Stream is a major step in pursuing the Russian Gazprom strategy to diversify its natural gas supply routes. The total length would be approximately 2400-2600 kilometers in length with a design capacity of 63 billion cubic meters. Europe's future gas supply would remain unaffected by potential Russian-Ukraine conflicts as the gas pipeline would completely bypass Ukraine. The offshore section would run under the Black Sea through the exclusive economic zones of Russia, Bulgaria and Turkey. The onshore section would cross Bulgaria, Serbia, Slovenia and Hungary and supply Western Europe via Austria and Italy.

Although it is primarily a "Russian project", Western players are also involved. According to the agreement, the shareholder structure in the South Stream offshore section is as follows: Gazprom owns 50%, the German Wintershall Holding (subsidiary of BASF) and French EDF each 15% and the Italian ENI 20%.

South Stream Hungary a truly big-ticket deal

South Stream Hungary is a joint project of Gazprom and the Hungarian energy giant, MVM. The final Hungarian gas route has not yet been decided. Still the official communication of Gazprom suggests that two parallel gas routes would cross Hungary one of them will go to Slovenia and the other one to Austria. The two gas routes together will be approximately 600 kilometers in length. According to market estimates, the total cost of construction would cost approximately in a range of EUR 1.5 to 2 billion..

Hungary shall soon select the contractor to carry out design and survey activities, spatial planning and environmental impact assessment for the Hungarian section of South Stream towards Baumgarten in Austria. In this context, the head of the Parliament's economic committee, Antal Rogán also announced that it would be important to allow a wide circle of companies to compete for the construction of the Hungarian section.

May the construction start at all?

The project needs to overcome several serious obstacles. The EU has a serious concern regarding its

Key players:
Gazprom, Wintershall Holding, EDF and ENI

EUR 1.5 to 2 billion worth project

High competition for the construction of South Stream Hungary

energy dependence on Russia. Gazprom dominates in this project as it controls 50% of the entire South Stream. This violates the Third Energy Package, stating that the pipelines in EU cannot belong to gas producers, as to prevent the distortion of competition. Gazprom is not allowed to simultaneously own production capacity and transmission network. Therefore, the EU called its member states to suspend implementation of the project until all the legal issues will be resolved.

However, Hungary wants to start its section, despite the opposition from the European Commission (EC) under an amended bill. The bill proposal states that only the approval of the Hungarian Energy Office is needed for pipeline construction. As international coordination bodies would not have jurisdiction, South Stream Hungary would practically bypass the EC. Other involved member states are also resolved to implement the deal. Austria for example has recently concluded the South Stream gas pipeline agreement, despite the objections of the EC.

When shall investors step in South Stream Hungary?

We shall see whether the South Stream will pass the EC test, but it is worth noting that Germany managed to implement the North Stream, a very similar Russian dominant energy project.

Despite the difficulties with the EC, the president of the Hungarian MVM is positive that the construction in Hungary may start within six months. This means that the selection of players in Hungary may happen in the next few months. Thus, this is the perfect time for investors to join this exceptional project.

Construction in Hungary may start within six months



Hungarian section of South Stream
(Source: Gazprom)

Who will the lucky buyer be?

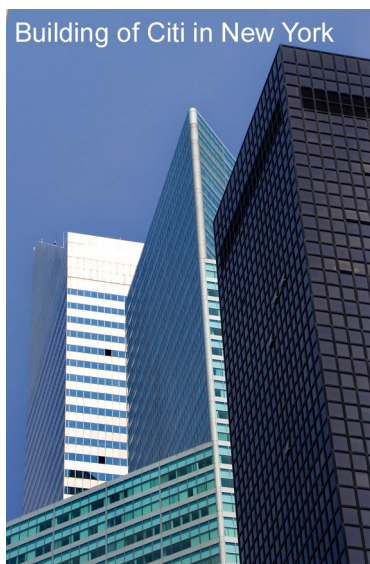
Citigroup sells its Hungarian consumer businesses

Due to global strategic considerations Citigroup has just announced that it will sell its very attractive Hungarian consumer business.

Citibank Hungary is one of the leading players in private banking and credit/debit card business. Most of the large universal banks operating in Hungary are very interested in such businesses. Therefore, some of the main competitors, such as KBC, Raiffeisen, Erste, Unicredit, GE Capital, Intesa Sanpaolo, Sberbank and AXA could become the potential buyers. Press suggests that Citigroup has just started to look around for interested buyers, so it seems that this is the perfect time to seize this exceptional investment opportunity.

Citigroup exits from 11 markets

Citigroup has recently announced „strategic actions to accelerate the transformation of Global Consumer Banking ..by focusing on those markets where it has the greatest scale and growth potential.” As a result Citigroup intends to exit its consumer businesses in 11 countries. The affected businesses in Europe include only Hungary and Czech Republic.



Strategic actions are currently expected to be completed by end of 2015.

Highly attractive banking asset

Citigroup's announcement received great attention in the Hungarian financial market. The consumer business, including private and premium banking services of Citigroup Hungary offered for sale is a truly exceptional banking asset. The sale of such a valuable asset is unprecedented in the Hungarian financial market.

Exceptional banking asset

Citibank Hungary is not among the biggest banks (its total 2013 assets were approximately EUR 3 billion), but it is one of

few profitable players in the Hungarian financial market.

Whilst many of the competitors realised significant losses on the CHF denominated loans and the interventions of the government in this area, Citibank Hungary has a much smaller exposure to this sector and has thereby managed to stay profitable even in this otherwise very challenging market environment.

In the consumer businesses Citibank Hungary excels in the credit/debit card sector and the private banking sector. It is one of the largest players in the private banking sector having managed approximately EUR 650 million worth assets.

EUR 650 million worth assets

Private banking services have already proven to be good investment targets in Hungary. In 2012 the private and premium banking service of BNP Paribas was acquired by Erste and as a result Erste has become one of top 5 private banking players in Hungary. Sale of the private banking sector of Citibank

Hungary may bring a similarly lucrative outcome.

Who are the potential buyers?

KBC, Raiffeisen, Erste, Unicredit, GE Capital, Intesa Sanpaolo, Sberbank and AXA could become the potential buyers

The potential investors should be aware that the Hungarian unit of Citibank is engaged in extending consumer loans and also interested in providing services to premium and private banking clients. Most of the large universal banks operating in Hungary are very interested in such businesses. Therefore, some of the main competitors such as KBC, Raiffeisen, Erste, Unicredit, GE Capital, Intesa Sanpaolo, Sberbank and AXA could become the potential buyers.

Press suggests that Citigroup has just now started to look around for interested buyers in Hungary.

Who will be the winner?

Perfect timing

This is a golden opportunity for investors wanting to enter or expand into the Hungarian financial market, especially given this highly attractive banking asset and perfect timing. It seems highly unlikely that there will be any similarly compelling offers in the near future.

Although exceptional times are ahead, opportunity only knocks once.

A new Chinese market breakthrough

RZBC to establish a citric acid plant in Hungary

After the press had reported several golden Chinese investment opportunities, another Chinese player, RZBC announced to build its citric acid plant in Hungary. The new Hungarian factory would produce 100,000 tons of citric acid annually covering 5% of the global market. The investment volume is expected to be close to EUR 100 million. The project is in the relatively early stage, so it is still not too late to catch up with this investment opportunity.

Hungary expects an overall growth in Chinese deals, as we reported in our previous edition. A said 10-



15 companies might enter Hungary with EUR 50-120 million worth of investments. We also reported that Chinese blue-chip companies like Wanhua and BBC Group planned major investments in Hungary. And last but not least, we wrote that the Hungarian government was in talks with China to realize two big-ticket railway construction deals. In this context, it is not a particular surprise that another Chinese player, RZBC also plans to make a major market breakthrough.

In September of 2014 RZBC announced to build its Hungarian citric acid plant. RZBC is a truly global citric acid producer covering more than 100 countries and having clients like Coca-Cola, Pepsi, Danone and Kraft Foods. Its new Hungarian factory would produce 100,000 tons of citric acid annually covering 5% of

the global market. The project is significant, as the investment volume is expected to be close to EUR 100 million.

Welcoming this new project, Péter Szijjártó, Minister of Foreign Affairs and Trade noted that Hungary has truly become the gateway to Europe for Chinese businesses. In addition, the Chinese ambassador to Hungary added that the choice of RZBC suggests that Chinese businesses feel confident in Hungarian-Chinese ties and trust the Hungarian business environment.

This remarkable investment is in the relatively early stage, but the progress is evident. Environmental licences have already been obtained. RZBC has already established its Hungarian subsidiary. Last, but not least, the Hungarian government – in line with its eastern opening policy – approved a one-off investment subsidy for the construction of the plant and RZBC in turn committed to employ more than 165 people by 2024.

Implementation of this project would bring another success story in the Hungarian-Chinese business relationship. Hungary is not simply scoring a rare chance to become one of the leading global producers of citric acid, but also to capture an outstanding opportunity to deepen Hungarian-Chinese business ties. RZBC may become another Chinese company willing to establish long term business intentions in Hungary.

Key players: Bank of China, Lenovo, ZTE, Huawei, Wanhua, BBKA Group, RZBC

EUR 100 million-worth investment

A new Chinese success story

MOL moving toward more acquisitions?

EUR 5 billion-worth DEA, the next potential target

After concluding major transactions with U.K operators, Wintershall and Premier Oil, the Hungarian MOL is likely to continue its expansion in the field of global exploration & production. We may shortly hear MOL announcing a new acquisition.

The newest target may be DEA, a prominent player in the field of exploration & production. If the planned deal to sell DEA to the Russian Mikhail Fridman led group of investors falls apart, MOL will most likely reopen talks about purchasing DEA. It remains to be seen how the story will end, but it is evident that MOL has a strong appetite to expand further by purchases of equities of Western exploration & production companies.

New acquisition story

Previous editions of Hungarian Watch reported that the Hungarian MOL has been a very successful



MOL to tap into UK operators

player in the CEE region, mainly active in the downstream oil industry (refinery & trade), but MOL has recently decided to enter into the global upstream industry (exploration & production) as MOL has recently bought altogether 20 offshore oil exploration & production licences from U.K operators Wintershall and Premier Oil. MOL may also establish closer business cooperation with other UK operators, such as TAQA and Enquest. MOL has clearly changed its strategy, although the regional focus and refinery privilege have been

neglected, the global exploration and production have become key.

This development may be just the beginning. Experts highlight that MOL will focus on a very active investment strategy in the upcoming years, especially in the field of exploration & production. In this context, it is worth noting that MOL concluded USD 1.550 million worth revolving credit facility agreement with a group of 15 banks on 30 October 2014. The total liquidity of MOL increased to EUR 4 billion allowing MOL to carry out further acquisitions. Overall, MOL has become very strong and acquisitive, so we might just hear MOL announcing a new acquisition story.

The next immediate target may be DEA, gas and oil arm of the German RWE. Although RWE made a deal to sell DEA for EUR 5 billion to the Russian Mikhail Fridman led group of investors, Britain has blocked the deal in the light of recent sanctions against Russia. This breaking news is of pivotal importance for MOL, as it has also been in a race for DEA. MOL announced that it would be interested in talks about DEA if the planned deal to sell it to the Fridman led group fell apart.

MOL concluded USD 1.550 million worth revolving credit facility agreement allowing further acquisitions

The next target may cost EUR 5 billion

Milestone deal

DEA is a very prominent player in the exploration and production field, so the sale of DEA would fit well with the expansion strategy of MOL. Firstly, DEA is present in 14 markets, its biggest markets are Germany and the UK, and it holds almost 200 oil and exploration licences. So, the potential deal would allow MOL to further integrate into the global exploration and production industry dominated by Western players. Secondly, according to experts if MOL acquires DEA its group level hydrocarbon production would nearly double. Thirdly, the transaction would also bring a significant increase in MOL's consolidated profit, as in 2013 DEA had EUR 940 million EBIDTA (earnings before interest, taxes, depreciation and amortization) which is about half of MOL's 2013 EBIDTA. All in all, this deal would present an outstanding opportunity for MOL to expand further.

DEA holds nearly 200 oil and exploration licences

How can MOL afford EUR 5 billion to buy DEA?

There is no question that the deal would be highly beneficial to MOL, but the question arises, how can MOL afford such an investment? MOL has a very balanced operation (more than EUR 4 billion in liquidity), but DEA is obviously a big bite, as the initial offer of Fridman led group was 5 billion.

MOL would be able to carry out this deal alone, only if it finds additional resources worth several EUR billion. Divesting its own asset may be the solution to this end. The sale of MOL's stake in the Croatian INA would particularly fill the gap which is estimated to be worth around USD 2-3 billion. "To sell or not to sell" this has been in focus for a long time and it is still a viable option, but right now it is difficult. Namely, only Russian players are interested in INA, but the EU does not want the presence of Russian interest in the strategic industry of a member state. Taken all this account, the most likely scenario is that MOL would purchase DEA jointly with Wintershall, another company that participated earlier in the tender for DEA.

Unplug from INA may bring MOL around USD 2-3 billion

MOL may purchase DEA jointly with Wintershall

What does the future hold?

The future may bring interesting surprises. Nobody thought one or two year ago that MOL could make such a swift breakthrough into the global upstream industry. As a next step MOL is considering to buy, nearly 200 oil and exploration licences of the prominent DEA. This deal would clearly be a milestone in MOL's extension.

We shall see what will be the outcome of the story of DEA, but one thing is for sure, MOL will do its best to expand further into the global exploration and production industry. Put another way, MOL may bring more major deals to Western energy companies and their business law firms.

Tesco is about to check out from its Hungarian operations

Tesco as one of the world's leading grocery and general merchandise retailers might consider leaving the CEE region, including Hungary in order to strengthen its UK position. This would be a major opportunity for Hungarian competitors such as Aldi, Lidl, Spar, Penny, CBA, Auchan and Metro. As analysts give close to fifty-fifty chance for this strategic decision, investors shall carefully follow the upcoming developments of Tesco.

Tesco shall ensure a better UK market position



Tesco faces a difficult time in the UK. With customers being lured away by ALDI and LIDL, Tesco's market share has dropped 3.6% over the past year, which is the fastest rate of any major supermarket chain in Britain. Pre-tax profits fell more than 90% in the first half of the year. But the bad news has not stopped. Just a couple of weeks ago an accounting error was discovered with a GBP 263 million shortfall in profits. It seems that Tesco badly needs a new strategy to regain its competitive position in the UK market.

Pursuant to the above, market analysts speculate that it might be a good move for Tesco to sell some of its operations worldwide and invest the cash from the purchase prices into strengthening its UK market position." *Tesco needs to simplify the group by selling assets, strengthening the balance sheet and reinvesting into the core*

UK business" one of the top 20 investors anonymously told Reuters. Should Tesco decide to sell some of its international operations, the analysts believe that the operations in South Korea, Thailand and the CEE region, including Hungary could go up for sale.

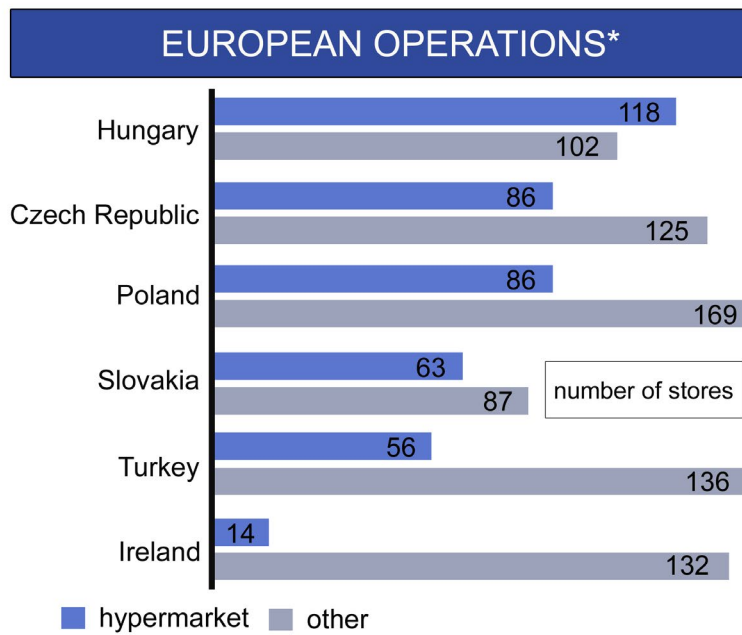
The management of Tesco does not want to confirm such speculation. However, it remains evident that revenues from sales could serve as an excellent base for reinvesting in the UK market. Analysts estimate that selling all of its international operations would eliminate GDP 6.6. million of Tesco's debt and would make a jump in cash-flow to GBP 4.9 billion.

Tesco's step out of Hungary would bring an exceptional opportunity for Hungarian competitors to expand. Whereas, the German four, Aldi, Lidl, Spar and Penny and the Hungarian CBA (out of which CBA is the strongest candidate) might be the potential buyers of the smaller Tesco stores, the French Auchan and the German Metro (out of which Auchan is the strongest candidate) might be the potential buyers of the hypermarkets of Tesco. Analysts give a near fifty-fifty chance for selling the Tesco international operations, so investors shall carefully follow its impending developments.

Tesco might leave Hungary

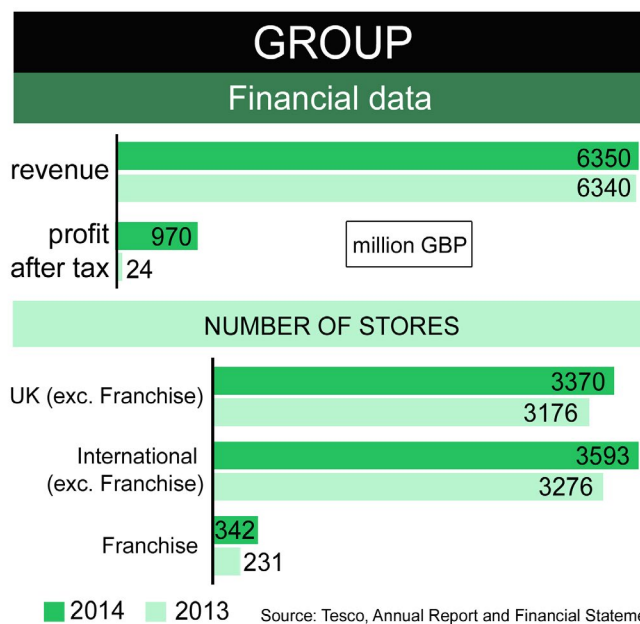
Potential buyers: Aldi, Lidl, Spar, Penny, CBA, Auchan and Metro

Fifty-fifty chance of selling Tesco operations worldwide



* February 2014

Source: Tesco, Annual Report and Financial Statements 2014



Source: Tesco, Annual Report and Financial Statements 2014

Banking industry still in turmoil

Hungarian Watch warned in several articles in this issue of the publication that major changes are ahead in the Hungarian banking industry. According to the latest developments banks may record several EUR billion of losses on conversion of foreign exchange (FX) loans, and the creation of the bad bank there may have also serious impacts on the Hungarian banking landscape. Meanwhile, the government keeps its eyes open on potential targets. Let's look closer at these major developments.

The borrower relief program aims to bail out people who took out loans denominated in Swiss francs, but made the repayment when the value of forint dramatically decreased. Hungarian banks that have used exchange rate margins or made unilateral changes to FX loans will

In this context, Márton Nagy, the managing director of Central Bank of Hungary (CBH) expects that banks are likely to compete fiercely to offer forint loans when the EUR 9-10 billion worth of FX loans will be converted next year, and this in turn will accelerate M&A deals. He strongly believes that banks with good capital and liquidity will obviously be interested in snatching up clients from unprepared rivals. *"This will be a watershed moment, and banks will generate intense competition, because they can acquire portfolio in the process,"* Nagy noted.

Márton Nagy also added that the introduction of the bad bank (in the form of a state asset manager) will cause further potential losses to this already troubled sector, as it will buy non-performing loans (NPL) of banks below the book value. The main aim of the establishment of the bad bank is to separate the NPL of banks from their healthy portfolio. In this way the overall portfolio of banks will improve, so selling banks in the future will be more digestible. The bad bank will apparently bring major changes for this industry as it will have approximately EUR 1 billion in buying capacity.



The bad bank will have
EUR 1 billion buying
capacity

The government to take over more banks?

Right now the sale of unprofitable banks (such as Erste, Raiffeisen or CIB) are not on the daily agenda. All these banks have said that they would stay in Hungary. However, analysts believe that foreign banks apply the wait-and-see approach, especially given that the FX loan conversion will be in focus in the near future, so banks will be able to calculate whether costs of operation make it worth staying in Hungary.

At the same time, the government's appetite will remain strong. In order to ensure larger domestic ownership, the government seems to be ready to step in as a buyer anytime a foreign bank decides to exit Hungary: *"If there is a bank that's looking to leave, the government is there to pick up the pieces"* Economic Ministry state secretary Gábor Orbán noted. So the government evidently keeps its eyes open. Market rumours suggests that the government officials have just held secret talks with Erste and Raiffeisen.

Secret talks with Erste and Raiffeisen

How many banks will really survive?

Taking all the above into account, the question arises, how many banks will remain at the end of this consolidation process. Márton Nagy, the managing director of CBH believes that there is only room for five large banks. *"It may be that every bank wants to stay, but at the end of the competition, which will be a competition in pricing, in efficiency and scale, five banks will remain because for the rest it will not be worth it,"* Nagy noted. The heads of major foreign banks including GE Capital, Erste and Raiffeisen who took part on the banking forum largely shared this assessment.

There is only room for five large banks

Overall, it seems that the cake in terms of total banking revenues will be significantly smaller, so it is just a matter of time when the Hungarian banking landscape will be definitely reshaped. Therefore, it is worthwhile for investors to keep a close eye on the upcoming developments in banking.

Hungarian automotive industry is still out in front

New major investments expected

The automotive industry remains as one of the great success stories of the country. The press regularly reports about production expansions, improvement of supplier networks and new greenfield investments. Audi, Patec, BorgWarner, Robert Bosch and Alumental will soon make new investments. The automotive industry definitely deserves great attention.

In the previous edition, we reported that the automotive industry is one of the great success stories of



Success story

the country. The automotive industry generated 18 EUR billion in production value, that is 18% of the total Hungarian manufacturing industry, 10% of the GDP and 18% of the total export value. The production will likely continue to rise. At the moment, 726 companies are involved in this industry, which provide workplaces for 120.000 people. So, it is no surprise that Hungary has become the regional hub for car production.

The big four, the German Opel, Audi and Mercedes and the Japanese Suzuki have already established their plants in Hungary. In addition, major tyre manufacturing companies, Hankook and Continental have also made significant investments by building their production sites in Hungary. The great geographic location, qualified, but affordable work force (30-50% lower cost than in Western Europe) and research and development (R&D) capacities present key assets for international players.

The press regularly reports about production expansions, new greenfield investments and improvement of supplier networks of the automotive industry. More than 50 projects out of 189 managed by the Hungarian Investment Promotion Agency (HIPA) are connected to the automotive industry. Hungary definitely expects to make further major investments. Let see closer what we can expect in the near future.

Audi to expand its logistic base – Audi built its logistic base last autumn at a magnitude of 75.000 square meters and at a cost of approximately EUR 30 million. Now Audi plans to expand its base by building a second warehouse in Győr. The exact location and the start of the construction have not yet been determined.

Patec to build its first European factory - The first European factory of the Singapore based Patec Group will be constructed in Miskolc. According to the plans, the company will employ about 400 people, in 15.000 sqm large plant and will manufacture exhaust systems and windscreen wipers for the Volkswagen group.

BorgWarner to build a turbocharger plant – The US supplier BorgWarner plans to build a, close to EUR 30 million worth, turbocharger plant in Oroszlány. The investment includes 15.000 sqm of production area

Key players: Opel, Audi, Mercedes, Suzuki, Hankook and Continental.

Audi, Patec, BorgWarner, Robert Bosch and Alumental will soon make new investments

and 10.000 sqm of warehouse and service space. The production may start in summer 2015.

Robert Bosch to develop its base in Hatvan - Robert Bosch as one of the largest suppliers plans to develop its base in Hatvan. The investment volume of the development will be close to EUR 10 million. Pursuant to the development plan, Robert Bosch will purchase production equipment and devices, and will employ 50 new employees.

Alumental to make a greenfield investment – The Polish supplier Alumental plans to build its first plant in Hungary. The investment volume will be close to EUR 30 million. The plant will supply raw materials for engines primarily for Nemak, a Mexican owned cylinder head manufacturer operating nearby Győr. Production is scheduled in Q/4 2016 with an annual production capacity of 50.000 tons.

In summary, the Hungarian automotive industry drives production in Hungary. It has a high investment potential constantly waiting for established players to make the next move and also new players to step into the market. Therefore, the Hungarian automotive industry definitely deserves great attention.

About VJT & Partners

The Firm

VJT & Partners is a Hungarian commercial law firm advising international and domestic corporate clients and entrepreneurs. The firm was founded by Janos Tamas Varga, who has created a highly successful team based on values including inspiring leadership, striving for perfection, commitment, courage and harmony.

VJT & Partners is recognised as one of Hungary's leading commercial law firms and also as an excellent collaborative partner, working hand-in-hand with its clients. Clients value the firm's absolute commitment, leading to effective and enduring relationships. The firm combines the highest degree of professionalism, the efficient delivery of legal services with dynamism, flexibility, responsiveness and personal attention.

Lawyers in the firm have developed an in-depth understanding of both the legal and the commercial realities of business. The firm prides itself in giving direct, honest and practical advice, tailored to its clients' needs. The shared values of VJT & Partners are at the very core of the creativity and 'fresh thinking' approach of the firm.

As a member of the EU, but not the single currency, Hungary has a unique language and business culture and a complex legal system bringing particular challenges. All lawyers at VJT & Partners have extensive experience of working with international and domestic companies alike, to help navigate these challenges and to achieve their objectives in Hungary, and to ensure appropriate regulatory approvals.

The leading legal directories rank VJT & Partners highly across a range of practice areas.

VJT & Partners is a full-service law firm that satisfies the needs of clients across a broad range of industries and professions. The firm's legal services include commercial contracts, competition, corporate M&A, data protection, dispute resolution, finance, immigration, employment, intellectual property, outsourcing, private equity, real estate, regulatory, restructuring and insolvency, and technology.

Practice Areas

The firm is especially active and highly ranked in the following areas:

Corporate mergers and acquisitions

VJT & Partners believes that advising on M&A transactions is to provide more than just legal advice. Understanding the logic and dynamics of the industry sector in which the client and other participants operate is a prerequisite for success.

We advise clients on international and Hungarian M&A transactions including acquisitions, disposals, mergers and demergers, from deal inception through due diligence and negotiations to post completion. The expertise of our multi-disciplinary team in the areas of corporate, commercial, competition, real estate, employment and regulatory enables us to provide excellent service.

Employment

The highly-rated employment lawyers at VJT & Partners have a wealth of experience in all aspects of contentious and non-contentious employment matters. Fully appreciated for understanding their clients' business goals, lawyers design structures and procedures that are watertight and defensible in many court proceedings.

We regularly advise employers on general employment matters including drafting employment agreements, internal policies, termination agreements, termination notices and complex mass dismissal structures as well as employee incentive schemes. We have particular expertise in managing work permit and business immigration applications as well as advising on the different employment and labour related issues which arise with commercial transactions such as outsourcing.

Our team has successfully represented employers and executive employees in all types of court proceedings in Hungary. In particular, we represent clients in disputes concerning issues which include unlawful termination, overtime payment and bonus claims.

Business Immigration

Immigration is built upon a system of complex legal rules. It is difficult for non-experts to fully understand the law and identify the best immigration strategy to pursue. VJT & Partners' immigration lawyers handle all aspects of business immigration cases, advising medium to high-net worth foreign individuals and multinational corporations in various matters from dealing with residence permit applications based on investment or setting up a Hungarian business to representing our clients in their Hungarian naturalization procedures.

Immigration lawyers at VJT & Partners have experience in tailoring solutions to the individual needs and circumstances of the client. We have the courage to develop new creative solutions even in the most difficult immigration cases.

How We Work

Lawyers at VJT & Partners are encouraged to develop, to enjoy their work and to become real 'Masters of Collaboration'. Clients comment on the firm's cooperation, communication and its absolute commitment to what they are trying to achieve.

In turn, we find that this leads to effective and enduring relationships. We combine the highest degree of professionalism and the efficient delivery of legal services with dynamism, flexibility, responsiveness and personal attention.

Our Values

The values that lie at the heart of our business ethos are the building blocks of our business. Nurturing the following values brings the 'hearts and minds' of VJT & Partners' lawyers together as one successful team. We would be happy to talk you through them, what they mean to us, to our business and our clients:

- Inspiring leadership
- Striving for perfection
- Commitment
- Courage
- Harmony

Office:

1126 Budapest
Kernstok Károly tér 8.
Hungary

Contact:

Tel: +36 1 501 9900
Fax: +36 1 501 9901
E-mail: office@vjt-partners.com
Web: www.vjt-partners.com