



CEE Equity Research | Car dealership | Hungary
12 December 2019

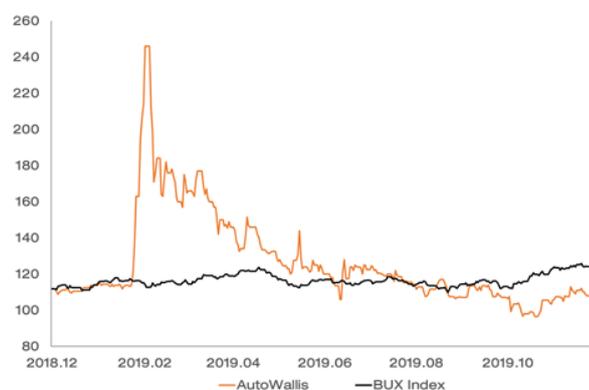
AutoWallis

Initiation of coverage: Accumulate

Target price (12-m): HUF 123

Share price: HUF 102

HUF million	2018	2019F	2020F
Revenue	65 450	75 661	85 096
EBITDA	2 082	2 467	3 111
EBIT	1 461	1 842	2 487
Net profit	847	1 234	1 901
EBITDA margin	3.2%	3.3%	3.7%
PAT margin	1.3%	1.6%	2.2%
EPS	3.1	4.6	7.0
DPS	0.0	0.0	0.0
BVPS	17.7	20.2	27.2
P/E	32.6x	22.3x	14.5x
P/BV	5.8x	5.1x	3.7x
EV/EBITDA	17.9x	14.9x	11.4x



Performance	12M	YTD	3M	1M
Absolute	-17.3	-8.2	-8.6	-2.9
Relative	-15.8	-18.1	-11.3	-3.3

Share price close as of 10/12/2019	HUF 102	Bloomberg	AUTOWALL HB
Number of diluted shares [million]	270.3	Reuters	AUTW.HU
Market capitalization [HUF bn/EUR mn]	27.9 / 84.2	Free float	14.34%
Daily turnover 12M [EUR th]	282	52 week range	HUF 96 – 246

Drive shift

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- We are initiating coverage of AutoWallis with an Accumulate rating and see a 21% upside potential to our 12-month DCF-based TP of HUF 123.
- AutoWallis is best in class in operations and a dominant player in CEE regional car dealership markets. It is present in 14 Central and South Eastern European Countries.
- Although we see plenty of risks to AutoWallis' businesses and uncertainties around its new five-year strategy, we believe its agility and operational management of its businesses are two aspects that should be viewed positively by investors.
- We expect organic EPS CAGR of 31% by 2024, albeit from a low base in 2018, driven by expected revenue growth and some improvements of operating margins.
- We assume a significant improvement in AutoWallis' ROIC by 2024, driven mainly by expected EBITDA margin expansion, which thus is likely to exceed peers' ROIC ratio, justifying relatively higher valuation multiples for AutoWallis.

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Investment case

- We are initiating coverage of AutoWallis with an Accumulate rating and see a 21% upside to our 12-month DCF-based TP of HUF 123. We note that our TP is highly sensitive to operating margin developments. If no margin improvement occurs while sales increasing in the coming years, we would reduce our TP to HUF 96, implying a 6% downside from the current share price, all else remaining constant. In the absence of a clear dividend policy, no dividend payment is included in our baseline valuation model.
- AutoWallis is best in class in operations and a dominant player in CEE regional car dealership markets. It is present in 14 Central and South Eastern European Countries. AutoWallis had EBITDA of HUF 2.3 bn on revenue of HUF 65 bn in 2018, employing more than 300 people. AutoWallis has three main businesses: domestic distribution, international distribution and automotive services, accounting for 47%, 43% and 10% of its sales revenue and 4%, 36% and 60% of its pre-tax profit in 2018, respectively.
- We see the market already pricing in strong revenue growth in the coming years. We expect AutoWallis's organic top-line growth to reach a CAGR of 14% by 2024 on the back of 1) strong underlying car markets growth in the Central Eastern European countries, 2) product offering extension; and 3) regional expansion.
- We expect EBITDA margin to improve from 3.2% expected for 2019 to only 4.1% by 2024 vs. management guidance for organic EBITD margin of 5.6%.
- We expect organic EPS CAGR of 31% by 2024, albeit from a low base in 2018, driven by revenue growth and some expected improvements of operating margins. If no margin improvement is achieved, we believe AutoWallis still would have the potential to increase its EPS at a CAGR of 24% by 2024 based on expected revenue growth.
- The primary drivers of organic EBITDA margin improvements and value creation will be new distribution agreements, like the one initialed recently with Jaguar Land Rover, organic regional growth, higher-margin add-on and aftermarket services, and cost reduction measures. International distribution is likely to generate relatively higher margins thanks to market penetration and income convergence towards EU levels. In contrast, domestic distribution is likely to see margins stagnating due to highly competitive premium car markets.
- We believe investor sentiment towards AutoWallis will be determined by how successful the company will be in implementing its ambitious five-year strategy presented in May. We note that we found AutoWallis' new strategy far too crude and simple for valuation purposes. Therefore, we decided to just focus on cash flows generated only from current businesses and disregard management guidance for earnings from acquisitions in the future.
- As we assume no acquisitions in the coming years but constantly improving capital intensity, thus leverage should decline constantly after 2020. We note, however, that should AutoWallis carry out sizeable M&A, its leverage will remain high going forward.
- AutoWallis's shares look overvalued compared to its peers based on 11.4x 2020 EV/EBITDA. That said, we assume AutoWallis will deliver rapid revenue and earnings growth in the coming years. Besides fast earnings growth we assume a significant improvement in AutoWallis' ROIC by 2024 as well, driven mainly by expected EBITDA margin expansion, which thus is likely to exceed peers' ROIC ratio, justifying relatively higher valuation multiples for AutoWallis.
- The new strategy gives us hope that AutoWallis will have the flexibility to effectively and strategically respond in many constructive ways to disruption caused by imminent technology changes and/or regulation and new customer trends. That, in our view, should also be reflected in its relative share price performance vs. the broader group of its peers going forward.
- The ongoing megatrends in the car and dealership industries, such as electrification, connectivity, diverse mobility and autonomous driving, are expected to wipe out at least 100 bps from car dealerships' return on sales by 2024. These megatrends while likely squeezing sales volumes and margins should create new opportunities in areas such as maintaining and operating car-sharing fleets, which could become a significant new source of income.

Valuation

We found AutoWallis’ new strategy far too crude and simple for valuation purposes. Therefore, we decided to just focus on cash flows generated from current businesses and disregard management guidance for earnings from acquisitions AutoWallis may seek in the future. Put it simple, we will react to acquisitions news when they have come out as opposed to trying to predict what AutoWallis intends to buy. Also importantly, in the absence of a clear dividend policy, no dividend payment is included in our baseline valuation model.

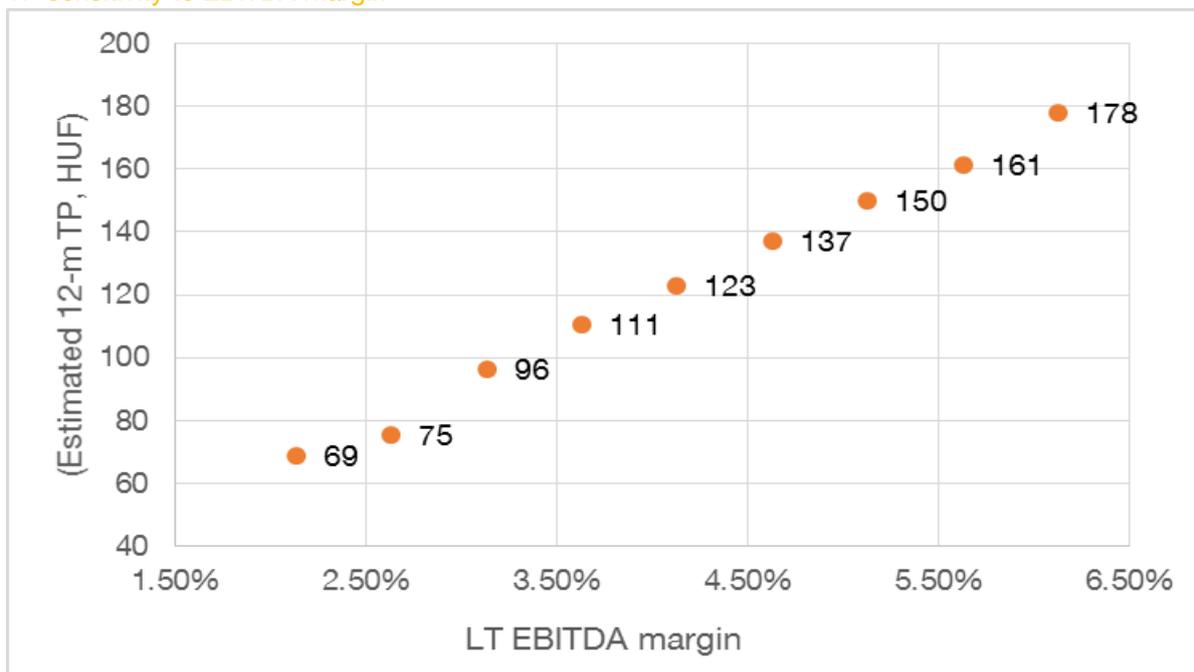
Discounted Cash Flow method: That we assume no dividend payments and inorganic growth in the coming years leads us to set, on the basis of future FCF performance, our 12-month TP at HUF 123, which leaves a 21% upside from the current share price. Our TP is highly sensitive to operating margin developments. If no margin improvement occurs in the coming years, we would reduce our TP to HUF 96, implying a 6% downside from the current share price, all else remaining constant.

TP sensitivity to LT NOPLAT growth rate

		LT NOPLAT Growth (%)					
		123.0	-1%	0%	2%	3%	4%
WACC	6.9%		94.9	102.0	122.4	137.7	159.0
	7.9%		95.2	102.3	122.7	138.0	159.6
	8.9%		95.4	102.6	123.0	138.4	160.0
	9.9%		95.8	102.9	123.3	138.9	160.6
	10.9%		96.0	103.2	123.8	139.2	161.0

Source: Concorde’s estimate

TP sensitivity to EBITDA margin



Note: We assume constant LT WACC at 8.9% and no dividend payments in the coming years

Source: Concorde’s estimate

With no dividend payments and M&A activity assumed, our valuation model factors in a gradual decline in the debt ratio over time. Of course, it would be logical to assume that our TP would be higher should AutoWallis keep its ND-to-EV ratio constant at around the current 30% level in perpetuity in order for creating an optimal capital structure by paying meaningful dividends and simultaneously investing in targets offering return on capital above the cost of capital, rather than holding its excess own funds in low-return cash instruments,.

AutoWallis DCF-model

Fair value (HUF) **111.7**
 12-m TP (HUF) **123.0**

w/o acquisitions

	2019	2020	2021	2022	2023	2024	2025	TV1
Revenue growth	15.60%	12.47%	12.85%	13.39%	13.64%	13.73%	13.73%	2.00%
EBIT/ Rev.	2.43%	2.92%	3.16%	3.36%	3.52%	3.67%	3.67%	3.67%
Tax	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%	17.00%
ND/V	32.75%	26.81%	20.11%	13.47%	6.57%	-0.37%	-0.37%	-0.37%
r _A	7.72%	7.88%	8.01%	8.46%	8.38%	8.32%	8.90%	8.90%
r _D	2.63%	1.71%	1.89%	2.18%	2.99%	0.00%	0.00%	0.00%
ROIC	10.66%	14.37%	16.53%	18.20%	20.10%	21.69%	21.62%	21.03%
NOPLAT	1 529	2 064	2 521	3 034	3 619	4 292	4 882	4 979
g (NOPLAT)							2.0%	2.0%
DIC	27	891	1 417	1 331	1 784	2 787	1 098	1 120
IC								
14 338 111	14 365	15 256	16 673	18 004	19 788	22 575	23 673	24 792
Revenue/IC	5.3	5.6	5.8	6.0	6.3	6.2	6.8	6.6
Risk free rate	2.5%	2.7%	2.8%	3.2%	3.2%	3.1%	3.7%	3.7%
Unlevered beta	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Beta multiple	1.4	1.3	1.2	1.1	1.1	1.0	1.0	1.0
Levered beta	1.222	1.135	1.135	1.135	1.135	1.135	1.135	1.135
ERP	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%	6.0%
Unlevered cost of equ	7.7%	7.9%	8.0%	8.5%	8.4%	8.3%	8.9%	8.9%
Levered cost of equity	10.2%	10.1%	9.5%	9.4%	8.8%	8.3%	8.9%	8.9%
Net debt	9 118	7 993	6 549	4 762	2 552	-160	-160	-160
Net debt (calculated)	9 118	7 993	6 549	4 762	2 552	0	0	0
D/E	48.7%	36.6%	25.2%	15.6%	7.0%	0.0%	0.0%	0.0%
E/V	67.2%	73.2%	79.9%	86.5%	93.4%	100.0%	100.0%	100.0%
r _E	10.2%	10.1%	9.5%	9.4%	8.8%	8.3%	8.9%	8.9%
WACC	7.6%	7.8%	7.9%	8.4%	8.3%	8.3%	8.9%	8.9%
P&L	2019	2020	2021	2022	2023	2024	2025	TV1
Rev.	75 661	85 096	96 030	108 889	123 737	140 728	160 053	163 254
D&A	703	709	719	734	754	780	1 601	1 633
EBIT	1 842	2 487	3 038	3 656	4 360	5 171	5 882	5 999
Financial rev.	-355	-196	-171	-139	-98	0	0	0
PBT	1 487	2 291	2 867	3 517	4 263	5 171	5 882	5 999
Tax	253	389	487	598	725	879	1 000	1 020
Net Income	1 234	1 901	2 379	2 919	3 538	4 292	4 882	4 979
Net compr. income	1 226	1 889	2 369	2 907	3 527	4 235	4 816	4 913
CF								
EBIT	1 842	2 487	3 038	3 656	4 360	5 171	5 882	5 999
EBITDA	2 545	3 196	3 757	4 390	5 115	5 951	7 482	7 632
NOPLAT	1 529	2 064	2 521	3 034	3 619	4 292	4 882	4 979
DIC	27	891	1 417	1 331	1 784	2 787	1 098	1 120
FCFF	1 502	1 173	1 104	1 704	1 835	1 506	3 784	3 860
Interest	-355	-196	-171	-139	-98	0	0	0
Tax shield	60	33	29	24	17	0	0	0
Ddebt	-2 014	-2 436	-2 653	-3 124	-3 458	-10	-4	-4
FCFD	-2 308	-2 598	-2 795	-3 239	-3 540	-10	-4	-4
FCFE	-807	-1 425	-1 690	-1 536	-1 705	1 495	3 780	3 856
dividend	-575 000	0	0	0	0	0	0	0
Dcash	-231 535	-1 425 224	-1 690 265	-1 535 645	-1 704 665	1 495 202	3 780 081	3 855 683
FCFF								
FCFF	1 501 729	1 172 996	1 104 385	1 703 529	1 834 843	1 505 520	3 784 092	3 859 774
D/V	33%	27%	20%	13%	7%	0%	0%	0%
WACC	7.57%	7.80%	7.94%	8.41%	8.35%	8.32%	8.90%	8.90%
Value of firm (bop)	41 202	42 820	44 986	47 454	49 739	52 058	54 882	55 979
APV								
FCFF	1 501 729	1 172 996	1 104 385	1 703 529	1 834 843	1 505 520	3 784 092	3 859 774
r _A	7.72%	7.88%	8.01%	8.46%	8.38%	8.32%	8.90%	8.90%
PV(FCFF)	41 065 212	42 733 286	44 926 156	47 418 109	49 724 089	52 057 790	54 881 682	55 979 316
TS	60 363	33 301	29 068	23 639	16 625	0	0	0
PV(TS)	136 491	86 664	60 189	35 940	15 339	0	0	0
Value of firm (bop)	41 202	42 820	44 986	47 454	49 739	52 058	54 882	55 979
FCFE								
FCFE	-806 535	-1 425 224	-1 690 265	-1 535 645	-1 704 665	1 495 202	3 780 081	3 855 683
r _E	10.20%	10.14%	9.54%	9.43%	8.76%	8.32%	8.90%	8.90%
PV(E)	27 547 742	31 163 210	35 747 348	40 849 229	46 238 281	51 994 561	54 823 513	55 919 983
D	13 493 793	11 480 242	9 044 607	6 391 878	3 268 118	-190 219	-200 538	-204 549
Value of firm (bop)	41 042	42 643	44 792	47 241	49 506	51 804	54 623	55 715
EVA								
NOPLAT	1 528 927	2 063 975	2 521 163	3 034 304	3 619 140	4 292 307	4 881 726	4 979 360
IC at the beginning	14 338 111	14 365 309	15 256 288	16 673 065	18 003 840	19 788 137	22 574 924	23 672 557
WACC	7.57%	7.80%	7.94%	8.41%	8.35%	8.32%	8.90%	8.90%
EVA	443 181	943 670	1 309 755	1 632 794	2 115 833	2 646 617	2 873 686	2 873 686
PV(EVA)	26 863 592	28 454 641	29 730 058	30 780 984	31 735 589	32 269 654	32 306 759	32 306 759
Value of firm (bop)	41 202	42 820	44 986	47 454	49 739	52 058	54 882	55 979

Source: Concorde's estimate

We note that when setting forward discount rates for each year coming we used a mix of swapped 1-year forward risk free rates prevailing in regional markets that we weighted by the relative size of end-user car markets as they appeared in 2018. We note that the opportunity cost for institutional and retail investors in Hungary are significantly different due to the “double” interest rate environment established by the government and monetary authorities. The annual return that can actually be earned on a coupon-bearing bond available for institutional investors is currently around 4 percentage points lower than the annual compound yield (near 5%) on a so-called retail government bond (MÁP+) with the same maturity, assuming that retail investors hold the bonds until their maturity date and can reinvest each annual coupon they receive at an interest rate equal to the yield-to-maturity. Taking into consideration the fact that the overwhelming majority of free float of AutoWallis’ outstanding shares are being held by local retail investors for whom we believe the relevant opportunity cost is around 5% p.a., we feel it appropriate to use a composite of risk free rates available for institutional and retail investors for setting proper discount rates for valuation.

With expecting no dividend and M&A, and thus financial leverage to decrease in the coming years, we assume two things to unfold in parallel: 1) The less debt AutoWallis needs to take on, the lower the beta will be of its equity in its business. Lower debt creates a lower fixed cost, interest expenses, which lessens exposure to market risk in outer years. 2) The proportion of equity financing will grow to 100% as net debt turns gradually into net cash (or negative net debt) that we treat setting it to zero and consider the excess cash and marketable securities separately adding it to firm value to arrive at the value of AutoWallis' equity.

We add that the beta value for AutoWallis also depends upon the sensitivity of the demand for its products and services and of its costs to macroeconomic factors that affect the overall market. Cyclical companies have higher betas than non-cyclical firms. AutoWallis which sell automobiles which are discretionary products should have a higher operational beta than the broad market. Having said that, with making more add-on services besides discretionary to customers and a switch from floating rate loan to fixed rate debt should result in lower beta, other things remaining equal. Even using lower beta the so-called liquidity discount that we believe should be included in valuation remains to be of importance and is determined by investors' perceptions (or misperceptions) of the stock.

On the contrary, the proportion of fixed costs in the cost structure of its business is low, which justifies a relatively low the beta for its business. This is because lower level of fixed costs decrease AutoWallis' exposure to all risk, including macroeconomic and market risks.

Comparative valuation: We favour EV/EBITDA and PEG based approaches to valuing AutoWallis. As evidence shows, it is changes in consensus operating earnings which have often driven relative and absolute share price performance. We believe that earnings performance is best captured through EV/EBITDA and PEG based valuation methodologies for auto-related names in different stages of their life cycle from a growth perspective. Our modified PEG ratio is based on the EV/EBITDA multiple. Aside from its own drawbacks (e.g. there is no standard time frame, or it assumes a linear relation between multiples and growth, and such it can be misleading in case of zero growth), the PEG ratio appears to give comparative valuation a leg up on the standard EV/EBITDA multiple. We conclude that based on its historical earnings growth, AutoWallis trades a significant premium to its peers, but using a prospective earnings multiple reveals discount to peers' valuation. This is not surprising, since the PEG ratio applies only for growth, and we expect AutoWallis to deliver striking revenue and earnings growth in the coming years, though our income estimates still lag behind management guidance.

AutoWallis' European peers

Ticker	Name	Last Price (LCY)	D Return (LCY, %)	Mkt Cap (EUR mn)	EV (EUR mn)
AUTOWALL HB Equity	AUTOWALLIS PLC	103	-8	84	110
SIX2 GR Equity	SIXT SE	84	21	3 593	7 657
EUCAR FP Equity	EUROPCAR MOBILIT	4	-49	645	5 595
NTG LN Equity	NORTHGATE PLC	303	-20	478	1 064
INCH LN Equity	INCHCAPE PLC	676	22	3 204	3 793
PDG LN Equity	PENDRAGON	11	-51	183	602
STRN NA Equity	STERN GROEP NV	12	7	73	351
MOTR LN Equity	MOTORPOINT GR	279	38	300	340
KAMUX FH Equity	KAMUX CORP	7	35	295	334
DOAS TI Equity	DOGUS OTOMOTIV S	9	111	316	643
APR PW Equity	AUTO PARTNER SA	5	19	140	193
CAR PW Equity	INTERCARS	203	-3	672	985
LOOK LN Equity	LOOKERS PLC	54	-42	249	449
BAH PW Equity	BRITISH AUTOMOT	1	-37	10	52
BILIA SS Equity	BILIA AB-A SHS	106	28	1 038	1 437
DIE BB Equity	D'IETEREN	58	76	3 196	2 486
MEKO SS Equity	MEKONOMEN AB	90	-2	482	1 012
OTOEL GA Equity	AUTOHELLAS SA	7	29	346	687

Operating performance comparison

Ticker	ND/EBITDA	Sales growth (%)	EBITDA margin	EBIT margin	Sales CAGR	3YR EBITDA CAGR	3YR NI CAGR
AUTOWALL HB Equity	4.6	10.1	3.3%	2.4%	6.8%	-18.0%	7.0%
SIX2 GR Equity	3.7	12.6	31.7%	13.3%	10.4%	10.1%	56.0%
EUCAR FP Equity	5.1	21.5	34.0%	12.7%	11.3%	41.4%	N/A
NTG LN Equity	1.9	6.2	36.0%	10.1%	6.4%	7.9%	-5.7%
INCH LN Equity	2.3	3.6	2.5%	1.9%	10.8%	-48.4%	-41.9%
PDG LN Equity	N/A	-2.4	1.1%	-0.3%	1.3%	-66.9%	N/A
STRN NA Equity	4.2	-1.6	5.9%	0.7%	0.4%	1.6%	-64.1%
MOTR LN Equity	1.3	6.8	2.5%	2.3%	13.4%	16.4%	N/A
KAMUX FH Equity	1.3	16.0	3.8%	3.6%	N/A	16.2%	N/A
DOAS TI Equity	4.5	-19.2	5.7%	4.9%	0.4%	8.1%	-21.2%
APR PW Equity	2.2	26.2	7.8%	7.0%	30.7%	44.1%	N/A
CAR PW Equity	2.9	15.5	4.9%	3.9%	18.4%	8.4%	13.9%
LOOK LN Equity	2.0	3.9	2.0%	1.5%	10.3%	-3.8%	-4.9%
BAH PW Equity	8.9	23.2	4.4%	4.2%	31.6%	-32.5%	-10.0%
BILIA SS Equity	2.0	3.2	5.7%	3.3%	11.7%	3.2%	0.0%
DIE BB Equity	-4.7	3.6	3.9%	3.2%	-11.6%	16.9%	-35.5%
MEKO SS Equity	4.2	33.0	8.2%	5.2%	12.3%	-9.1%	-12.5%
OTOEL GA Equity	2.1	38.1	31.3%	15.0%	37.2%	20.8%	27.1%

Source: Bloomberg, Concorde's estimate

Yet there remain a number of challenges with determining fair EV-based earnings multiples for AutoWallis. First, EV-based earnings multiples are generally susceptible to inconsistencies (industrial net debt/cash, financial services, at-equity stakes, and minorities at book value). Furthermore, auto industry-related stocks have usually high beta, and as a result trade in line with broader economic developments. At a sector level, they are highly geared to changes in investor sentiment and sector relevant news flow, such as changes in tariffs, tax environments, fuel prices, EU carbon emissions regulation, government incentive programs, penetration of disruptive technologies etc. Yet putting the beta component aside, comparing relative valuations provides limited insight due to companies' varying business mixes, complexity of their services, and the large differences in individual ROIC performance. Certainly, companies with higher ROICs should trade at relatively higher multiples. Our baseline scenario assumes rapid earnings growth and a significant improvement in AutoWallis' ROIC in the coming years, driven mainly by expected EBITDA margin expansion, which thus is likely to exceed peers' ROIC ratio, justifying a relatively higher valuation multiple for AutoWallis.

Comparative valuation

Ticker	EV/SALES	EV/EBITDA FY1	P/E FY1	FCF Yield	DIV yield	ROIC	WACC
AUTOWALL HB Equity	0.5	11.7	22.6	6.4%	n.a.	10.7%	7.7%
SIX2 GR Equity	2.1	6.9	17.5	-11.5%	2.7%	8.0%	5.4%
EUCAR FP Equity	2.0	17.2	7.0	-49.2%	3.3%	4.3%	1.3%
NTG LN Equity	1.3	3.1	8.2	11.2%	6.2%	6.5%	3.7%
INCH LN Equity	0.3	7.8	11.4	12.3%	4.0%	5.8%	7.5%
PDG LN Equity	0.1	4.7	N/A	-34.6%	2.7%	-29.8%	4.9%
STRN NA Equity	0.4	9.1	5.0	-168.4%	8.1%	1.0%	1.4%
MOTR LN Equity	0.2	9.6	14.3	7.1%	2.8%	32.6%	4.4%
KAMUX FH Equity	0.4	8.6	15.8	5.4%	2.7%	21.3%	5.8%
DOAS TI Equity	0.4	6.0	66.4	7.2%	0.0%	8.4%	12.7%
APR PW Equity	0.6	7.2	11.5	1.8%	N/A	16.2%	6.1%
CAR PW Equity	0.5	8.3	11.2	9.9%	0.3%	9.7%	8.1%
LOOK LN Equity	0.1	5.2	16.8	12.3%	5.0%	8.3%	2.6%
BAH PW Equity	0.3	N/A	N/A	130.8%	N/A	6.1%	7.1%
BILIA SS Equity	0.4	7.0	12.8	1.2%	4.6%	16.7%	6.1%
DIE BB Equity	0.4	7.7	14.1	6.3%	1.6%	4.1%	6.6%
MEKO SS Equity	0.9	6.5	8.5	N/A	2.6%	6.8%	4.3%
OTOEL GA Equity	1.3	N/A	N/A	-1.6%	N/A	11.6%	2.0%

Source: Bloomberg, Concorde's estimate

We note that economies of scale can give AutoWallis advantages over smaller dealerships. In practice, economies of scale will provide AutoWallis with two options: it may charge the same price as its competitors, but have better operating margins, or it may charge lower prices than its competitors and have a much higher capital turnover ratio. Having exclusive distribution rights can also ensure that AutoWallis will have cost advantage over its competitors.

We also suggest that investors should avoid comparing valuations at any time against those of the past. In industries undergoing radical changes, we think it is misleading to compare past performance and valuations with those of the present. In addition, firms that have excelled consistently in terms of growth and profitability in a sector always deserve to trade above industry average earnings multiples, and they should also be de-rated compared to benchmark indices and the broader industrial group. Likewise, we do not believe that the prior cycle is a good proxy when considering valuation today for several reasons. First, in the prior cycle there was limited perceived risk of the potential extent of disruption within the broader industry (from new market entrants and technologies such as autonomous driving and mobility services). Second, while new emissions regulations have always been a headwind, they did not present the same level of uncertainty around costs and consumer adoption as the fast transition to electrification and community mobility today.

Following the VW diesel scandal and the subsequent de-rating of the auto-related stocks, and in light of looming even more stringent emissions regulations we believe investors' reluctance may prevent earnings multiples from returning to the prior cycle level. We are even afraid that higher earnings and FCF growth might not necessarily be reflected in a higher earnings multiple, as there are legacy perceptions (e.g. concerns about low market liquidity, transparency and corporate governance issues) around Hungarian small caps, which can also influence earnings multiples that investors are willing to pay.

Finally, we do not think evaluating AutoWallis on a sum-of-the-parts basis provides incremental value, as today it shows no appetite to separate and/or break-up its businesses.

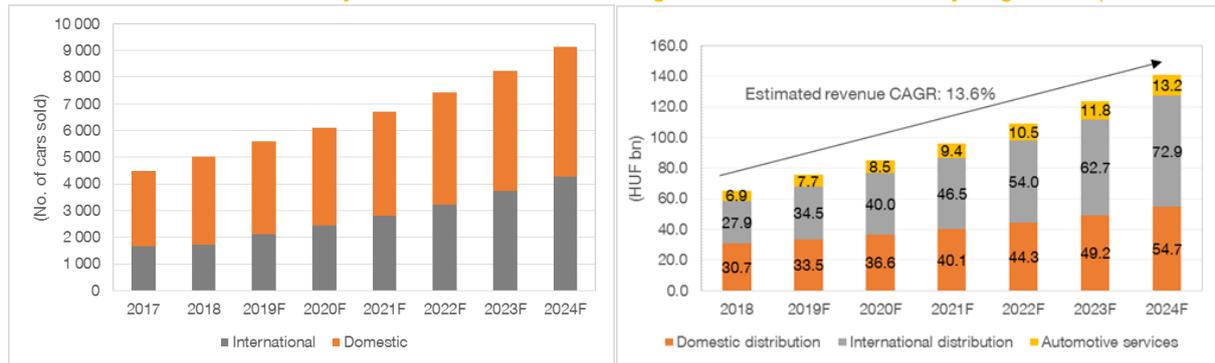
Earnings estimate

Although in the recent past car dealers in the region collectively have had good years in terms of sales growth, we are predicting a slowdown in revenue arising from ICE vehicles. If that was not enough dealers globally look set to face margin compression despite selling more vehicles. The industry's gross profit as a percentage of selling price for new vehicles has been on decline to around 6% while it also dropped for used vehicles to around 12% in 2017/18, down from 12.5% the year before. AutoWallis' gross margin for domestic distribution also slipped to below 13% in H1/19 from 14.4% in the same period last year.

AutoWallis faces many of the same challenges as other industry players: the competitive market environment, changing technology and customer preferences, risks around costs associated with new services, electrification and CO₂ compliance of brands it sells. But unlike smaller competitors AutoWallis benefits from economies of scale (at this point in the cycle), its strong relationship with BMV (which is not experiencing the same launch challenges as at other premium OEMs), and its regional presence which should enable it to generate above industry-average top-line growth.

Top-line growth: We see AutoWallis's organic top-line growth to reach a CAGR of 14% by 2024. There might be three primary drivers for this excellent revenue growth: 1) Central Eastern European car end-user markets realized significant growth during the last five years, a trend which we expect to continue in the coming years; 2) AutoWallis has constantly expanded its product offering into new vehicle form and size of various premium brands, putting a floor beneath incremental volume gains, while also offering high-added value accessorial aftermarket services to obtain more market share; and 3) increased presence in Central Eastern and South Eastern European countries means that the majority of growth in these markets over the next 2-3 years will likely be captured.

Estimated no. of cars sold by AutoWallis and revenue growth and breakdown by segments (2018-24F)



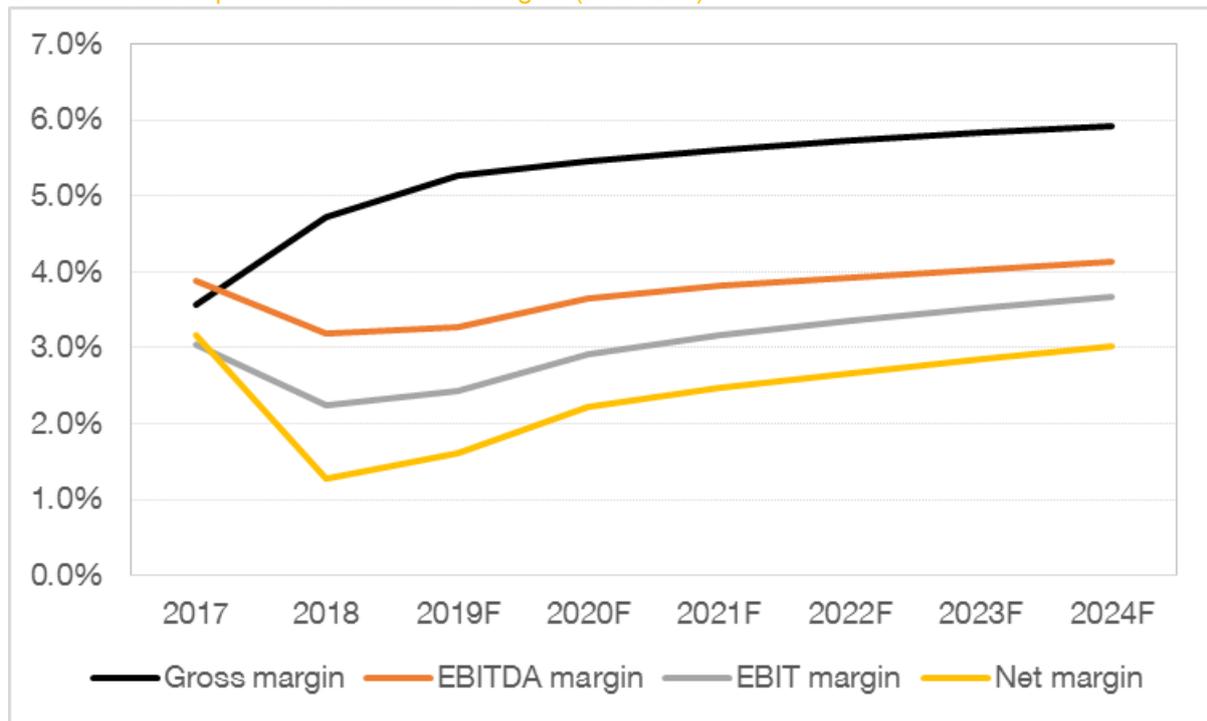
Source: AutoWallis, Concorde's estimate

From mid-2020s onwards we see limited growth in end-user vehicle markets and forecast Central Eastern European car sales to slow down to a CAGR of 2-3%. At the same time, we anticipate changing car sales mix towards cars with alternative powertrains largely at the expense of diesel cars. With Europe accounting for ca. 55% of BMW's total sales, it is not surprising that we expect top-line growth to be a challenge in outer years, even if BMW and other premium brands plan AutoWallis is partnering with to launch a string of several important electrified car models. In other words, we do not see any premium models which could lead to a material step-up in volumes from where AutoWallis sits today but gaining market share or entry into a new business segments we believe should compensate for slowing car sales growth.

Margin development: Despite AutoWallis' own buoyant expectation for solid earnings growth in the coming years, we remain concerned that operating margin developments will not be as significant as AutoWallis expects to be given industry players' (car manufacturers and distributors) struggles in a highly competitive landscape, tightening regulation (CO₂ compliance) and consumers' growing preference for new mobility services and technologies (electrification, MAAS and the cost of developing connectivity and assisted driving systems).

In fact, AutoWallis does not provide investors with insight into how it wants to step up its organic EBITDA margin from current 3.5% (1H/19) and historical 3.4% to 5.6% as guided to 2024. Our best guess is that EBITDA margin could improve to only 4.1% by 2024 given a strong headwinds from the megatrends, such as electrification, connectivity, diverse mobility and autonomous driving, facing all operators in the industry.

Estimated development of AutoWallis' margins (2017-24F)



Source: AutoWallis, Concorde's estimate

We anticipate that the traditional distribution model will be more and more often challenged by integrated omni-channeling, driven by the evolving consumers' preferences. Small, independent dealers are expected to gradually go out of business due to their low economic viability, while stronger players remain interested in their assets. The current leading CEE dealers, like AutoWallis, who already achieved a cross-border presence, are likely to continue to expand, adding new business streams (such as real estate, rental and leasing options, financial services) to their offer, enlarging their geographic scope, and accepting new members in their partnerships while those dealerships who can stay on their feet becomes even more competitive.

We agree with analyses which predict that the ongoing megatrends in the car and dealership industries will have wiped out at least 100 bps from return on sales by 2024. It is highly likely that the growing number of online sales based on a direct distribution model and the further rise in mobility services will lead to fewer new car sales in the future. The breakthrough of electrification and autonomous driving will likely reduce demand for maintenance and repair services. This we believe will hurt the aftermarket business, particularly for dealers in urban areas.

It is important to remind that BMW, the major car manufacturer partner of AutoWallis, appears to have weathered the disruption caused by the introduction of WLTP better than some of its German arch rivals (e.g. Volkswagen or Daimler), incremental cost headwinds from CO₂ compliance and new technology development ongoing for some time will put a drag on its margins.

AutoWallis expects an overwhelming improvement in its automotive service segment's EBITDA margin based on new services and consolidation, but we are very skeptical about the profitability of car sharing services in the long run given the increasingly competitive sharing market and inadequate demand. To be able to offer the high-quality service appreciated by customers, we believe a great deal of effort and additional services (for example, driving school and an intuitive booking platform) are required. The daily operation with customer service is cost-intensive, but necessary in order to make the fleet available to customers in good condition, while competition tends to prevent costs being passed onto customers.

The reality is that many dealerships struggle to hold earnings flat in a challenging environment which we acknowledge does not make the sector a particularly compelling investment story in the near term. Admittedly, if the top-line is growing but margin evolution is unlikely to be similarly significant, it will be difficult to see what else could drive earnings growth and positive earnings revisions in outer years.

But, to be fair, AutoWallis is not standing still: in light of significant wage growth witnessed across the whole region, we are confident that AutoWallis will remain committed to keeping a tight lid on controllable costs and improve efficiency (we expect the revenue/IC ratio to improve slowly but continuously), acknowledging that a large percentage, if not all, of the cost savings are countermeasures, offsetting the cost inflation inherent in increased costs associated with new accessorial services. Clearly, in an industry where challenges are mounting, even in the event that sales grow steadily we believe entry into new markets and a higher scope and complexity are unlikely to drive major margin expansion. This is actually the main reason why we forecast only 80 bps increase in AutoWallis' organic EBITDA margin by 2024, coming on the back of add-on services, international distribution expansion and cost measures.

We believe the primary drivers of organic EBITDA margin improvements and value creation will be new distribution agreements, like the one initialed recently with Jaguar and Rover, organic regional growth, higher-margin add-on and aftermarket services and cost reduction measures. International distribution is likely to generate relatively higher margins thanks to gradual market penetration and income convergence towards EU levels. In contrast, domestic distribution is likely to see margins stagnating due to the highly fragmented and thus competitive premium car market.

Pursuing both retail and wholesale distribution combined with complex offering of consumer services makes AutoWallis less vulnerable to penetration of disruptive technologies, or changing demand pattern. In its international markets (the Balkans, in particular), AutoWallis acting as a wholesaler is sitting in a comfortable position between car manufacturers and retail distributors thanks to its efficient stock management. However, with the change of pace in electrification and customer behavior towards mobility, we expect pressure on margin to spread across the whole industry.

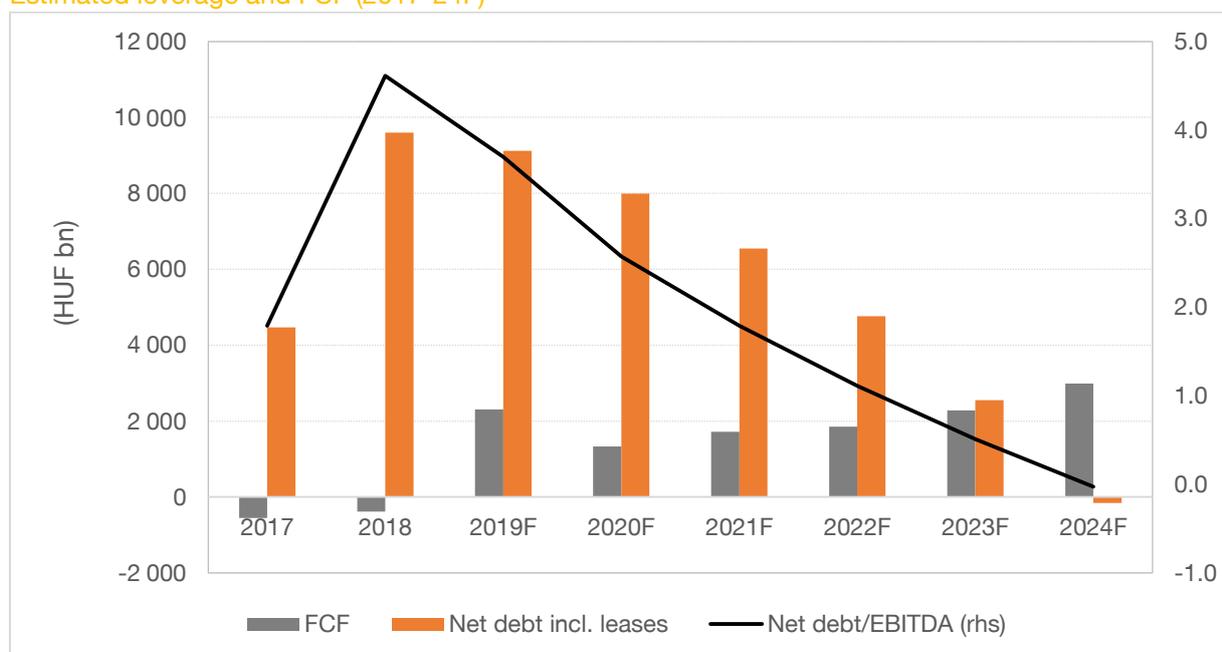
Scale and complexity: The global car manufacturers typically outsource distribution in those markets where consumer purchasing power is steadily increasing, or starts from a lower level and / or there is no production facility or local market knowledge is necessary to support sales. AutoWallis is a reliable regional partner for global car manufacturers it represents. It plans to further extend its geographical presence based on its existing distribution agreements with auto brands, and by obtaining distribution rights from 2-3 additional premium brands.

Over the past two years, AutoWallis, has taken steps to gain market share through focused strategic actions. The most powerful, in our view, has been the expansion of premium car products offering into different brands (e.g. Jaguar Land Rover), categories and price-points, and thereby putting a floor beneath increasing its customer base. While effective for bolstering the top-line, this strategy has widened AutoWallis's scope as well as complexity. Looking at the industry across the Central Eastern European region and some of AutoWallis's domestic competitors, AutoWallis today has larger scale and complexity than many dealerships.

Given the absolute costs involved in operating dealerships, we believe that having higher scale and revenues, against which to incur costs presents a relative advantage. Historically, AutoWallis appear to have outperformed (class leading operating margins). We believe this has been achieved through pursuing a larger scope. AutoWallis now competes in a very broad number of segments and price ranges while focusing on the premium vehicle segment. In addition, unlike its competitors AutoWallis' flexible strategy will make it able to offer a wide scope of accessorial services to customers leveraging on its sound financials, strong management team and deep market knowledge to develop retail and wholesale sales and distribution ability. All this adds to its complexity, which will also drive costs.

Leverage: Although we do not incorporate M&A into our earnings model, the reality is that AutoWallis is eager to do acquisitions. In these cases, AutoWallis is likely to use debt financing to the extent of less than 50% for its future acquisition payments. We understand that the planned take-over of some targets will also be financed by issuing new shares; new debt will thus not be required. Even so, we anticipate its ND-to-EBITDA ratio may remain in the region of 4.0x. As we assume no acquisitions in the coming years but constantly improving capital intensity, thus leverage should decline gradually after 2020. We note, however, that in case AutoWallis carries out sizeable M&A transactions, its leverage is likely to remain high going forward.

Estimated leverage and FCF (2017-24F)



Source: AutoWallis, Concorde's estimate

Free cash flow was negative in 2017 and 2018 but we expect cash flows generation to turn positive this year. Residual-value risk is limited as less than 10% of AutoWallis's assets at year-end 2018 were exposed to this risk.

We note that working capital level is high and expected to grow in the years to come. Of course, any more investments in working capital will tie up cash, and therefore may reduce cash flows in the future period. The same is true for capital expenditures. The net capital expenditures will depend on how fast AutoWallis will be growing or expected to grow. As a high growth firm AutoWallis is likely to see its net capital expenditures increasing somewhat from current levels, particularly when it will do acquisitions since these are like capital expenditures.

Earnings growth: We expect EPS CAGR of 31% by 2024, albeit from a low base in 2018, driven by revenue growth and some improvements of operating margins. If no margin improvement is achieved, we believe AutoWallis still would have the potential to increase its EPS at a CAGR of 24% by 2024 based on expected revenue growth.

Dividend: AutoWallis paid dividend of HUF 2,875 a share to the owners of "B" series dividend preference shares from its 2018 earnings, equivalent to total dividend payments of HUF 575 mn. AutoWallis has not yet elaborated a long term dividend policy coherently with its long term strategic objectives. Therefore, we do not calculate dividend payments until they have announced.

Risk factors:

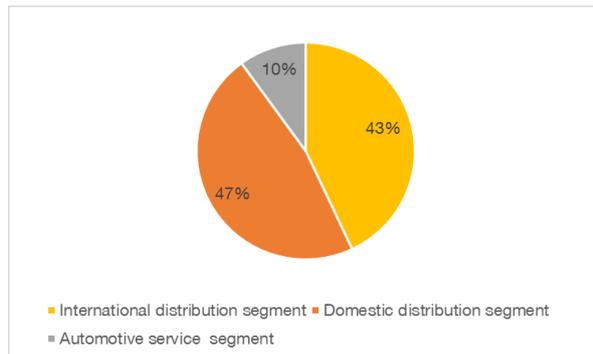
- It cannot be guaranteed that AutoWallis' recently announced 5-year business strategy will be successful and that growth will be implemented in a value creative way. Strategy is based on market forecasts and AutoWallis' own calculations. Planning errors, wrong market forecasts and analyzes would result in an inappropriate execution of the medium-term strategy, which not only would fail to yield benefits, but also may result in disaster.
- There are numerous kind of business relationships between the AutoWallis Group affiliated companies. Part of AutoWallis' revenue and services provided by their affiliated companies. In the event of any future change in the ownership structure of AutoWallis or its affiliates, the relationship of the AutoWallis Group with these companies may change that could adversely affect the effectiveness of AutoWallis' business model and limit future financing opportunities.
- Consumers' perception of brands sold by AutoWallis may change negatively, which may have a dampening effect on AutoWallis' sales and earnings performance.
- New technologies that may be introduced by AutoWallis in the future may be less productive than predicted causing impairment losses. Not only can technological developments transform the areas in which AutoWallis is present, but in some cases certain core activities can even be completely eliminated or significantly reduced (e.g. by introducing severe restrictions on diesel vehicles). If certain novel technology solutions in which AutoWallis does not have sufficient experience gain traction, while competition gets stiffer, and sales channel structures and methods to reach customers changes overwhelmingly, AutoWallis' market share, sales and profitability may deteriorate.
- Possible adverse macroeconomic developments (i.e. economic slowdown, worsening external and internal imbalances) in Hungary and other key target countries (thus primarily in Romania, the Balkans, the Czech Republic, Slovakia) may have a negative impact on supply-demand conditions of key products and thereby affecting profitability of AutoWallis' activities.
- A possible agreement between the United Kingdom and the European Union on Brexit could also adversely affect demand for some of European luxury car models imported and distributed by AutoWallis.
- Environmental and tax legislation in Hungary and some of the key target countries where AutoWallis may seek investments are considered to be relatively underdeveloped - decisions of authorities and courts are sometimes contradictory, inconsistent and difficult to implement w/o additional costs incurring, which with the introduction of applicable environmental and traffic restriction rules and additional tax charges could have a negative impact on AutoWallis' operation.
- Tightening automotive industry regulations in Hungary and the EU, and the application of such regulations (e.g. the introduction of new CO₂ quotas or various traffic restriction measures or further restrictions on diesel vehicles in certain markets) and their significant changes can also affect AutoWallis' profitability, market position and competitiveness of its businesses.
- Operation permits, regulatory approvals or certificates necessary for the operation of AutoWallis may be revoked or not extended.
- The automotive industry is expected to undergo significant changes in the near future. There are three main drivers of transformation: the decline in usage of conventional fossil fuels, the proliferation of autonomous technologies and the proliferation of community motoring. Any intensification of competition in the future may require significant, yet unforeseen investments, and may have a negative impact on the prices of products / services sold by AutoWallis. Having said that, we believe that AutoWallis has well - diversified automotive market presence and significant professional experience and background to face the new challenges that may arise.
- The performance and success of the AutoWallis Group depends to a large extent on the experience and availability of its executives and key employees. AutoWallis struggles to retain these key professionals by providing competitive employee benefit packages and incentives, but there is no assurance that one or more experienced key professionals will leave AutoWallis in the future.

- The lack of a strong team in place may derail post-acquisition integration process. If estimated synergies are not captured quickly they may never be captured. Implementation cost and timing issues can also be underestimated. To choose a wrong benchmark can easily lead to a higher valuation premium than justifiable, restricting AutoWallis' ability to achieve potential synergies from takeover deals it intends to carry out.
- A significant part of AutoWallis' revenue comes from a few number of customers who usually bring about high customer concentration, thus leaving AutoWallis be exposed to failure or late-payment risk of major customers. The loss of a small number of sales contracts may have a significant impact on AutoWallis' future revenue and profitability. AutoWallis has fixed term contracts with certain customers, suppliers and of funding. There is no guarantee that the parties will be able to agree to an extension after the expiration of these contracts. It cannot be excluded either that the fixed-term contracts will be terminated unexpectedly or, in exceptional cases, before the expiry of the fixed period.
- Implementing new investments and developments is a capital-intensive activity that requires significant funding. In addition to its own resources, AutoWallis secures financing for its daily operating needs by borrowing from financial institutions. Certain factors (including economic conditions, changes in credit policies and interest rates) may increase, complicate, delay or even disable the implementation of AutoWallis' new strategy, including among others future acquisitions, extension and repayment of financing. It is worth noting that most of AutoWallis' loans are floating rate loans and are linked to reference interest rates such as BUBOR or EURIBOR. Any unfavorable changes in the interest rate policy of regional central banks can lead to an increase in the cost of funding, and make it more difficult to obtain financing, or even renew and repay the current credit facilities,
- Adverse FX rates movements (EUR, HRK, RON, PLN, etc.) may also adversely affect AutoWallis' profitability considering the fact that foreign exchange rate related transactions (including new car purchases) are an essential part its operation.
- It cannot be excluded that financial, legal or other events arising in connection with the completion of the future acquisitions will result in a significant tax liability of AutoWallis or the acquired companies or any other subsidiaries as a result of a future tax assessment.
- The malfunctioning or security of AutoWallis' IT systems may have consequences for its activities and profitability.
- There may be a loss event which is wholly or partly outside the scope of AutoWallis Group member companies' existing insurance policies and the AutoWallis Group will be obliged to bear the damage itself.
- There is no guarantee that AutoWallis shares will be adequately liquid in trading on the stock market, so that shareholders may have only a limited opportunity to sell the shares, while low liquidity may influence the valuation of AutoWallis' shares.
- AutoWallis cannot guarantee that its activities will be profitable in the future or that earnings will be paid out automatically as dividend to shareholders. It is worth noting that AutoWallis does not have an approved dividend policy. As the new growth strategy bears a great deal of implementation risk, there is no guarantee that AutoWallis will pay dividend to minority owners in the future.
- **The interests of minority owners may be in stark contrast to the way in which the principal shareholder aims to expand AutoWallis' businesses (including the possibility of making overpriced acquisitions, or using treasury shares or any new shares issued either publicly or in the framework of a private placement in an improper way for inorganic transactions in the future). In addition, in the event of a potential future capital increase, if the minority shareholders are not allowed to participate in, their ownership in percentage terms will be further reduced.**

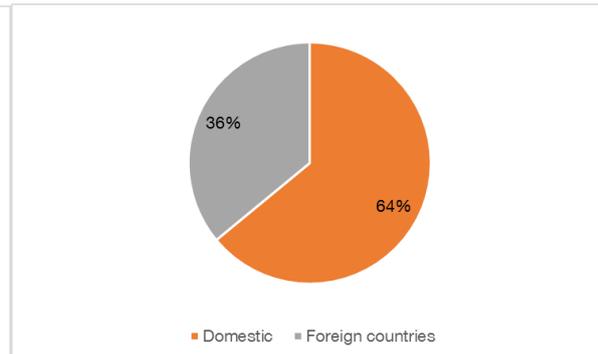
Overview of AutoWallis' business

AutoWallis is best in class in operations and a dominant player in CEE regional car dealership markets. It is present in 14 Central and South Eastern European Countries. AutoWallis had EBITDA of HUF 2.3 bn on revenue of HUF 65 bn in 2018, employing more than 300 people. AutoWallis has three main activities: domestic distribution, international distribution and automotive services, which accounted for 47%, 43% and 10% of its sales revenue, and 4%, 36% and 60% of its pre-tax profit in 2018, respectively.

Revenue breakdown by segments in 2018



Geographic revenue breakdown in 2018

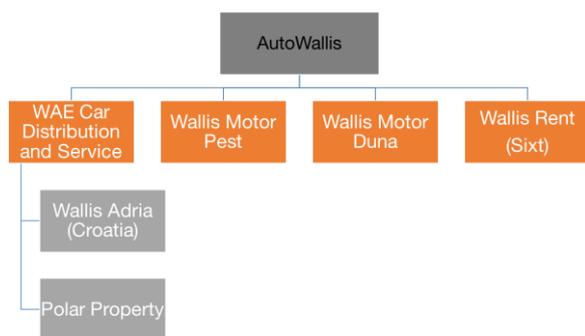


Note: Foreign countries are Albania, Bulgaria, Czech Republic, Bosnia-Herzegovina, Croatia, Serbia, Kosovo, Slovenia, Macedonia, Montenegro, Romania, Slovakia and Poland, out of which the Balkan countries account for the overwhelming majority of sales revenue.

Source: AutoWallis

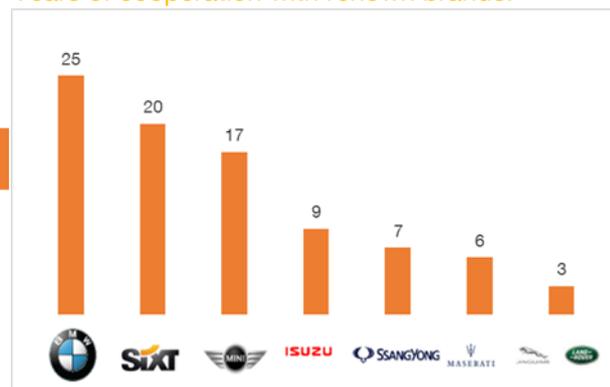
In 2018, AutoWallis, formerly called as Altera Wealth Management Co. which pursued wealth management activity, decided to step into the domestic and CCE automotive trade and aftermarket service industry as an exclusive member of the Group consisting of WAE Car Distribution and Services Ltd., Wallis Motor Duna Car Dealership Ltd. and their subsidiaries, Wallis Adria doo, and Polar Property Ltd. Since then these companies and AutoWallis itself have been forming the AutoWallis Group.

AutoWallis' group' structure



Source: AutoWallis

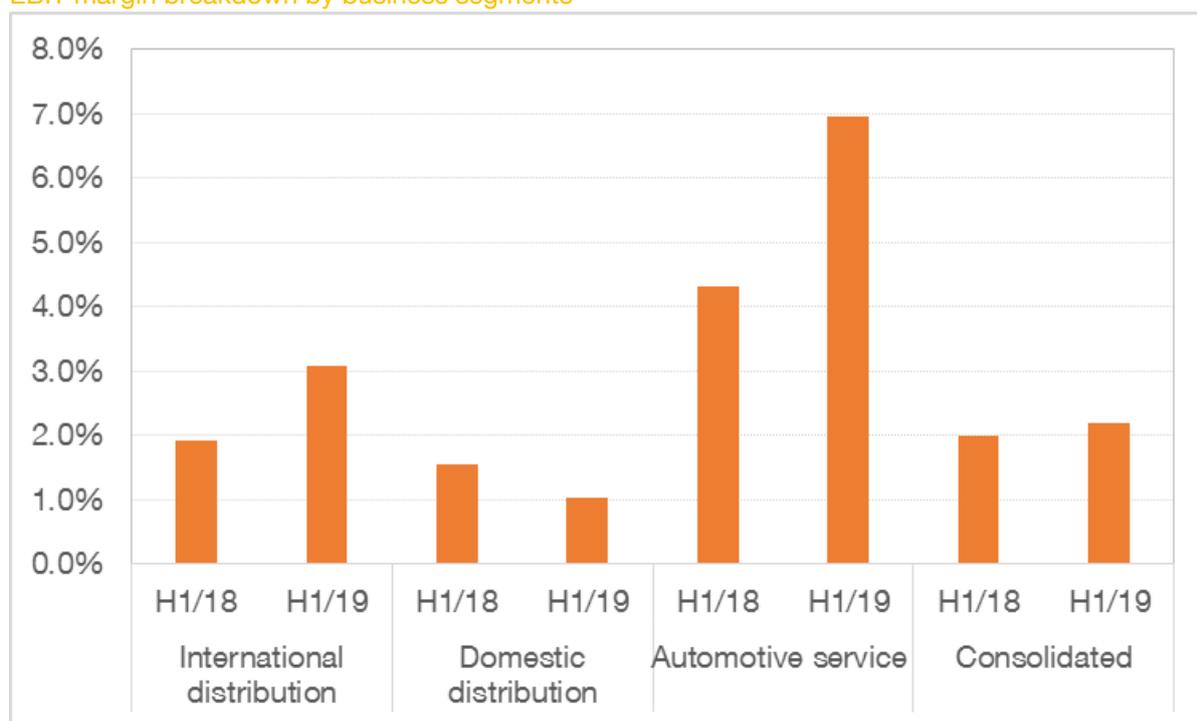
Years of cooperation with renown brands:



The group member companies in Hungary and the CEE and SEE regions are engaged in the retail and wholesale of motor vehicles and vehicle parts, repair services, and short and long term car rental. Brands represented by the group include BMW passenger cars and motorcycles, MINI, Isuzu, Jaguar Land Rover, Maserati, Ssangyong, supply of Saab spare parts and Sixt rent-a-car, of which car brands are present in the regional premium car market segments, while Sixt holds a dominant position in the car rental market.

While giving the majority of sales, domestic distribution makes rather thin EBIT margin (ca. 1% on our estimate) due to the highly fragmented domestic premium car market and the relatively high number of BMW brand distributors with comparable size. In contrast, international distribution generates relatively higher EBIT margin (ca. 3% on our estimate) as premium vehicle market segment is not that fragmented in the Balkans, while there is a constant convergence in penetration and household income towards EU levels supporting both sales in volume and pricing. Automotive service segment adds the highest EBIT margin (ca. 7% on our estimate) benefiting from higher added value services (including aftermarket vehicle services and accessorial services).

EBIT margin breakdown by business segments



Source: AutoWallis, Concorde's estimate

Product diversification is a restraining factor for the company's business risk profile, with around 90% of revenues stemming from car sales. Some diversification is achieved through sales channels: retail accounts for around 30% of car sale revenues and wholesale for 60%. Diversification through the different markets is limited, with the two premium ones, JaguarLandRover and BMW, accounting for around 70% of total revenues. Despite having been positioning across 14 countries. AutoWallis' has strong dependence on two countries, Hungary and Croatia. Hungary represented 64% of total revenues in 2018, and the two countries combined represented 75%-80%.

The low profitability is another constraint for the company's business risk profile. EBITDA margin was 3.2% in 2018, or around 4% when adjusting for operating leases. This is mainly attributable to automotive sales. The services business, on the other hand, is very profitable, contributing around 50% of total EBITDA in 2018 despite a very low revenue share, on our estimate.

Revenues per car sold

	International distribution			Domestic distribution		
	H1/18	H1/19	Ch.	H1/18	H1/19	Ch.
No. cars sold (new + sold)	948	1 706	80.0%	1 596	2 092	31.1%
Revenue per car sold (HUF mn)	15.8	9.7	-38.5%	8.7	8.7	0.0%
EBIT per car sold (HUF mn)	0.3	0.3	-1.9%	0.1	0.1	-32.5%

Source: AutoWallis, Concorde's estimate

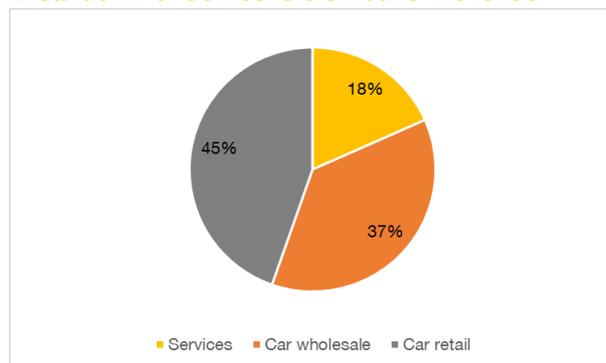
In the used vehicle segment AutoWallis operates its own dealerships and service points. Main competitors of AutoWallis in the domestic market are the community of other leading dealerships of the brands sold by AutoWallis, and the dealerships of competing brands of motor vehicles.

In international distribution (this relates particularly to the wholesale segment for car brands JaguarLandRover, Isuzu and Ssangyong), AutoWallis benefits from being the exclusive distributor in several central and south-eastern European countries.

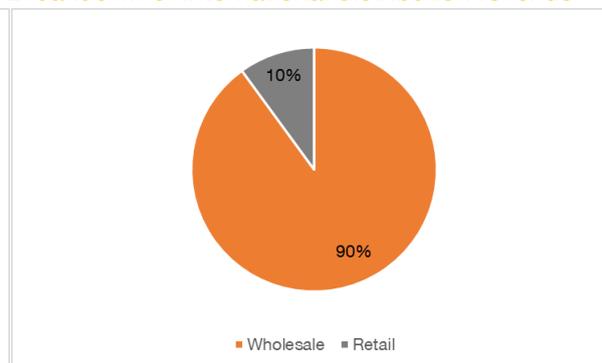
Sales channels: AutoWallis integrates retail and wholesale activities into its activities to capture and control margins through the entire distribution value chain in the most effective way possible.

In Hungary, AutoWallis' revenue come predominantly from retail segment (ca. 85-90%), while wholesale distribution account for the vast majority of its sales in international markets, of which distribution in the Balkans represent the largest chunk.

Breakdown of domestic distribution revenue



Breakdown of international distribution revenue



Source: Concorde's estimate

Operating as a wholesaler AutoWallis purchases and sells cars and vehicle parts in large quantities to many different retailers and distributors for onward sale. This way AutoWallis is able to buy cars from car manufacturers for a lower unit price as it is buying in bulk, which reduces the handling time and procurement costs involved.

This also requires to rent some warehouse storage space to facilitate those sales, and that the inventory in warehouse, even if it is normally kept at a low level, be integrated seamlessly with a wholesale management platform to always know how many of each item is in warehouse, ready for those large wholesale orders from international markets that needs to be fulfilling.

Being a wholesaler with exclusive distribution rights to sell premium car brands gives AutoWallis a solid market position as well as access to a diverse range of dealership outlets. Offering cars as wholesale allows AutoWallis to reach a large customer base, therefore making it able to grow its business relatively quickly. The exclusive wholesaler position naturally drives retail dealerships' interest for AutoWallis' offerings who is an indispensable wholesaler for the distribution of certain car brands.

When selling goods via wholesale, it provides AutoWallis with a much faster and easier way to expand into regional markets. Any growth and expansion is defined primarily by its relationship with local dealerships and vehicle parts outlets who buy products from AutoWallis. As a wholesaler, AutoWallis provides its resellers with the best service to allow them to grow their business and trust them as a repeat supplier. On the other hand, by selling products to retailers AutoWallis undoubtedly places faith in their ability to retain the brand identity of its products. Operating as a wholesaler in the Balkans, it is not always be possible for it to have control over how products are merchandised, especially at multi-branding dealerships, how it's discounted or what other competitive cars and products it's displayed alongside.

Its accounting system is calibrated to allow it for multicurrency transactions so that it theoretically can sell across multiple currencies to various clients, quickly and easily. Another part to this is that when selling via wholesale, AutoWallis are able to ship goods internationally in bulk, which depending on workflows and product costs, is a cheaper way of selling.

As a retailer at the front line of building a relationship with the consumer, AutoWallis is able to be better responsive to the changing needs and desires of its consumers in the domestic market, in particular. By being the retailer, it can personally select the the channels, which are primarily physical showrooms and an online presence. To keep control of the business from start to finish, maintain own virtual or brick and mortar showrooms and to grow the business quickly, all at the same time, allows AutoWallis to retain direct contact with its consumers.

Also importantly, operating as a retailer is ideal for AutoWallis to keep an eye on margins across the sales channels as each platform incurs different costs. Having a grip on all of the hidden costs, such as insurance, shipping, and inventory costs can ensure AutoWallis to make a profit, even if it is barely visible due to the highly competitive domestic premium car market.

1. International distribution activities

In connection with its international distribution activities, AutoWallis operates as an exclusive importer in each country.

AutoWallis's main international distribution activities are:

- regional brand building
- logistics
- marketing
- retail network management
- car workshop network development
- vehicle parts supply

AutoWallis is a global distributor of Jaguar Land Rover and Ssangyong vehicles and parts in both wholsale and retail. AutoWallis has been selling Ssangyong in Romania since 2012, and in 2018 it was awarded the distribution rights in the Czech and Slovak markets. As a distributor of Jaguar and Land Rover vehicles, it is present in seven Balkan countries: Albania, Bosnia and Herzegovina, Croatia, Serbia, Slovenia, Macedonia, and Montenegro. AutoWallis has established a subsidiary, Wallis Adria d.o.o., in Zagreb, to manage the Jaguar Land Rover activity in Yugoslav markets and in Albania.

No. of new premium passenger car registration in Hungary by brands

	H1/19	H1/18	Ch. (%)
Albania	1 714	1 682	1.9
Bosnia-Hercegovina	5 701	5 532	3.1
Czech Republic	128 498	143 784	-10.6
Croatia	36 156	38 229	-5.4
Poland	278 332	273 045	1.9
Macedonia	2 381	2 288	4.1
Romania	71 620	60 068	19.2
Serbia	12 243	11 570	5.8
Slovakia	52 075	51 891	0.4
Slovenia	45 330	47 587	-4.7
Total	634 050	635 676	-0.3

Source: DataHouse

No. of new premium passenger car registration in Hungary by brands

	H1/19	H1/18	Ch. (pps)
Albania	8.5%	10.5%	-2.0
Bosnia-Hercegovina	13.2%	10.3%	2.9
Czech Republic	7.7%	7.8%	-0.1
Croatia	8.0%	8.6%	-0.6
Macedonia	9.9%	9.8%	0.1
Romania	7.7%	8.4%	-0.7
Serbia	13.7%	12.9%	0.8
Slovakia	8.6%	9.6%	-1.0
Slovenia	6.9%	7.7%	-0.8
Total	634 050	635 676	-0.3

Source: DataHouse, S.C. A.P.I.A. Consult; ZAP

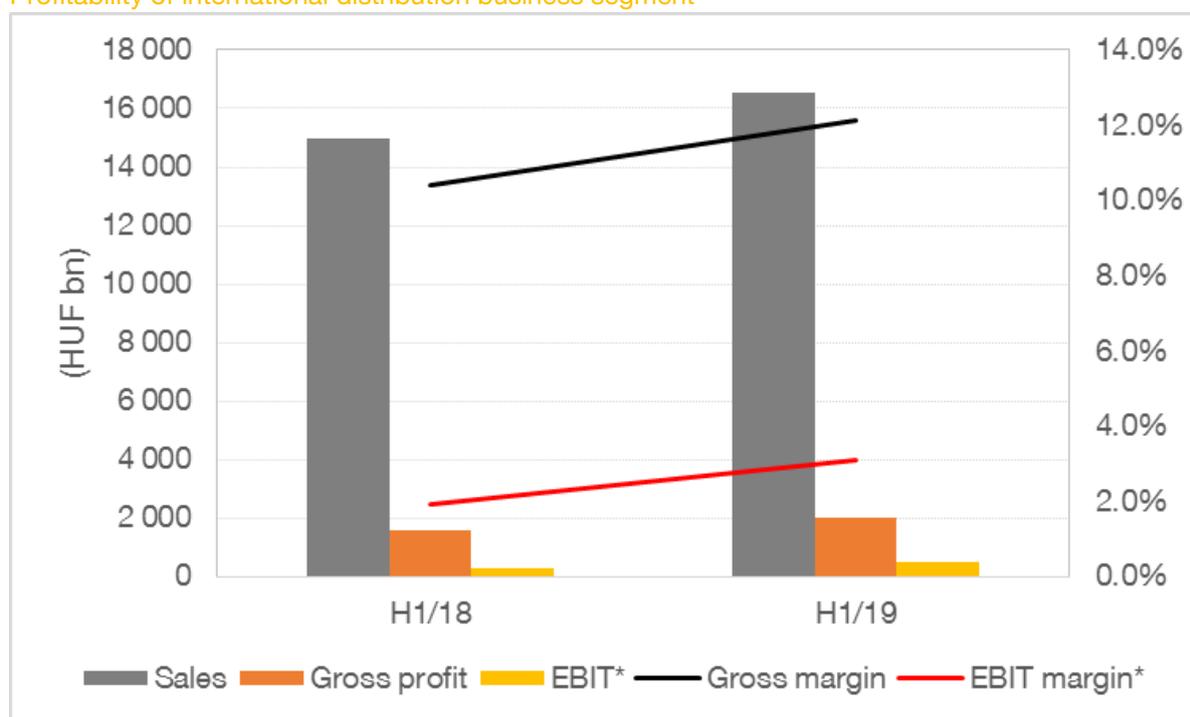
In the framework of its international distribution activities, AutoWallis does not operate own dealerships or service centers, but only contracts with independent vehicle retailers to cover the export markets. Its retail network consists of nearly 60 partners. Local staff in various markets are responsible for local sales, marketing and network development. AutoWallis coordinates its international distribution activities from its distribution center in Hungary. Car stock for the international distribution activities is stored at a logistics partner in Hungary (in the city Győr), from where it is eventually shipped to 11 export markets.

The number of new vehicles sold as part of international distribution activities:

	2015	2016	2017	2018	H1/18	H1/19
New cars sold	22	246	1 678	1 736	948	1 706

Source: AutoWallis

Profitability of international distribution business segment



Source: AutoWallis, Concorde's estimate*

2. Domestic distribution segment

AutoWallis is positioned towards the premium and luxury car distribution segment in Hungary. By means of a 5-year dealership contract with BMW, AutoWallis as a retailer represents one of the most prominent and respected luxury automotive brands in Hungary.

AutoWallis's main domestic distribution activities are:

- new car sales
- used car sales
- vehicle parts sales
- local brand building
- stock management
- customer contact
- site-based availability

As part its domestic distribution activities of new and used motor vehicles, motorcycles and spare parts, AutoWallis deals with in new and used BMW cars and motorcycles, ISUZU, Jaguar, Land Rover, Maserati, MINI, and Ssangyong brands. JaguarLandRover and BMW brands accounted for around 70% of total revenues in 2018. Based on newly registered cars in Hungary, AutoWallis' market share was around 2% in 2018.

AutoWallis is acting as the largest and longest-running dealership of BMW car, motor and MINI in Hungary. AutoWallis currently operates BMW's retail business of passenger cars, motorcycles and parts in three locations in Budapest in a total net floor area of over 12,000 square meters, which have been completely renovated according to BMW standards, and owned or operated under a long-term lease agreement. AutoWallis sells new BMW models, BMW electric and hybrid models, and BMW motorcycles with a complex component background in domestic retail sales, and MINI products in a separate two-floor building. In addition to presenting new models, this site also offers a selection of BMW Premium Selection and used cars.

In addition to BMW and Maserati, AutoWallis represents the Isuzu brand in Hungary as an exclusive wholesale distributor. The brand has a long history with Japanese automakers and has become one of the largest commercial vehicle manufacturers in the world for over a century. In Hungary, Isuzu is a dominant market player in the pick-up car segment. AutoWallis also represents the South-Korean "4x4 specialist" Ssangyong Automotive and Parts Wholesale Business in Hungary since 2012 as well.

As for car brands, BMW has increased its market share in the premium segment in the past two years thanks to its new models, while Audi's have declined compared to BMW. Volvo and Lexus brands have emerged as important players in the segment, which have seen significant growth over the years. The new BMW X5 and X7 SUV models (X5 and X7) are highly sought after in the domestic market, while the new BMW 3, which has been launched in the market in 2019, is expected to see significant growth as well. In the case of BMW Motorcycles, AutoWallis lost a few percent of its market share, as rural dealerships grew.

No. of new premium passenger car registration in Hungary by brands

	H1/19	H1/18	Ch. (%)
Mercedes	2 160	2 164	-0.2
BMW	1 958	1 493	31.1
Audi	1 502	1 358	10.6
Volvo	975	850	14.7
Lexus	375	348	7.8
MINI	264	122	116.4
Land Rover	88	91	-3.3
Porsche	61	74	-17.6
Jaguar	54	107	-49.5
Total	7 437	6 607	12.6

Market shares by premium brands

	H1/19	H1/18	Ch. (pps)
Mercedes	29%	33%	-11.3
BMW	26%	23%	16.5
Audi	20%	21%	-1.7
Volvo	13%	13%	1.9
Lexus	5%	5%	-4.3
MINI	4%	2%	92.2
Land Rover	1%	1%	-14.1
Porsche	1%	1%	-26.8
Jaguar	1%	2%	-55.2

Source: DataHouse, Concorde

Despite strong price competition created by other major dealerships of the brands sold by AutoWallis, and dealerships for vehicles and related parts of competing brands (Audi, Mercedes, etc.) AutoWallis holds more than 40% of the domestic market for new BMWs and MINIs and is likely to continue to hold this prominent market position going forward.

Sales in the Maserati brand sold by the AutoWallis Group stagnated in the absence of new models. The Isuzu D-Max in the light commercial vehicle pick-up market share in Hungary was 13% in 2018. According to domestic market research, Isuzu is ranked fourth in the pick-up segment, behind Ford, Toyota and Nissan, ahead of Mitsubishi, Fiat, Volkswagen and Mercedes.

The Ssangyong brand in Hungary is expected to have less than 0.5% market share. The SUV segment will grow by nearly 40% in 2018, where the brand is the most present, and a further sales increase is expected on the back of two new Ssangyong models that have been introduced this year.

Wallis Automotive Europe, which is a subsidiary of AutoWallis, has recently obtained the exclusive importer rights of Jaguar Land Rover vehicles and spare parts in Hungary. Wallis Automotive Europe will start selling Jaguar and Land Rover vehicles in the Hungarian market from April, 2020, which means that the company will be present with these two classic brands in a total of nine countries. In markets where Jaguar Land Rover vehicles are sold by AutoWallis, Jaguar cars sold by AutoWallis account for 5.9% of all Jaguar Land Rover vehicles and that number has doubled since 2016. Jaguar Land Rover sold more than 600,000 cars worldwide in the last two years, nearly three times more than 10 years earlier. Jaguar Land Rover cars account for around 3-4% of the total number of vehicles sold during a year in Western Europe and 10% of all new premium car models. AutoWallis hopes to be able to generate as much revenue from Jaguar Land Rover vehicles in three to four years as it currently does in the Balkans, at a tens of billions of forints, with relatively high margins.

Used car trade activity

Used car sales were included in AutoWallis's commercial activities prior to the opening of the premium used car center, as it has had decades of experience in trade since 2000 in used BMW MINI cars and motorcycles through Wallis Motor Pest Ltd. and Wallis Motor Duna Ltd. AutoWallis's used car commercial business has been involved in the used car trade with varying degrees of intensity over the last twenty years. Two years ago, it opened one of the largest BMW dealerships in the region.

The number of new and used vehicles sold in Hungary:

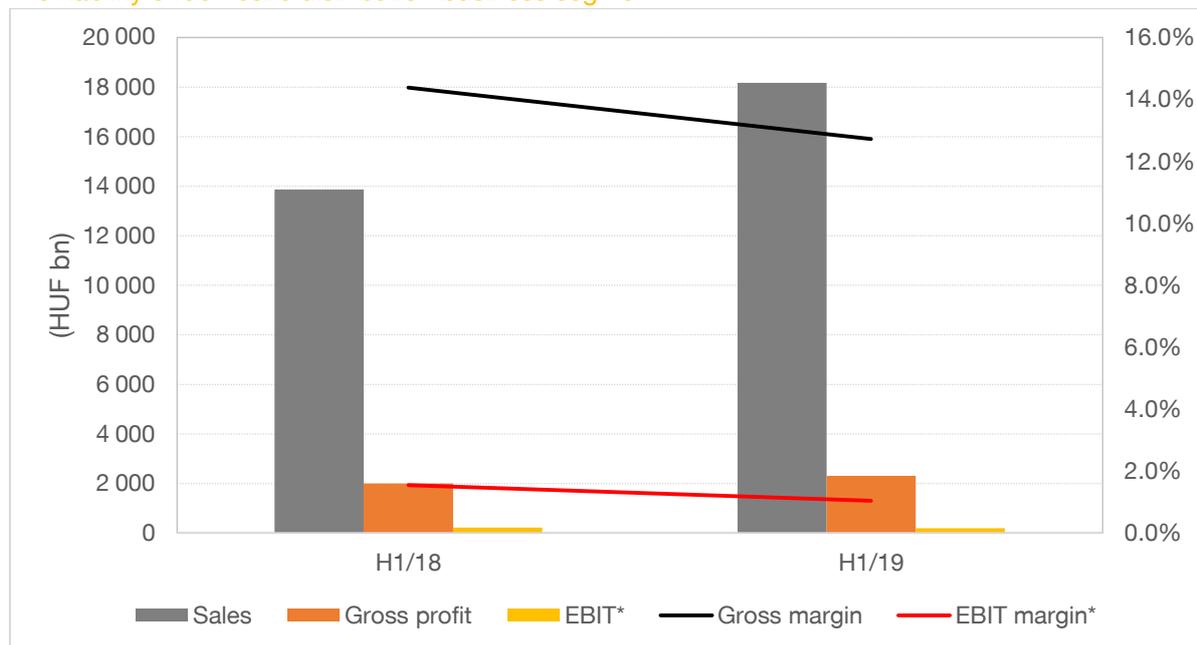
	2015	2016	2017	2018	H1/18	H1/19
No. of new cars sold	1 902	2 197	2 395	2 732	1 337	1 638
No. of used cars sold	362	399	411	551	259	454
Total	2 264	2 596	2 806	3 283	1 596	2 092

Source: AutoWallis

In the fall of 2018, AutoWallis opened a new unit, the Wallis Premium Used Car Center, where it is constantly dealing with the trade for nearly 60 premium-grade, primarily novel, used cars. In the new salon, customers can choose from a significant selection, with 24 months warranty, proven vehicle

history, and 6-month or 10,000 km free repair service, and at the new location, besides the BMW premium selection, the MINI Used Car Next program is also available to customers.

Profitability of domestic distribution business segment



Source: AutoWallis, Concorde's estimate*

Looking to the future, AutoWallis wants to further strengthen its leading market position through consolidating smaller dealerships, representing new premium brands, optimizing stock management, achieving economies of scale in auto parts sales, paying special attention to advanced accessorial services provided in addition to its basic aftermarket services, strengthening client relationship, and exploiting opportunities for collaboration across the distribution chain.

3. Automotive service segment

AutoWallis offers a full range of service backgrounds and ancillary services to all of its domestic retail brands (BMW, MINI, Maserati and ISUZU) at its premises as well as other brand-independent service activities. Although the segment is considered rather small in terms of revenue generation, in fact it is a major EBITDA contributor. Similar to the retail business, AutoWallis' aftermarket services are regulated by BMW. Its well-established relationship with BMW makes a high entry barrier to competition, leaving an only limited market share for the rest of the contracted service providers for BMW in Hungary.

AutoWallis's main automotive service activities are:

- vehicle motor service
- car rental service
- independent motor service and parts sale
- car sharing
- community mobility
- serving electricity transport
- mobility as a service ("MAAS", i.e. the integration of various forms of transport services into a single mobility service accessible on demand)

AutoWallis is also engaged in short- and long-term car rental. The branded services operated by other rival brands in the domestic market as well as the market formed by smaller non-branded services create competition. Rival car rental companies, like HERTZ, Europcar, AVIS, etc., at Liszt Ferenc Airport

in Budapest is of particular importance when it comes to competition. AutoWallis also offers high quality car rental services within the service segment as a Hungarian member of Sixt Rent-a-car's international network.

German-based Sixt and Wizz Air recently entered into a cooperation agreement, through which the car rental company offers reduced rental rates and other comprehensive services to the passengers of Wizz Air. In return, Sixt customers receive a benefit with every rental through the Flight Credit program of Wizz Air. The agreement covers the entire international Sixt network, including its Hungarian member, Wallis Autokölcsönző (a car rental company owned by AutoWallis).

AutoWallis also made its FlizzR brand for lower-end car rental available to its customers in recent years. With this step, in addition to premium car rental, it launched a lower-end car rental service companies. AutoWallis is market leader in airport car rental. The domestic car rental market growth is also supported by the increase in the number of foreign visitors in Hungary. While the traffic of the Liszt Ferenc International Airport has grown by more than 10% in recent years, AutoWallis' revenues from the car rental business expanded significantly, thereby it has become the number one car rental company at Liszt Ferenc International Airport.

Rental fees are usually depend on the location of the pick-up station, the length of the rental to the car category and extras that customers will seek. There is often an additional one-way fee, the amount of which depends on the distance between the stations, as the vehicle usually needs to be transported back to the pick-up station. The duration of the rental influences the composition of the rate, and thus, the cost of the total rental. Weekly and weekend rentals are generally cheaper than daily rentals. Prices for rentals may vary depending on the vehicle model, vehicle demand at the time of pickup, and whether customers pay in full before or at the end of the rental. In principle, the rental prices also vary according to vehicle size. The higher the quality and luxury of a vehicle and the more features it has, the higher the rental price. If demand is high and only a few vehicles are still available, the rental price for the respective vehicle category increases. There is also a range of protection options and extras. These additional services provide security for every claim and allow you to have a carefree and relaxed car rental. On top of these factors, the renter is liable for all costs and fees incurred in connection with traffic and administrative offenses, and she has to return the vehicle to the pick-up station with a full tank to avoid a refueling fee.

Operational highlights of the Automotive segment:

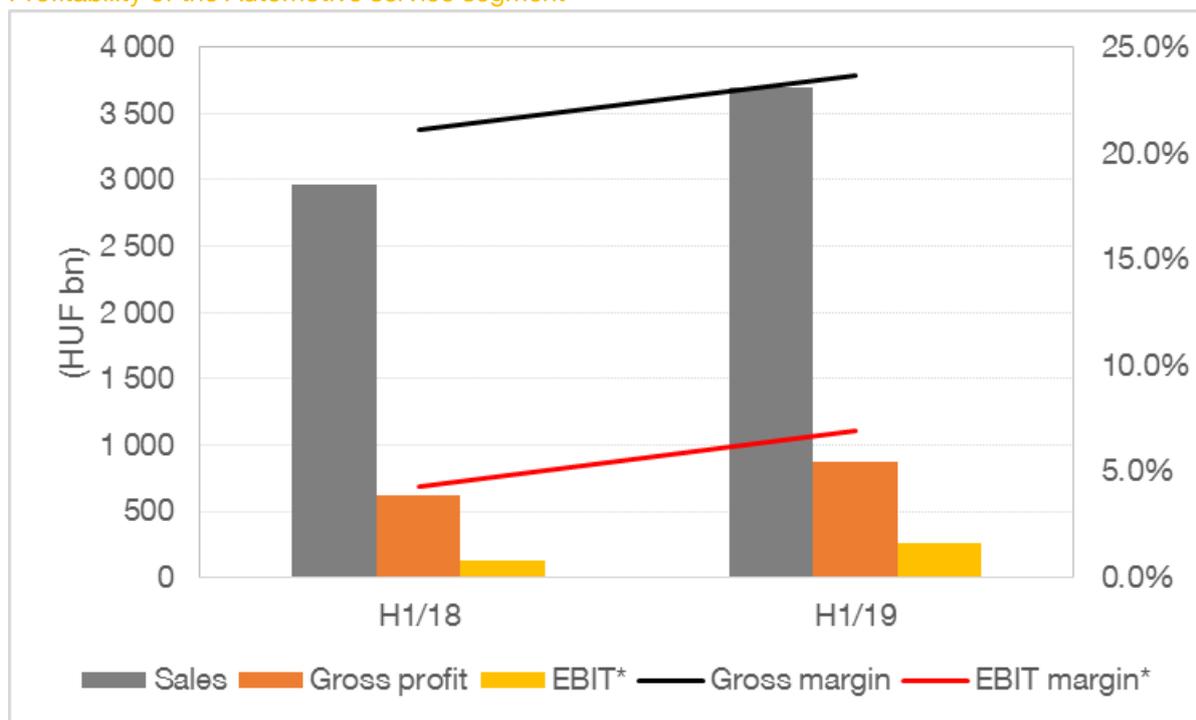
	2015	2016	2017	2018	H1/18	H1/19
No. of service hours	34 093	37 325	38 220	44 099	21 819	25 118
Size of car fleet for rent	385	457	499	535	446	495
No. of rents	18 806	21 856	24 372	25 021	10 746	11 207

Source: AutoWallis

The hourly rate varies by the make, complexity and age of a car in need to be repaired or inspected. Servicing luxury cars usually cost 3x more than small or mid-range cars. The calculation of the hourly rate also depends largely on the service provided: certain services such as equipment, materials used, expertise, etc. depending on the hourly rate, they can be much more expensive than others.

Total service prices are also influenced by whether customer needs a return-to-return car service, a replacement car, fleet management or non-stop service.

Profitability of the Automotive service segment



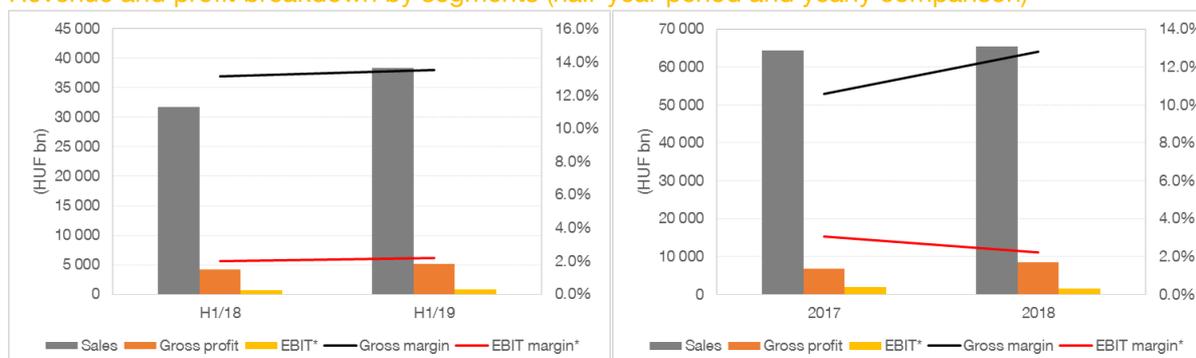
Source: AutoWallis, Concorde's estimate*

AutoWallis' primary goal to further improve the profitability of its automotive service segment. It believes that this segment has the potential for fastest growth among its business activities. AutoWallis believes it can further accelerate the segment's revenue and earnings growth by integrating MAAS services into basic activities, while offering motor services and vehicle logistics services to other MAAS service providers, putting more emphasis on car sharing and other community services, and providing fleet management and financing services.

First half results

In H1/19 the main reason for profit growth and gross margin expansion was driven by the better profitability of the international distribution segment and profit growth generated by the automotive services segment, which is constantly improving. We note that operating results were affected by several factors in 2018 (eg. by the introduction of tighter WLTP standards in the fall of 2018, which boosted customers' purchases for many brands last summer across the EU, or the low margin car stocks created in new markets at that time), making the base extremely high compared to this years' figures.

Revenue and profit breakdown by segments (half-year period and yearly comparison)



Note: AutoWallis, Concorde's estimate*

Source: AutoWallis, Concorde's estimate

Real estates used for daily operation in Hungary

AutoWallis' subsidiaries typically rent real estates, premises, with the exception of the Biatorbágy property own property, which is recorded under non - current assets. In addition, non-current assets include motor vehicles, investments in rental property and other machinery, equipment.

The Asset Companies rent the following properties:

- Wallis Motor Pest Ltd. - Budapest, Hungária körút 95. The rental company is DALP Ltd. The total area is 10 333 sqm.

- Wallis Motor Pest Ltd. - Budapest, Váci út 175. The rental company Váci 175 Irodaház Ltd. Total area: 2,434 sqm.

- Wallis Motor Pest Kft. - Budapest, Váci út 173. The plot area is used only for car parking. Lessor: V177 Real Estate and Maintenance Ltd. Total area: 5 766 sqm.

- Wallis Autókölcsonzó Ltd. - Budapest Váci út 141 real estate (office, parking, sales area). Lessor: Balansz Real Estate Investment Fund (office leased: 397 sqm and rented parking spaces (48). In addition, the company leases smaller properties necessary for its operation.

Real estates have significance primarily in relationship to overall corporate strategy. AutoWallis is still undecided on whether to utilize the real estates it owns or rents through a separated real estate management company or run them as it does currently. The projected return have a place in this determination. The essential considerations in any decision regarding real estate facilities are a projection of changes likely to occur in the market environment and a prediction about what AutoWallis's responses to these are likely to be. The close relationship between real estate facilities and market trends emphasizes one of the most significant attributes of these fixed assets - their temporal utility, which in fact is recognized by accounting practice in its treatment of depreciation allowances.

IFRS 16 – Leases

Under IFRS 16, effective from 1 January 2019, the definition and financial statements of a lease have significantly changed. New accounting rules for leases are meant to improve comparability, but may also affect covenants, credit ratings, borrowing costs all commonly used financial ratios and performance metrics such as gearing, current ratio, asset turnover, EBITDA, EBIT, interest cover, and therefore stakeholders' perception of companies. Balance sheets and FCFs will grow, gearing ratios will increase, and capital ratios (ROCE, ROIC) will decrease, but fundamental valuations should remain unchanged.

Under the new regulation, a contract qualifies as a lease or contains a lease when it transfers the right to use (ROU) an underlying asset for a specified period against payment, with the lessee being entitled to the asset, and the right to make decisions regarding its use.

Under IFRS 16 a lessee will no longer make a distinction between finance leases and operating leases; all (material) leases will be treated as finance leases, with the exception of short-term leases (i.e. leases with duration of less than 12 months) and low value leases.

On the other hand, the lessee is now required to recognize all its leases in the balance sheet as assets together with the related obligation at the inception of a lease.

In the statement of financial position, the lessee will recognize the asset and the liability for the lease, while in the statement of profit and loss, the lessee will report the interest cost and the depreciation of the leased asset instead of the operating lease expenses. Rental expenses will be replaced by depreciation and interest expense in the income statement (similar to previous finance leases). This results in higher front-loaded lease expenses, which in some cases might lead to lower earnings (EPS) and equity immediately after entering into a lease compared to an operating lease previously.

The initial value (at the time of recognition) of the lease liability is measured at the present value (NPV) of the lease payments outstanding at the date of the inception of the lease. For the purpose of calculating the NPV of lease obligation, lease payments are discounted at an implicit interest rate (ie. at the rate at which the fair value of the underlying asset and other direct costs incurred by the lessor equals to the sum of the discounted value of lease payments and the non-vesting residual value) should be the this interest rate can be easily determined. If not, the so-called incremental interest rate must be used to determine the NPV of lease obligation (which in fact is an opportunity borrowing rate that would be incurred if the lessee were to obtain the asset by borrowing under similar market circumstances).

The new accounting treatment will lead to higher net debt and EBITDA, with the majority of the former rental expenses being reflected in depreciation instead of the operating lease expenses, and to a higher invested capital for the lessee (hence a lower ROIC).

The introduction of IFRS 16 should in principle have no impact on equity valuation, since the change of the definition of the lease does not change the economics and underlying cash flow generating capacity of the business. IFRS 16 will increase the enterprise value of companies as net debt will increase, while equity value (i.e. the NPV of the remaining lease obligation) should remain the same.

Rental expenses will be excluded from EBITDA, while capex should not be made equal to depreciation in the terminal value period (as which has two implications for valuation:

- FCF will be higher over the remaining lease period (lease-related depreciation will be reflected in the lease obligation, and lease payments will be reflected in interest payments and redemptions of the lease obligation, however, these are financing items and do not impact FCF), and
- operating earnings will be less vulnerable to fluctuations of interest rates, which serves a reason for applying a lower unlevered beta. However, the lower unlevered beta should be compensated by higher financial leverage (as a consequence of higher net debt).

Enterprise value will also increase, with leases once considered as operating but now recognized as financial on the lessee's B/S. As the increase in the NPV of future lease obligations (increase in net debt and hence also in enterprise value) are in most cases relatively low compared to the operating lease expenses under IFRS 16 (resulting in an increase in EBITDA), the EV/EBITDA multiple decreases except for those companies with long average remaining lease terms and / or low valuation multiples. As a rule of thumb, when the lease multiple (the NPV of lease obligation / current operating lease expenses) is lower than the current EV/EBITDA multiple, the EV/EBITDA multiple should decrease following the introduction of IFRS 16. Conversely, when the lease multiple is higher than the current EV/EBITDA multiple, the EV/EBITDA multiple should increase, ceteris paribus.

AutoWallis' lease obligation has risen under IFRS 16 mostly due to the recognition of leased real estates, and, to a considerably lesser extent, Sixt's auto fleet which is in part lease financed (by Merkantill Bank, which is OTP Bank's subsidiary engaged in lease financing of new and used cars in Hungary). AutoWallis determines the present value of the lease payments by using an incremental interest rate on leases because the internal interest rate is not immediately available.

Inventory management and cash flows

Against the backdrop of strong headwinds with shrinking dealership margins it is of paramount importance to dealers to balance the scales by using dealer inventory management best practices. Car dealer inventory management is a unique challenge, and optimizing inventory and increasing front-end gross profit requires a keen understanding of each vehicle's market. Car dealers may not be able to control which models a manufacturer produces in a given year but there are other inventory decisions that can be made to meet consumer preferences with regard to size, fuel consumption and quality. There are hundreds of models of vehicles for sale that can be pulled into the dealership assortment, but if dealers do not have "the one" customers are seeking the sale is lost.

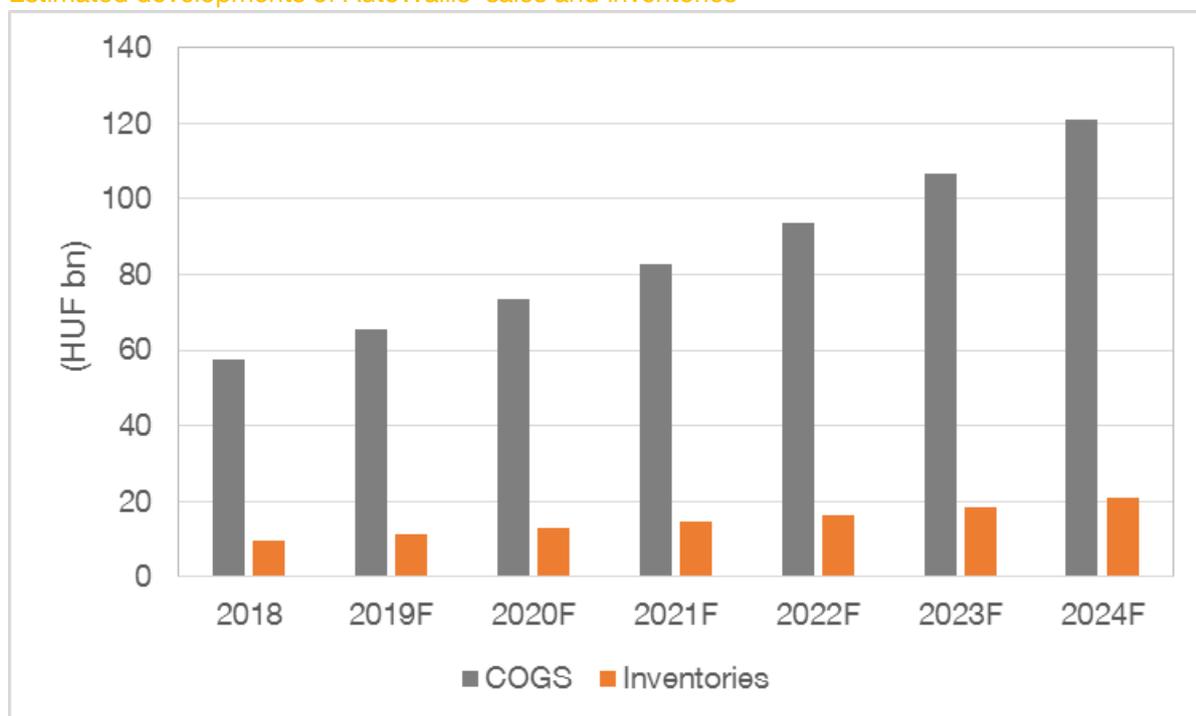
Efficient inventory management applies to pricing more so than many other aspects of the selling process. To manage inventory in a timely manner vehicles must be competitively priced based on prevailing market conditions. Besides competitive pricing price transparency is also important for auto inventory management, as trust almost always becomes a factor when customers are making a high price-tag purchase. Variety is also one of the key factors to moving inventory at a dealership. Of course, in order to source the right mix of inventory dealers need to know each vehicle’s market and what’s in demand among their customer base.

There is also the risk of used car sales cannibalizing new car sales of the same make and model. For used vehicles it’s important to consider the existing supply and demand since the number of used vehicles is increasing. The higher the supply is the more competitive dealers need to be with the pricing in order to avoid holding a vehicle too long. Aged inventory is a huge hindrance for turning a profit given the current excess of older vehicles in the market. The longer an aged vehicle sits on the lot the larger the wholesale loss will be and the longer the cash will be stagnant.

Inventory can tie up a large portion of dealers’ working capital. Proper inventory management software allows dealers to efficiently track sales by model, manufacturer, and to create the optimal inventory mix that lead to faster vehicle turnaround time and improved ROI. Data that is gathered through inventory analysis can help fine-tune resourcing. It reveals the cash cycle, providing a stronghold for when it is best to pile up vehicle inventory and a timeline for vehicle disposal. The analysis can also provide important insights on pricing within the market.

AutoWallis is closely monitoring market trends and dealers’ inventory levels to know exactly what and how much to have, plus when to order additional items to have enough to meet client demand. All this information are updated regularly to make sure inventories are consistent with what is recorded in the system and to avoid a mismatch between demand and supply and all the uncertainty associated with this.

Estimated developments of AutoWallis’ sales and inventories



Note: When predicting future inventories we kept inventory turnover constant at 57 days.
 Source: AutoWallis, Concorde’s estimate

Indebtedness and financial gearing

AutoWallis' debt (mostly consisting of loans for the financing of the vehicle stock) together with long-term and short-term lease obligations amounted to HUF 12.5 bn at the end of June 2019. As a result, its adjusted net debt (ND)-to-EBITDA ratio, based on 12-m trailing EBITDA, was 4.56x, while ND-to-equity ratio stood at 229.3% according to our estimate. We note, however, that outstanding loan is fully covered by the value of the vehicle stock, considering the direct financing for each vehicle. At the end of June 2019, the amount of inventories was around HUF 12 bn on AutoWallis' B/S.

As part of its funding strategy, AutoWallis has successfully applied for NBH's Funding for Growth Program. It obtained its international credit rating (BB-), and thus it met all conditions required for participation in the bond program. AutoWallis' overall credit risk is being rated at B+. Rating agency will reconsider rating negatively if the ND-to-EBITDA ratio climbs above 5.5x on a sustained basis, for example, due to higher-than-expected negative free cash flow and/or overpayments for acquisitions. A negative rating action will also be triggered by the loss of important dealership/importer contracts and/or larger-than-currently assumed debt-financed M&A transactions.

AutoWallis, if it participates in the bond program, intends to use the proceeds of around HUF 3 bn at face value from the issuance of long-term bonds with a possible tenor of 7 years to refinance some of its existing loans with floating interest rates and leasing lines, in particular to replace the leasing contracts of the Sixt franchisee and Wallis Motor Pest.

That AutoWallis has an ambitious inorganic growth plan for the coming years suggests to us that, if acquisitions are implemented, its gearing should increase further. Although we do not incorporate M&A into our earnings model, the reality is that AutoWallis looks very eager to do acquisitions in the coming years. If so, AutoWallis is likely to use debt financing to the extent of less than 50%. We understand that the planned take-over of some targets could be financed by issuing new shares; new debt will thus not be required. Even so, we anticipate its ND-to-EBITDA ratio may remain in the region of 4.0x. As we assume no acquisitions in the coming years but constantly improving capital intensity, leverage should decline gradually after 2020. We conclude that if AutoWallis carries out M&A transactions, its indebtedness is likely to remain high in outer years.

Shareholder structure

AutoWallis' share capital consists of three type of share series: "A" series voting shares (200,000 pieces), "B" series dividend preference shares (200,000 pieces), and "C" series ordinary shares (270,261,400) with a par value of HUF 12.5 each.

"A" series voting shares and "B" series dividend preference shares are owned by Texeber Real Estate Llc. domiciled in Hungary. Texeber Real Estate Llc. is wholly owned by Tibor Veres.

All "C" series ordinary shares are being introduced to the Budapest Stock Exchange. Ownership of "C" series ordinary shares are as follows:

Owners	Direct ownership			
	Ownership (%)		Voting rights (%)	
	"C"-series common shares	All shares	"C"-series common shares	All shares
Wallis Asset Mgmt Ltd.	72.47	72.36	72.47	72.36
Employees	7.36	7.35	7.36	7.35
Andrew John Prest	5.81	5.80	5.81	5.80
Free float	14.36	14.34	14.36	14.34

Source: AutoWallis

In 2018, AutoWallis' Board of Directors of decided to increase the share capital by HUF 3,038,923,500 from HUF 344,344,000 to HUF 3,383,267,500 by issuing 30,389,235 new ordinary "C" series shares with a par value of HUF 100 each in the framework of a private placement in receipt of contribution in

kind of the Companies. The capital increase were implemented on September 9, 2018. At the Extraordinary General Meeting held on 17 December, 2018 shareholders approved stock split of "C" series ordinary shares. As a result, the face value of all shares has changed from HUF 100 to HUF 12.5 but the amount of share capital remained unchanged and the rights attached to the shares remained the same.

On 25 October, 2019, Wallis Asset Management Ltd. (WAM) transferred free of charge 19,890,331 AutoWallis ordinary shares to the AutoWallis Employee Share Ownership Program Organisation, so the number of AutoWallis ordinary shares, owned by WAM changed to 195,861,703 ordinary shares. As a result, WAM currently holds 72.47 % of the issued voting ordinary shares and 72.36 % of the total voting shares. Wallis Portfolio Ltd. has 97.58% ownership and voting rights in WAM.

Following the share transfer transaction, regarding the total amount of issued share owned by WAM and TEXBER Llc. which is indirectly owned by the mutual beneficial owner Tibor Veres, the directly and indirectly owned aggregated shares are 72.51 % which is 72.51 % of the total issued equity capital.

The priority rights of the preference shares were cancelled on the day of AutoWallis' General Meeting of 30 April 2019.

Employee Share Ownership Program (ESOP)

In August 2019, WAM decided to launch an Employee Share Ownership Program (ESOP) for the managers of the AutoWallis Group. The ESOP means no extra expenses or obligations for the company (including the other institutional and private investors outside of WAM) – besides the operational costs of the ESOP organization –, as the 7.35% (19,890,331-piece) share portfolio necessary for launching the program has been handed over by WAM free of charge. It is important to emphasize that, this way the employees and the management of the Group are motivated by intensives from the received resources and not on AutoWallis' own expense, so the ESOP could support to reach the goals set by the new long term strategy not only directly but also indirectly via its incentive effect. At the beginning, 24 managers of the Group will take part in the 2 and 3 years long programs, who will only receive their AutoWallis shares (and the related dividends paid up until then), if the goals set in in the long-term strategy are reached. The ESOP shall be operated by an ESOP organization independent from AutoWallis.

The main owner of AutoWallis had indicated earlier that it would promote the realization of this strategy in several ways, and its aim is to considerably increase the shareholder value. Besides supporting the ESOP, WAM had also committed itself to repay to AutoWallis in the form of a capital increase conceivably via private placement those dividends to be paid by AutoWallis. **While at first sight this is a seemingly generous gesture by the principal owner that can make a significant contribution to maintaining AutoWallis' borrowing capacity when financing its subsequent acquisitions and growth, it could gradually dilute minority shareholders' ownership and voting rights, in our view.**

We strongly agree with the principle that executives may not be so preoccupied with reporting a profit year by year. It should be equally important for them to spend as much time as they should in managing their company's long-term future. We seriously accept the thesis that the essence of managerial responsibility is the extended time lapse between decision and result, thus currently reported profits should hardly be a reasonable basis on which to compensate AutoWallis' top executives, especially in light of high valuation multiples of AutoWallis' stocks.

We are in the view, however, that pursuing these goals could soon become inconsistent: rapid international expansion and retention of WAM's high ownership. If AutoWallis is successful in expanding internationally, the need for additional financing soon raises major problems concerning the extent to which current high ownership of WAM can be maintained.

Share buyback

The EGM authorized AutoWallis' Board of Directors to repurchase shares to the extent of 25% of the share capital at a price of maximum 120% of the closing share price on the Budapest Stock Exchange (BSE) prior to the day of the share repurchase transaction.

The EGM also authorized the Board of Directors to raise AutoWallis' share capital by a maximum amount equivalent to 75% of its registered capital as of the date of the EGM during a 5-year period starting after the date of the EGM. Only the "C" series ordinary shares with a par value of HUF 12.5 each can be issued during any capital increase. The issue value of new ordinary shares shall be determined by the Board of Directors at the higher of the weighted average share price of the 30 days preceding the date of the Board of Directors' decision on the capital increase, or if this price is lower than the closing share price published on the website of the BSE on the day preceding the date of the decision to increase the share capital, then the closing price published on the website of the BSE before the date of the decision to increase the share capital.

New ordinary shares issued during the increase of share capital must be listed on the stock exchange. The authorization to increase the share capital may be renewed and shall apply to all cases and methods of capital increase.

Reverse acquisition

Reverse acquisition occurs when a (usually) publicly traded company is taken over by a private company. First, owners of the private company obtain control over the public company by buying adequate number of shares on the market. Second, the public company 'acquires' the private company by issuing its shares to owners of the private company. Finally, both entities are merged into one entity or operations of the private company are transferred to the public company. In the end, the benefit for the owners of a private company is that they can take their business public without going through costly and lengthy IPO process.

In a reverse acquisition, the cost of the business combination is deemed to have been incurred by the legal subsidiary (i.e. the acquirer for accounting purposes) in the form of equity instruments issued to the owners of the legal parent (i.e. the acquiree for accounting purposes).

Consolidated financial statements prepared following a reverse acquisition shall be issued under the name of the legal parent, but described in the notes as a continuation of the financial statements of the legal subsidiary (i.e. the acquirer for accounting purposes).

The equity structure appearing in the consolidated financial statements prepared following a reverse acquisition reflects the equity structure of the legal parent, including the equity instruments issued by the legal parent to effect the business combination.

The basic earnings per share disclosed for each comparative period before the acquisition date that is presented in the consolidated financial statements following a reverse acquisition shall be calculated by dividing the profit or loss of the legal subsidiary attributable to ordinary shareholders in each of those periods by the number of ordinary shares issued by the legal parent to the owners of the legal subsidiary in the reverse acquisition. The calculations assume that there were no changes in the number of the legal subsidiary's issued ordinary shares during the period from the beginning of the period in which the reverse acquisition occurred to the acquisition date.

If the published price of the equity instruments of the legal subsidiary is used to determine the cost of the combination, a calculation shall be made to determine the number of equity instruments the legal subsidiary would have had to issue to provide the same percentage ownership interest of the combined entity to the owners of the legal parent as they have in the combined entity as a result of the reverse acquisition.

If the acquisition is implemented by contribution transfer, the acquisition-date fair value of the consideration transferred by the accounting acquirer for its interest in the accounting acquiree is based on the number of equity interests the legal subsidiary would have had to issue to give the owners of the legal parent the same percentage equity interest in the combined entity that results from the reverse acquisition. Accordingly, the equity structure of the legal subsidiary (the accounting acquirer) is restated using the exchange ratio established in the acquisition agreement to reflect the number of shares of the legal parent (the accounting acquiree) issued in the reverse acquisition.

AutoWallis' reverse acquisition transaction overview

In the first half of 2018, AutoWallis redefined its long term objectives in order to become a major mobility service provider of the Central and Eastern European region. As part of its strategy AutoWallis decided to invest into companies in the Hungarian and Central-Eastern European motor vehicle trade and service landscape. The investment was made by transferring assets and liabilities of four motor vehicle trading and service subsidiaries of WAM into AutoWallis.

As a first step in the reverse acquisition transaction, WAM purchased a 23.33% stake in AutoWallis, and then increased its holding further to 25% by purchasing an additional 1.74% of the ordinary shares.

Prior to the private placement few private investors (individuals) who owned the Companies acted in concert with WAM and Andrew John Prest to obtain influence over AutoWallis. The purpose of their coordinated action was to achieve a combined shareholding of more than 25% in AutoWallis, partly through the purchase of shares and partly through the contribution of all the shares of the Companies to AutoWallis. To this end, these persons acting in concert have made a mandatory purchase offer for all the shares of AutoWallis. At the time of the private placement, the ownership and voting rights of these persons acting in concert were, taken together, 92.37% in all shares and 92.51% in ordinary shares. The coordination agreement between these investors has been terminated by the private placement for the capital increase, and thereafter there is no further agreement between them to continue acting in concert with any procedures related to AutoWallis.

By these share transactions, WAM (as well as persons acting in concert with it) had an obligation to make a public offer for all the shares of AutoWallis. The public offer was closed without a transfer of any shares. Following the closing of the public offer, WAM held 863,370 ordinary shares of AutoWallis, whereby its ownership reached 25.44% of the outstanding ordinary shares and 25.07% of AutoWallis' total issued share capital.

As a second step of the reverse acquisition transaction, AutoWallis' share capital was increased by HUF 15.8 bn via contribution of capital of Wallis Asset Management's four wholly owned companies and their affiliates, which were engaged in vehicle distribution and services. These companies were as follows:

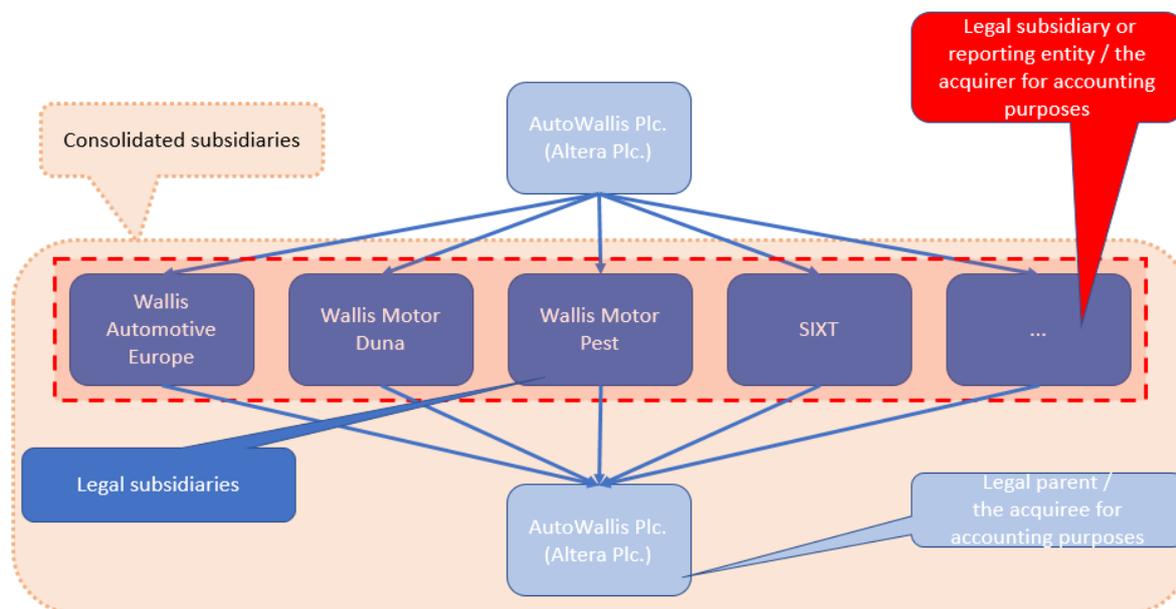
- WAE Car Distribution and Service Ltd. and its subsidiaries:
 - a) Wallis Adria d.o.o;
 - b) Polar Import Polska Sp. Zo.o .(already divested)
 - c) Polar PropertyLtd.
 - Wallis Motor Duna Car Trade Ltd.;
 - Wallis Motor Pest Car Trade Ltd;
 - Wallis Auto Rent Ltd.

The transaction was a reverse acquisition because the legal acquirer (AutoWallis) was controlled by an entity (Wallis Asset Management) who controlled the entities which became AutoWallis' subsidiaries by the reverse acquisition [IFRS 3.6 and 3.7, and specifically IFRS 3.B19].

In fact, the accounting acquirer was not a legal entity, but a combination of entities (the combined entity) previously controlled by the same legal entity (Wallis Asset Management). The combined entity is also a reporting entity under IFRSs because

- their management has decided to present a combination of these combined assets, income and financial statements presenting its financial position; and
- they form an integral whole in terms of their activities for their ultimate owner.

AutoWallis' reverse acquisition chart



Note: Assets and liabilities of the accounting parent (legal subsidiary), including equity after the acquisition, will be recorded at book value (cost), as it cannot be adjusted to market value. Fair value (in kind value) may not be included in the consolidated financial statements. The individual (separate) financial statements include the fair market value of the Companies. The assets and liabilities of the accounting subsidiary (i.e. the legal parent – AutoWallis Plc.), including equity after the acquisition, are stated at fair value. The accounting subsidiary (the legal parent) account for negligible amount of assets in the Group, as it has not taken any new investment position for some time, so it did not have any significant financial investment at the time of the reverse acquisition. The market value of legal subsidiaries (the accounting parents) is shown in the legal parent's stand-alone balance sheet at a value of HUF 15.8 bn.

Source: AutoWallis

The purchase price of HUF 1.608 bn paid in connection with the reverse acquisition was incurred by the legal subsidiary (the acquirer for accounting purposes, or the combined entity) in the form of the remaining interest (10.18%) in the former owners of the legal parent (the acquiree for accounting purposes). The purchase price paid for the reverse acquisition (hereinafter "payment") reflected the fair value of the net assets of the legal subsidiary (accounting parent - reporting entity) that the former owners of the parent (accounting subsidiary) acquired in the framework of the acquisition. This can be derived from the equity ratio before the capital increase:

Fair value of contribution (HUF bn)	15.8
Remaining interest of former owners of the legal parent	10.1779%
Payment in shares (HUF bn)	1.608

Source: AutoWallis

AutoWallis' Future Strategy

AutoWallis has expanded dynamically in recent years but its organic growth is expected to slow down, as there seems to be only limited room for growing as fast in its existing markets as before. That is why AutoWallis' strategic plan is centered on exploiting both organic and inorganic growth opportunities.

AutoWallis' strategic objective is to become one of the most reliable and credible wholesale and retail distributors and a major mobility service provider in the CEE and SEE markets, while providing shareholders with an appropriate return. To this end, AutoWallis' management this spring elaborated a set of policies aimed at supporting it in preserving its dominance in the domestic car dealership market, while also expanding regionally to obtain economies of scale and improve profitability.

This set of policies is summarized in a five-year strategic plan and, as a pattern, identifies what AutoWallis is trying to be.

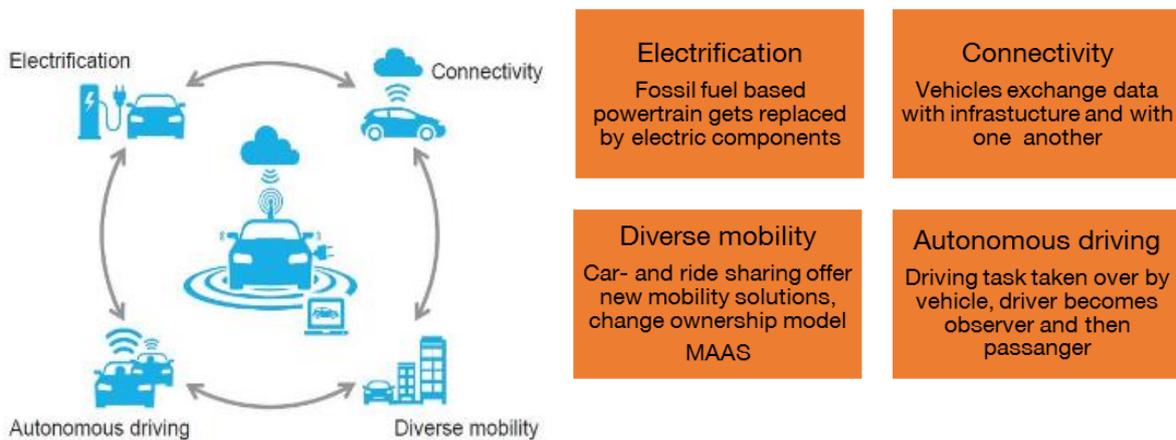
Main ingredients of the new strategy are as follows:

- Optimization of existing operating model;
- Improving economies of scale by regional expansion;
- Integrating value creating opportunities within the Group (incl. exploiting synergies);
- Using innovative sales and service channels;
- Building AutoWallis brand regionally;
- Maintaining a reliable partner position for major car manufacturers in CEE and SEE regions

The major trends that are forming the automotive industry and bringing different thinking to AutoWallis' boardrooms are:

- Autonomous vehicles (IoT and AI)
- Powertrain electrification
- Diverse mobility
- Connectivity and digitalization (machine learning and big data)

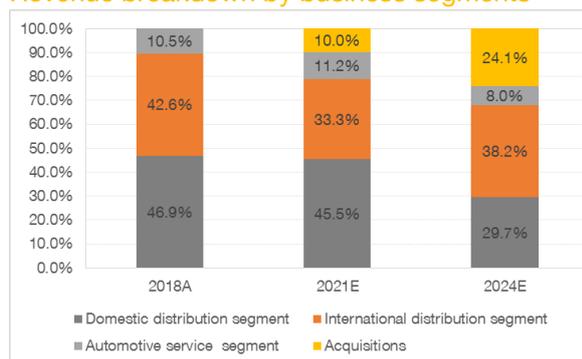
Four disruptive technology-driven trends that shaping the future of mobility



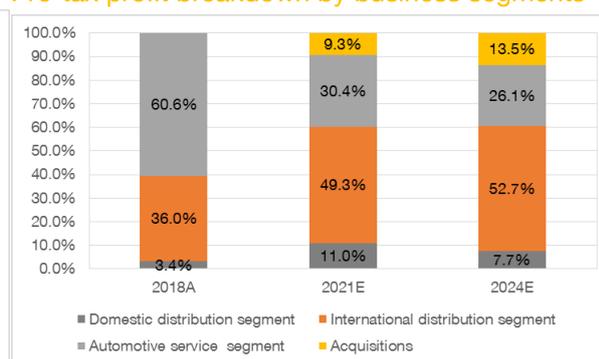
Source: McKinsey, Concorde

In response to these major trends in global car markets and mobility, AutoWallis is prepared to expand in CEE and SEE regions. It aims to act as major player in consolidating mid-sized car dealership and auto parts companies in these regional markets. It strives to make its businesses less vulnerable to business cycles and disruptive competition by diversifying properly its revenue and grabbing new business opportunities, such as car sharing, autonomous driving technologies, distribution of electric vehicles, data based services related to mobility.

Revenue breakdown by business segments



Pre-tax profit breakdown by business segments



Source: AutoWallis

Generally speaking, we deem that there is no such thing as a good strategy in any absolute, objective sense. The first thing that can be said about corporate strategy is that having one is a step forward. The second is that the more definite a policy is, the more helpful it can be to make strategy explicit and provide direction to investors. Any strategy, once made explicit, can quickly be evaluated and, if necessary, improved later. But more details should be communicated to community to avoid the danger that the strategy is misunderstood, in our opinion.

Although somewhat detailed presentation about AutoWallis’ future strategy is publicly available, we think the quality of information might leave something to be desired. AutoWallis’ new strategy includes financial goals of doubling revenue and increasing EBITDA by five times in the next five years compared to 2018, by combining internal and external steps. While it is easy to comprehend the implied growth rate, these financial objectives leave too many basic questions unanswered. To reach it in what way? To reach EBITDA doing what exactly? AutoWallis also articulated that it would provide stockholders with a fair return, which is a policy no one could possibly disagree with. What does a fair return mean?

Bluntly, few key financial goals presented do not provide us with a sufficient basis for evaluating AutoWallis’ strategy in an appropriate manner according to the following criteria:

- Internal consistency
- Consistency with the environment
- Appropriateness in the light of available resources
- Satisfactory degree of risk
- Appropriate time horizon
- Workability
- Agility

To achieve particular objectives requires a set of empirical, but critical, estimates of the necessary resources: the rate at which they will have to be committed, and the likelihood that they will be available. In our experience, besides misunderstanding major market trends the most common errors are either to fail to make these estimates at all or to be excessively optimistic about them.

Establishing a strategy is like aiming at a moving target: AutoWallis has to be concerned not only with present position but also with the speed and direction of movement. Failure to have a strategy consistent with the environment can be costly to it. That also explains why it is so important to find a balance between strategic goals and available resources. AutoWallis’s critical resources, such as available funds, competence, human skills, physical facilities, exclusive distribution contracts with premium car brands, know how, etc. all represent its capacity to respond to threats and opportunities that may be perceived in the dynamic environment.

Similarly to resources, strategic objectives also have time-based utility. For instance, a degree of market penetration becomes significant a goal only if accomplished by a certain time. Delay may deprive it of all strategic significance. We believe the five-year long time horizon of its new strategy

provides AutoWallis with a great range in choice of tactics to be able to deal with the highly unstable environment, and that presented strategic goals have been established far enough in advance to allow AutoWallis to adjust to them if it became necessary.

We believe that AutoWallis' agility and operational management of its businesses are two aspects that should be viewed positively by investors. The new strategy gives us hope that AutoWallis will have the flexibility to effectively and strategically respond in many constructive ways to disruption caused by imminent technology changes and/or regulation and new customer trends. It has already showed the ability to use a bit of foresight about its future and think strategically in terms of preparing to handle circumstances such as changing customer tastes by adapting solution to new market trends. We believe AutoWallis can stand out with multiple agilities (analytical, operational, inventive, communicative and visionary), thus likely to weather better than some of its competitors. That, in our view, should also be reflected in its relative share price performance vs. both the BUX and the broader group of its peers going forward.

Presentation of strategic plan points to AutoWallis' aim to continue organic growth through the followings:

- Increasing the market share of current activities;
- Increasing operational efficiency;
- Consolidating companies currently incubated within in the Group (e.g. Wallis Kerepesi, which is one of the largest car dealer in Budapest, the used car online platform JóAutók.hu, the online auto auction website Auto-Licit.hu, or the car-sharing company DriveNow);
- Developing those real estates which are necessary for growth.

AutoWallis plans to make a string of acquisitions in the coming years. It is continuously screening candidates for a good strategic fit. It has already identified 20 specific potential acquisition targets and in some cases made the first round buying offer. AutoWallis' management expects the benefits of M&A transactions to come in the form of higher market share, more tangible and intangible assets, additional customer base and sales channels, revenue growth, cost synergies, obtained know-how and sales skills, etc.. Nevertheless, it remains to be seen how big control premium is implied in the purchase price. A too high premium would certainly make it difficult to create value, as the majority of value would be transferred from the acquirers' shareholders to the targets' owners.

The primary reason to pursue M&A is to expand into new markets or gain control of new brands and technologies. That, however, could result in additional benefits in the form of cost reduction. We believe AutoWallis will hunt for synergies selectively and in stages. It look for activities that, if coordinated, will yield cost savings or enhance revenues without disrupting the target's core business. Common procurement management is usually a good tool to start with to have benefits quickly after the organizations have merged into one. Sharing operational know-how and synchronizing the strategy planning process is often the next stage, followed by unifying cultures and values.

We stress that cross-border acquisitions are notoriously tough to manage. Retrospective reviews show that most of them destroy shareholder value. Acquirers often fail to make value creative transactions because they do not comprehend the target companies' business environment. while the acquired companies' managers do not understand the acquirers' expectations and goals. Setting common goals, procedures, and reporting yields economies of scale and scope, and reduces operational and overhead costs—the raison d'être of most M&A, but takeovers frequently result in disgruntled employees and a departure of top talent. Creating common procedures (procurement, marketing, reporting, etc.) is a very complex process and undoubtedly time consuming. In the integration process, organizational morale may decline and employee turnover may increase, let alone that the acquirers usually have a nonintrusive nature, meaning that their capacity to achieve substantial cost reductions, especially by eliminating jobs, sacking employees, and streamlining supply chains is limited. These unforeseeable costs may eventually outweigh the expected monetary benefits of the targets' structural integration.

Becoming bigger, by itself, may not make economic sense to us. Easy deals are hard to come by in the automotive market. All depends on highly disciplined deal making by means of which resources are allocated to their best use and transaction multiples reflect the targets' stand-alone intrinsic value. In fact, value creation (which is not the same as accretion in accounting results) requires increasing the expected free cash flows in the newly combined entity beyond current expectations. But evidence shows that companies engaged in low-margin and low growth businesses fail to precisely predict revenue and margin improvements when making M&A deals. In fact, many companies have difficulty even maintaining revenue growth and profitability of their current activities after the transactions are closed because of unpredicted customer churn and discount offered to retain existing customers and significant costs spent on acquiring new customers. M&A implementation and integration costs can also exceed due diligence estimates and may be equivalent to a full year value of potential synergies or more. Finally, we are unconvinced that meaningful synergies could be created from a perceived lower cost of capital. We do not believe that combining companies can lead to a lower aggregate risk they face. Of course, optimizing the targets' capital structure can result in a little more value but should hardly be a major value driver factor.

In our opinion, as AutoWallis pursues its goals and gets conceivably bigger and more profitable, it must not only change the way it operates; it must also steadily push ahead its time horizon, which will not be an easy thing to do. On the other hand, AutoWallis wants to reach its ambitious financial targets in a relatively short time, therefore the takeovers deals are virtually mandatory that we warn inherently bears the implementation risk.

AutoWallis's inorganic growth plan assumes only one transaction per annum in the coming years. The goal is to acquire multi-brand car dealership, regional car fleet and auto parts companies with annual turnover of min. HUF 5-15 bn (EUR 15-45 mn) in the domestic and foreign markets (in the Balkans, in particular). Also priority is to obtain exclusive premium car distribution rights in new markets and distribution rights for new brands in as many new countries as possible. Targets that AutoWallis has reportedly selected are presumably smaller in size. If AutoWallis' management can help them to improve profitability or increase earnings meaningfully, the combined companies may generate higher cash flows than the companies on a stand-alone basis. However, we must stress that there is no a critical amount of information about the planned M&A transactions on which to base our evaluation properly.

Notwithstanding that, we believe that the so-called partnering approach would help AutoWallis to overcome these challenges. Instead of totally integrating overseas businesses, we believe it would also make sense to give the targets a great deal of operational autonomy on key issues such as employing or pricing, i.e. allowing them to continue operating quazi independently, almost as if there had been no change of ownership, and as they were a partner in a strategic alliance, even when they were in the same or related businesses, while also recognizing their strategy, social capital, the quality of their talent, and knowledge on industry- and company-specific issues (i.e. on customers, markets, and competitors' best and worst capabilities, just to mention a few). By doing so, AutoWallis would reduce the unintended consequences of target companies' integration into its current business, and create an operational environment in which knowledge and best practices would be shared and the targets' management would be incentivized (e.g. by a share deal) in return for delivering results. Meanwhile, partnering would entail carefully exploiting those synergies that are not disruptive to the targets' businesses.

Aside internal cash generation AutoWallis intends to secure funds for the planned acquisitions via low-risk forint-based bank loans or corporate bonds, or public capital increases. We believe that the current yield and interest and stock market environment support the feasibility of its strategic goals at the lowest possible cost. Having that said, it remains to be seen whether AutoWallis can raise enough capital through taking debt to pay in cash fully for the targets, and how the capital structure will look after a string of the transactions. We note that if potential synergies from the deals do not materialize to the extent originally imagined (e.g. because of lack of rigorous due diligence and execution or the

lack of capabilities to develop businesses fast enough to capture the value), AutoWallis can end up with a debt burden that it could find hard to manage.

It is also a matter of choice whether AutoWallis pays in its own shares for the acquired company. If they believe their shares are more overvalued than the targets', they will certainly be more inclined to issue new shares and pay with them. However, the capital market will use this information (that AutoWallis shares might be overvalued) when evaluating AutoWallis shares. We note that issuing new shares to offer them for the target makes AutoWallis' current shareholders less vulnerable to any value destruction if implementation goes poorly.

According to AutoWallis' new strategic objectives the majority of revenue and EBITDA growth will come in after 2021. Given this long execution period, there is the risk that the estimation of benefits of future M&A deals and organic steps may become disconnected from reality. While we believe that cost synergies can be easily achieved if AutoWallis acquires businesses with similar characteristics to its own, estimates of pricing power and market share may prove not to be consistent with future market growth, competitive environment and changing consumer behavior reality. The acquirer companies often make overly upbeat assumptions about how long it will take to integrate the targets' businesses, consequently they can be wrong when anticipating how long it will take to realize synergies, as the circumstances are overtaken by subsequent events.

The reasons for the risk increasing as the time for payoff increases is, of course, the inherent uncertainty in any venture. This is especially true of companies like AutoWallis whose environments are unstable. Bad timing for M&A deals can even make it impossible to capture any synergies, not to mention that savings, even if they can be real, are not perpetual. We are concerned that resources committed over long time spans can make AutoWallis vulnerable to changes in the environment. Since the difficulty of predicting such changes increases as the time span increases, we consider expectations for cash flows from M&A projects implemented in the far future as highly uncertain. Our concern here is not only with the quantitative aspects of expectations but also with the identification of some qualitative factors which may serve as a rough basis for evaluating the degree of risk inherent in the new strategy.

We believe these concerns need to be mitigated in order for investors to form a positive perception of AutoWallis' inorganic growth objectives.

When it comes to evaluating M&A opportunities we always focus on the value created by the transaction measured in terms of the NPV of the exploited (cost and revenue) synergies that the business combination is expected to generate versus the premium (the amount above the estimated intrinsic value of the target based on discounted cash flows) the acquirer has to pay. The value creation may arise from better revenue growth, margin improvements, more efficient capital utilization, or a lower cost of capital. We assert that the source of value creation, if any, will depend primarily on AutoWallis' strategy and capabilities.

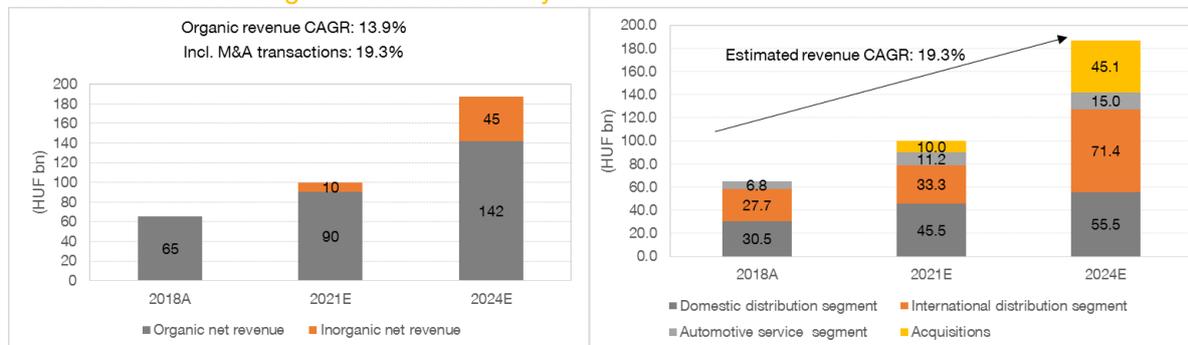
As AutoWallis is one of the most efficient operators in its industry, we see synergies from domestic M&A transactions coming mainly through cost savings and an improvement in the targets' ROIC while revenue synergies will play a minor role. Cost containment measures can potentially be as follows:

- Eliminating overlap in sales, marketing and administrative activities (e.g. lowering the combined budget);
- Pooling procurements;
- Improving capital efficiency (i.e. lowering the capital intensity);
- Transferring best operating practices;
- Optimizing accounting and back office functions;
- Consolidating stock management;
- Consolidating leadership functions and strategic planning;
- Exploiting synergies in combined finance;
- Using common IT platform, CRM and ERP systems; and

- perhaps reducing the industry sales capacity overall.

Conversely, M&A transactions carried out in regional markets may result in revenue synergies by acquiring untapped markets and superior distribution networks, but also fostering penetration in existing markets. In this case, AutoWallis can lend financial and management support to the targets who have limited access to cheap financing and international market knowledge.

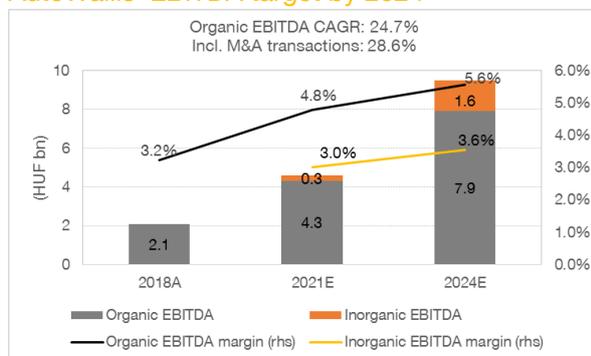
AutoWallis' revenue target and breakdown by 2024



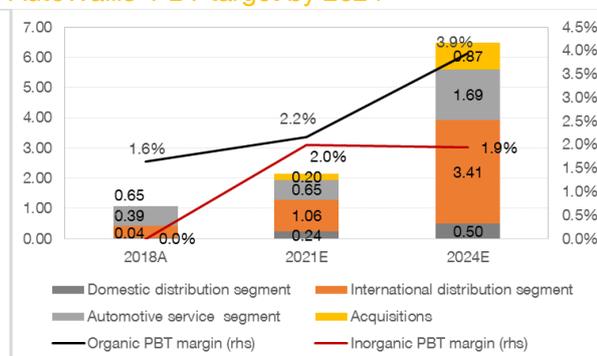
Source: AutoWallis, Concorde's estimate

AutoWallis' strategic plan incorporates EBITDA of HUF 1.6 bn on revenue additions of HUF 45 bn coming from newly acquired companies by 2024, implying a marginal EBITDA margin of ca. 3.6%. That compares with EBITDA margin of 3.3% AutoWallis is likely to reach on its existing activities this year. Interestingly enough, AutoWallis targets EBITDA margin of 5.6% on its current activities by 2024, compared to 3.2% in 2018, which, if achieved, would be a significant improvement. However, we still not sure that Auto will be able to reach this financial goal, and need greater clarity on where extra revenue growth or incremental cost savings will come from to make this happen. Any failure to deliver on will certainly shake market expectations and investor sentiment towards AutoWallis somewhat.

AutoWallis' EBITDA target by 2024



AutoWallis' PBT target by 2024



Source: AutoWallis, Concorde's estimate

Based on AutoWallis' own expectations for the targets' total EBITDA contribution and an observable benchmark revenue multiple of 0.5x that we feel it appropriate to use for its future M&A transactions, we conclude that new acquisitions could turn to be margin dilutive, and thus CROIC could turn to be less than a reasonable cost of capital (min. 9%) assumed for targets' valuation.

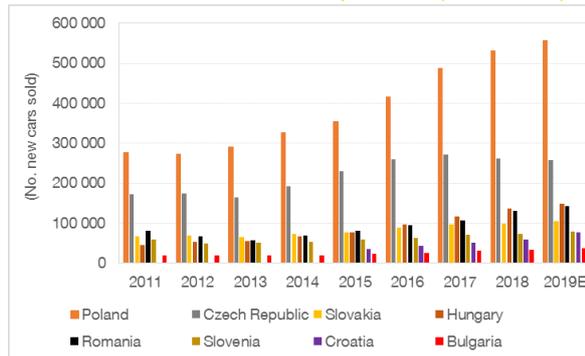
Putting it all together, we believe only in those cases when the CROIC (cash return on invested capital) is greater than the acquired companies' stand-alone cost of capital (9%<) are Autowallis' current shareholders compensated properly for taking the additional risk. Therefore, we conclude that there is a great deal of risk that AutoWallis's acquisitions will finally turn out to destroy value rather than create any. We note, however, that if the final capital structure is different to a reasonable extent from what we assume for each transaction (min. 30% debt financing), or the purchase price implies a revenue multiple below what we assign to each potential deal, there might be value creation.

Passenger car market in CEE

Growth: Against the backdrop of healthy economic growth across the CEE region, new vehicle sales have grown robustly over recent years. The growth rate of new PC registrations is even striking in light of a significant increase of used car import at the same time.

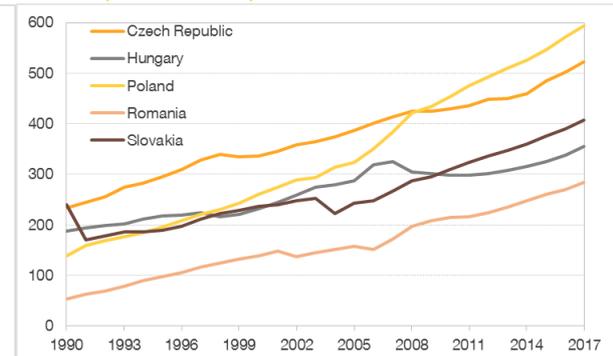
According to ACEA, between 2013 and 2018, e.g. Hungary experienced the fastest growth in sales of new passenger cars (PC) among those European Union Member States where AutoWallis is present, with a 5-year CAGR of nearly 20% that has been attributed to an increased consumption fueled mainly by rapid wage growth.

CEE new car market developments (2011-19E)



Source: ACEA

Vehicle penetration per thousand inhabitants

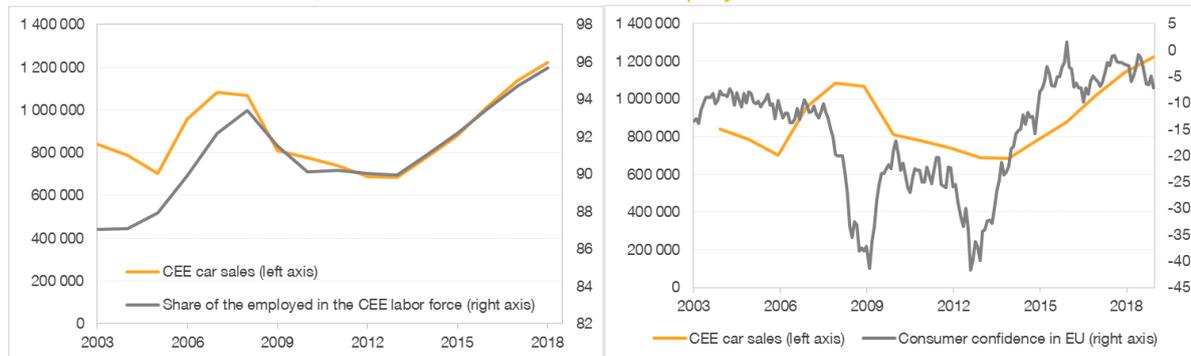


Source: Eurostat

The proportion of households with cars has not changed much over the last 5 years, but reached its maximum so far in 2018 (46%) in the CEE region. There is a steady increase in the number of motorists in the upper classes, i.e. graduates (60%+) and those in the highest income bracket (50%+). Between 2016 and 2018, the share of car users among those aged 30-39 and those in the lower middle income group increased most, from 50 to over 60 percent for the former and from 40 to over 50 percent for the latter. As for consumer trends medium class cars form the most preferred type of passenger cars and demand for luxury cars also grows rapidly unlike the trends in Western Europe where smaller and more fuel economic cars are gaining consistently higher market shares.

Even if the global car market is likely to slow down, yet sales volumes in the region CEE looks set to hold out unless a recession hits (consensus forecasts 2-3% growth p.a. on average in the region in the coming years). We believe the CEE markets new car sales should in the longer term maintain their upward trend, owing to the larger numbers of first-time car buyers and a still higher economic growth than in Western Europe. Strong consumer confidence and job data effectively support car sales. Also supportive is the governments' automotive specific stimulus, as we witnessed recently in Hungary. Such measures usually lead to an increase in demand followed, though, by an immediate drop once the stimulus expires.

The evolution of car sales, consumer confidence and employment in CEE countries



Source: ACEA, Bloomberg, World Bank

The majority of dealers also believe that the car market is holding support, even though the growth rate of new car sales seems to be setting up for a slowdown in the forthcoming years. Aside relative sturdy macro indicators we have another good reason for not expecting a sharp downturn in demand for PCs in the region.

Overall though, there is a sense that CCE countries are in the late stage of the current economic cycle, credit conditions are going to be more stringent in the coming years and consumers will be getting more cautions. The great unknown here remain the currency rates as the majority of Eastern European countries still operate outside the Eurozone, with their volatility rendering forecasts as unreliable.

As past examples show, car manufacturers have cut prices for PCs during the period of economic meltdown to offset weakening demand and keep sales at a consistent level. Due to the high working capital needs and fixed costs of operating a car dealership, dealers have been willing to sacrifice variable margin in order to retain fixed cost coverage. We believe this dynamic is still prevalent in the market in light of increasing wage costs and stronger unions.

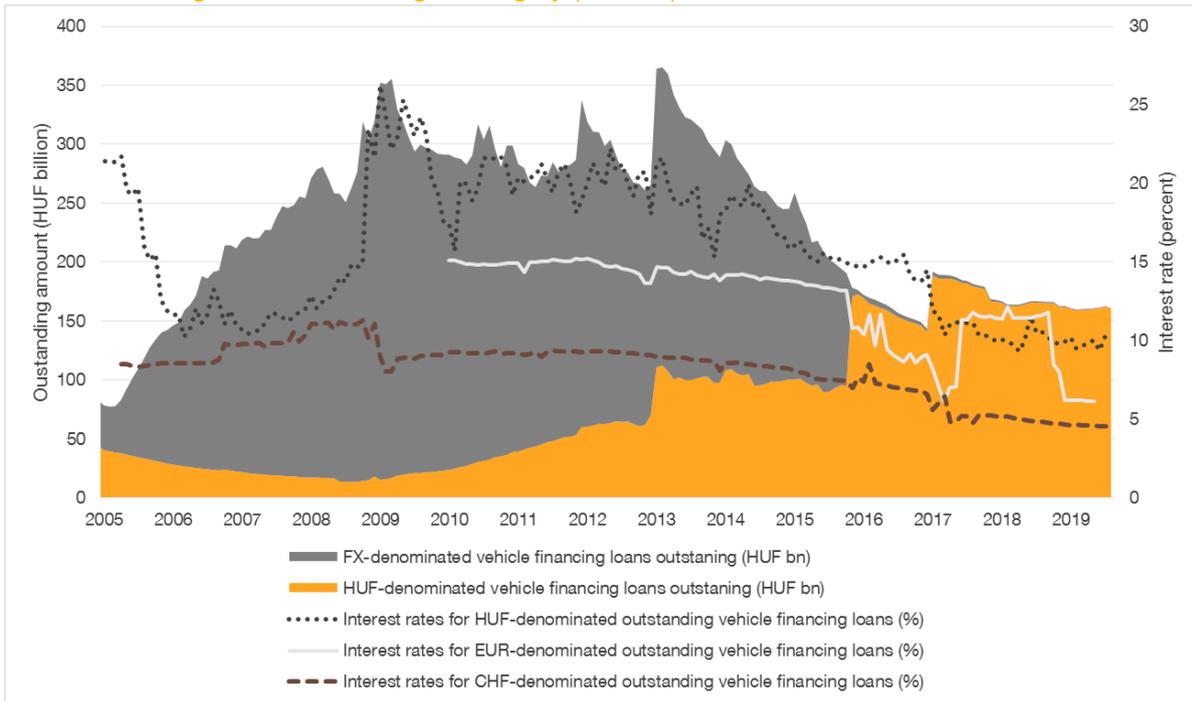
Competition: Competition is tough in the regional automotive markets both within the brands and between them. We expect more consolidation in the industry to come via acquisition of smaller dealers by larger ones, but also through dealers waiting for the collapse of their competitors to pick up their assets and brands at bargain prices. While dealerships are still mostly run by owners or family members, certain restructuring processes could be observed such as more powerful dealers or importers taking over dealers with financial difficulties, or lack of leadership in order to establish multi-brand and multi-showroom groups, resulting in a decrease in the number of players.

Besides factors such as brand importers' or producers' price policy (such as transferring the costs of promotions or rebates to dealers) and the geographical location of the dealership, competition (including mounting market consolidation pressure from increasing used car imports), the car brand and market demand for fleet and used cars still had the most significant impact on dealers' margins. The requirements of the tight sales plans would mean that dealers will struggle to maintain the current level of margins in the light the higher costs of maintenance of automotive showrooms arising from, inter alia, the increase in salaries of the workers.

Financing: For maintaining the stability of revenue, dealers also offer financial services (credits and leasing) and non-guarantee service of used cars. The popularity of leasing and credit purchase is supported by a strong relationship between banks, leasing companies and dealers, which also helps dealers to finance their cars in showrooms.

Cheap financing as a result of expansionary monetary policies plays an important role in keeping vehicle sales elevated. Easy access to credit facilities and car purchasing state subsidy launched for large families were also of the main factors influencing the market. Customers found it easier to obtain a car loan (car loans have increased by over 10% p.a. during the period of the past 5 years, with the number of loan applications accepted by banks also rising, and those who can get a credit were eased to contribute a lower down payment and to pay lower fixed interest rates for a longer maturity, though the depreciation of the local currencies was clearly unhelpful). Even so, a car purchase is still a large investment in relation to salaries, while car loan over longer periods of times may be perceived as expensive.

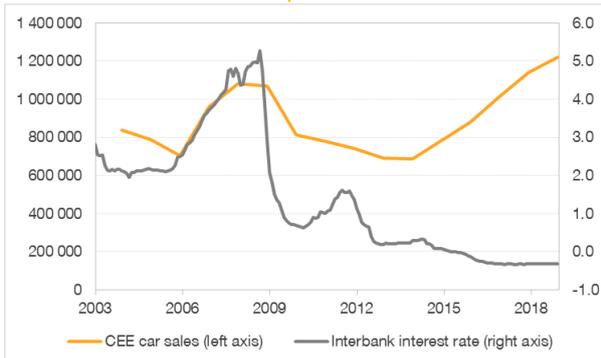
Vehicle financing loans outstanding in Hungary (HUF bn)



Source: National Bank of Hungary

Car dealers also rely on borrowings, mostly on short-term rolling loans for financing of inventory, yet benefiting from the historically very low interest rate environment. Credit lines are still available abundantly, while the incidence of bad debt has constantly been going down. This is quite a blessed period for any business to manage and build diversified product portfolios e.g. servicing centers, repair shops, and after sales products ahead of radical changes in market circumstances. Many car dealers have already decided to expand their scope of activities and invest in new areas. This alone is evidence of how the dealers’ attitude to changes has changed in the last few years and where the industry heads in the future.

CEE car sales and European 3m interest rate



CEE car sales and crude oil price



Source: ACEA, Bloomberg

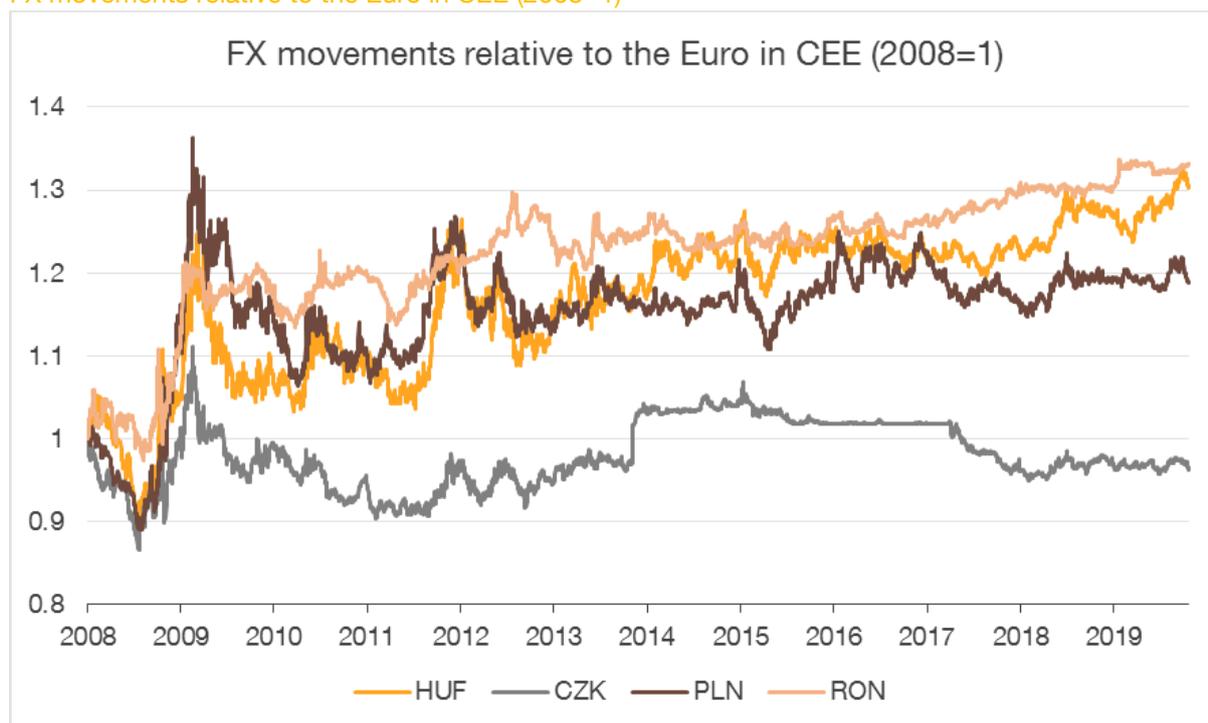
Fuel prices: Normalized oil and fuel prices have also been supportive to the car market historically. While conventional wisdom suggests that there should be an inverted relationship between new car sales and fuel prices, we think that changes in duties and taxes on fuels and cars, as well as progress in powertrain developments and fuel economy, make learnings from historical relationships of limited value going forward.

Obviously, PC penetration and demographics will also play a role in determining sales opportunities in the regional auto industry over the next decades. Having that said, it is extremely difficult to predict

what will be the outcome of declining population (including expats) and relative low car penetration in the CEE region, particularly when improvements in quality have also led to older cars staying in circulation for longer and the relative economics of owning a vehicle over ten years old compared to one several years younger has also improved.

FX: Margins during the recent years were not just a result of sales strategy or pricing policy of importers, but also a reflection of development in local currency exchange rates vs. the EUR. The weakening of some of the CEE currencies (HUF and RON, in particular) might have affected the margin negatively for those car importers and brands who did not hedge against the adverse exchange rate movements.

FX movements relative to the Euro in CEE (2008=1)



Source: Bloomberg

Labour cost: The most labour intensive department is still servicing, which, on average, employs two-to-three times more people than the sales department. The good climate in the sector is particularly reflected in the increasing number of people employed in the overwhelming majority of showrooms' sales departments. On the other hand, the dealers face problems appearing in the recruitment of new workers, particularly at the servicing departments (besides upper management the service workforce is the most technically qualified staff in a dealership), mainly due to the large wave of emigration which affected Hungary and Poland in recent years and – related to this – rising salary expectations. Dealers offering servicing in their showrooms need to cope not only with rising salary costs, but also additional outlay on training to introduce new employees and, increasingly, the costs of agencies searching for new employees. We do not expect major turnarounds to take place in the short term; however, difficulties with employment do not apply only to car showrooms.

Taxes: Frequent changes in the taxation environment are of only average importance for local dealerships.

Taxes on vehicle acquisition in the European Union

Country	VAT	Registration Tax
Austria	20%	Based on CO2 emissions (max 32% + bonus/malus)
Belgium	21%	Based on cylinder capacity and age (Brussels-Capital) Fuel, age, emission standards and CO2 (Flanders) Cylinder capacity, age and CO2-based bonus/malus scheme (Wallonia)
Bulgaria	20%	Plate costs (BGN 25) + eco tax (BGN 160)
Croatia	25%	Based on purchase price, CO2 emissions and fuel type
Cyprus	19%	Based on CO2 emissions and cylinder capacity
Czech Republic	21%	Registration tax (max CZK 800) + eco tax based on emission standards
Denmark	25%	85% of vehicle's value up to DKK 193,400 + 150% of the rest. Reductions based on safety equipment and fuel consumption.
Estonia	20%	Registration label (€62) + registration card (€130)
Finland	24%	Based on retail value and CO2 emissions (min 2.7%, max 50%)
France	20%	Registration tax (varies by region) + CO2-based bonus/malus scheme
Germany	19%	Registration fees (€26.3)
Greece	24%	Based on net retail price, emissions technology and CO2
Hungary	27%	Based on cylinder capacity and emission standards
Ireland	23%	Based basic price and CO2 emissions
Italy	22%	Based on vehicle type and horsepower + registration fees (+ €145.00) + CO2-based bonus/malus scheme
Latvia	21%	Registration costs (€43.93) + national resources tax (€55)
Lithuania	21%	Based on vehicle type
Luxembourg	17%	Registration stamp (€50) + supplement (€24 or €50)
Malta	18%	Based on vehicle's value, CO2 emissions and length
Netherlands	21%	Based on CO2 emissions and fuel efficiency
Poland	23%	Based on cylinder capacity (up to 18.6% of vehicle's value)
Portugal	23%	Based on cylinder capacity and CO2 emissions
Romania	19%	Registration fees (€8.6)
Slovakia	20%	Registration fees (min €33 based on vehicle's value, engine power and age) + plate costs (€16.5)
Slovenia	22%	Based on selling price, CO2 emissions and fuel type
Spain	21%	Based on CO2 emissions (max 14.75% for 200g/km or more)
Sweden	25%	None
United Kingdom	20%	First registration fee (£55)

Source: ACEA

Site developments: The opening of new sites for the same brand seems to dominate dealers' expansion concept. This direction is reasonably safe because of the knowledge of the specific nature of the brand and the developed terms of cooperation with the national distributor. However, there is sign that those dealers who plan to present in new locations, are willing to try to work with another distributor and, in a way, diversify activities regarding the brands marketed. On the other hand, new brands entering the CEE car markets, mostly from Asia, are encouraging to dealers. In a way, one method of combining plans to expand activities with a new brand for a given dealer is the opening of new multi-brand showrooms opened in the large cities (more than 200,000 inhabitants) at the dealer's expense in return for granting brands and sales exclusivity, where showrooms are expected to be prospering best. This is an increasingly popular method of conducting dealership activities and its further expansion can be expected. Multi-branding is very popular business model of dealership, which is a means of reacting to increasing competition on the car sales market, and it may also help to maintain the viability of dealerships in low sales or remote areas. The multi brand dealers are quite independent in selecting their suppliers, although different brands are not usually sold in the same showroom.

Multi-branding: We predict that the traditional distribution model will be more and more often challenged by integrated omni-channeling, driven by the evolving consumers' preferences. Small, independent dealers are expected to gradually go out of business due to multi-channeling and low economic viability, or they may be bought out by bigger players interested in their land assets. The current leading CEE dealers, like AutoWallis, who already achieved a cross-border presence, are likely to continue to expand, adding new business streams (such as real estate, rental and leasing options, financial services) to their offer, enlarging their geographic scope, and accepting new members in their partnerships, while those dealerships who can stay on their feet becomes even more competitive.

Presently, car manufacturers may require dealers to sell other brands in separate premises, through a separate company, with separate management and a separate sales force, and in practice this makes multi-brand sales uneconomic. Brand specific sales personnel could represent a substantial additional cost and therefore put a brake to multi-branding development, unless it is decided by the dealer while the manufacturer pays all the additional costs.

A dealer who wants to specialize in selling cars will have the choice between carrying out after-sales servicing himself or subcontracting it to one or more official repairers. This opportunity ensures that customers can turn to at least one official repairer. Car dealers who have their dealership terminated will be able to stay as official repairers of the make, while independent repairers may qualify to become official repairers if they fulfil the criteria set by car manufacturers, which will improve service to consumers and regional coverage.

Distribution rights: Now that many car manufacturers are restructuring their dealership networks with a view to reducing the number of dealers across the EU, low sales volumes in low sales areas are compensated for by granting special conditions in order to keep the dealers in such areas. Although car manufacturers are not allowed to combine exclusive sales territories and selective distribution for a single dealer, they can decide to implement exclusive distribution in one market and selective distribution in another. This could make sense where the manufacturer's objectives differ in various EU states. Under exclusive distribution, the car manufacturers keep de facto a control on where a dealer establishes a sales or delivery outlet. But under this type of distribution, the authorized distributors are free to sell to independent car resellers and these independent operators are able to trigger arbitrage between the exclusively allocated territories and across the EU.

Any dealer member of a car manufacturer's official network has an obligation to provide for sales and servicing of cars according to the car manufacturer's request. Car dealers are in theory allowed to sell vehicles of more than one brand, in practice they rarely do so. Car manufacturers protect their brand image by requiring their vehicles to be displayed in a brand-specific area of the showroom. Although the regulation provides that car dealers may not be prohibited from opening secondary sales or delivery outlets anywhere in the EU, they, however, have to comply with the manufacturer's criteria for the area concerned. Geographic coverage can also be attained without problems if car manufacturers implement exclusive distribution systems, but the geographic coverage degree depends mainly upon the manufacturer's decision.

In the regional car dealership market there seems to be a dependency between the type of dealership possession and willingness to expand in the coming years. Family-run businesses are mostly willing to stay where they are and continue operations without a focus on further expansion. The reasons given for exiting are management succession issues, or bad financial conditions recorded in books, or just simply the feeling that the dealership business will not be running well in the future (as the chances for sales growth in the coming year are likely to be very small), and it is more reasonable to allocate the investable capital elsewhere. For those who do plan expansion in the coming years starting with new dealership looks the most common way, while expanding the same brand to new locations in also on the card. In this context, it is worth noting that the largest average percentage share of revenues from the activities of automotive showrooms is, to the same extent, sales of new cars and vehicle servicing followed by fleet sales and retail sales of used cars.

Aftermarket service: Also noteworthy is the trend that revenues from vehicle servicing, which can be explained, inter alia, by the gradual increase in living of standard of society, the customer's demand to receive the service guarantee for years after the car purchase and the quality of the services offered is growing. In effect, the interest of customers in servicing their cars in appropriately equipped authorized repair workshops centers prepared with the necessary knowledge for offering a full and proper mechanic and auto repair service for vehicle maintenance & inspections is increasing. Whereas there is a strong correlation between the expiration of guarantee period (once the inspection is not mandatory) and the use of cheaper generic substitutes for service, customer awareness is increasing and so does subsequently the inclination to use original parts, even in post-guarantee repairs.

Auto parts: With the significance of original spare parts clearly increasing, most showrooms and services do not use substitutes in the case of guarantee repairs. All the more so that it is most visible in large cities, where increasingly affluent customers buying increasingly expensive, better equipped cars can afford to use original spare parts. Another element which influences the increase in interest in original spare parts is the increasing number of vehicle fleets. In their case, the majority of servicing is conducted with the use of original parts.

Used car segment: The statistics show that the import of used cars is still growing at a double-digit rate in CEE countries. Therefore, it seems that this line of dealers' business will continue to grow fast and, in addition to the sales of new cars, generate more and more revenues for car showrooms. The vast majority of dealers, ca. 90%, buys used cars from customers when selling new cars, whereas slightly less than half intermediate in the sale of cars placed into consignment sales points (so-called trade-in) which are owned by dealers operating a sales showroom. In line with the expansion of the automotive market, this form of obtaining cars on the secondary market should remain significant. Apparently, operating an appropriate sales infrastructure, while buying used cars from their customers when selling new cars is an excellent incentive supporting sales of new passenger cars.

Most purchases of passenger cars are used cars in CEE economies, so dealers cannot ignore this market segment. Having an appropriate sales infrastructure, they have an easy task, while buying used cars from their customers when selling new cars could be an excellent incentive supporting sales of new passenger cars. The share of imported cars in dealer sales is equally significant. Due to the fact that the CEE currencies have been losing in their value against hard currencies until recently this year, import of cars, both from the EU and from the USA, became even less profitable.

This year, the share of cars that are older than four years in total import has been increasing, which results in lower sales in dealers' showrooms. The average age of the vehicle fleet is about 14 years, rising gradually due to imports of older cars.

Domestic workshop market

According to public databases in the online space, there are about 12,000 service providers operating in Hungary today, but most of the data contained therein has not been verified.

More than 90% of the domestic vehicle workshops are brand-independent. The majority of service providers who position themselves primarily as branded service have also designated brand-independent repair as a service they undertake. Domestic services are usually focused on few activities. Services requiring more specialized equipment or expertise are carried out by only few after-sale service providers. However, 15-20% of service providers already offer insurance administration and there is a particularly high proportion of those vehicle services that deal with handling technical inspection. Any motor vehicle kept in Hungary must be regularly inspected and may be driven on public roads only with a certificate of roadworthiness. Initial inspection of a purchased vehicle is valid for four years, after which the vehicle must be inspected every two years at a reliable garage. If one buys a used vehicle in Hungary she must have it inspected every two years as of its initial registration or inspection. A change in owner does not alter the validity of a vehicle's inspection. If one moves a vehicle

to Hungary from another EU Member State, she must have the vehicle inspected again when registering it in Hungary.

The hourly rate varies by service providers, and also depends on the complexity and age of a car in need to be repaired or inspected. Servicing luxury cars usually cost 3x more than small or mid-range cars. The average price is not a very accurate metric in the market, as domestic services are rather specialized, and the calculation of the hourly rate also depends largely on the service provided: certain services such as equipment, materials used, expertise, etc. depending on the hourly rate, they can be much more expensive than others.

Prices are also influenced by whether the service provider comes to the house for the car, provides a replacement car, fleet management or non-stop service, credit card payment or even wi-fi connection in customer waiting room.

The convenience of the customer is gaining importance. Of the most basic convenience services, appointment, consultation, customer service, wi-fi connection and fleet service are provided by 87%, 68%, 65%, 57% and 61% of the services.

Customer mobility is also an increasingly important issue in the after-sale service provider market. The return-to-return service is expanding, that is, when a service representative takes the vehicle from a specified address and then returns it after repair or maintenance - this is now provided by almost half of the trusted service providers (43.91%). For the time being, the number of service providers providing replacement vehicles for the duration of repair is still low (14.41%), as is non-stop car takeover (15.05%). The share of non-stop repair service providers is even lower (7.02%).

With a very low percentage of credit card payment service providers - so far only a quarter of companies provide this - credit card payers can now gain a clear competitive edge in the market.

The future of mobility and car dealership business

The automotive industry and retail car dealership models are on the cusp of fundamental change due to a combination of consumer power change and the rise of disruptive new technologies. There are challenges facing market participants ranging from electric and autonomous vehicles to the prospect of personal vehicle ownership. Car suppliers, new market entrants, city planners and policy makers are struggling to figure out what the implication of relatively nascent technologies and business models might actually be for future mobility and transportation.

That said, it is very difficult to assign a material terminal value to investments in new technologies which could become less prevalent over time. Furthermore, we believe the auto industry and other parts of the value chain should go through full consolidation to address future investment burdens and achieve synergies by sharing the costs, while striving to become specialists with focused, limited scope and investment requirements, thereby unlocking value, and thus potentially deserving higher valuations.

Megatrends impacting mobility



We add that besides these tendencies there are other broader trends such as expanding online sales, raising awareness on climate change dangers and global warming, aging population in the developed world and inexorably growing global nominal GDP which are also of importance when it comes to what will influence future mobility.

Source: Frost & Sullivan

Over the past decades, car manufacturers have achieved cost savings by investing into mechanical, performance-oriented features that allowed for higher returns. But that dynamic is shifting as content requirements of automobiles in emissions, safety and simplicity continue rise while consumers pay no more for these features than they did earlier. Electronic innovations will account for the vast majority of advances in modern vehicles. Vehicles will become integrators of multiple technologies, productive data centers—and, ultimately, components of a larger mobility network. As every vehicle becomes a source for receiving and transmitting bits of information over millions of iterations, safety and efficiency should improve and car manufacturers and dealers should be in a position to capture valuable data.

Mobility-related technologies will inevitably continue to advance with the aim of improving efficiency while maintaining a suitable balance with costs. Electric powertrain motors have already entered a genuine market penetration phase, and we believe rising demand will further accelerate technological innovation. Although technology will have a profound impact on attitudes towards mobility, that does not necessarily mean the global vehicle market size will shrink - rather, it will become more diversified as new business models and different technological solutions will be available. A shift to a more digitized and consumer-focused market however means that car manufacturers are not the only dominant players anymore. Innovative start-up companies, supported or incubated by major multi-national companies, and the technological disruption that comes with it, are bringing completely new ideas from every corner of the economy. More and more disruptive players will enter the car market to demonstrate their ability to challenge incumbent car manufacturers to the satisfaction of costumers. In response, car manufacturers will no longer hesitate to be partnered with start-ups rooted in other industries, such as the entertainment industry, to design the next generation's dream cars.

Automobiles become more digitally enabled, and with it connected services will be increasing. The automobile will need to compete in a digital world, and that will demand new expertise and attract new competitors from outside the industry. Common online platforms can connect supply and demand globally to increase the efficiency of players across the supply chain. As value chains shift, data and mobility systems gain prominence and vehicles are programmed to drive themselves, the automotive industry's basic business model could be transformed. Indeed, the very concept of cars as autonomous freedom machines may shift markedly over the next 50 years. Disruptive technologies will create challenges for existing automotive leaders whose competence lies in established ones. Collaboration between cutting-edge startups and multi-national conglomerates could combine the best of emerging talent and real-world clout to bring lasting change to the industry. However, attracting talent will be more difficult as the core of automotive research and engineering may consider migrating to software-driven innovation hubs.

Integrated mobility solutions



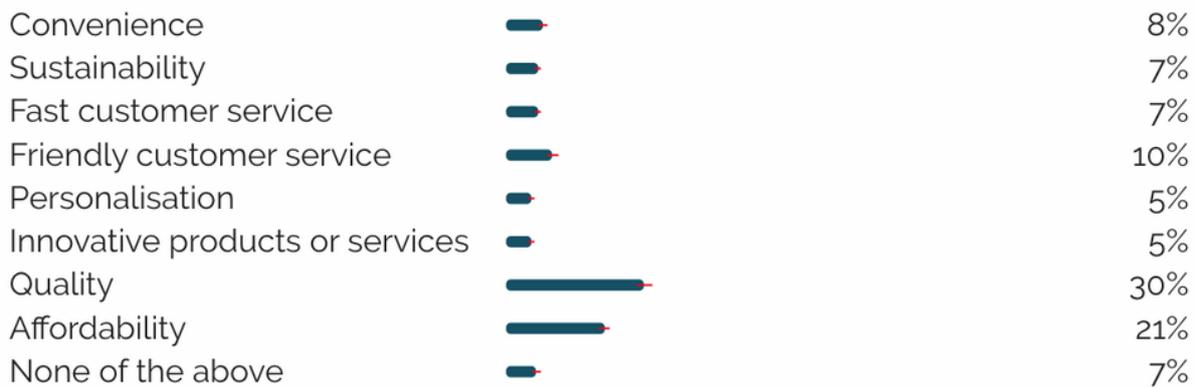
Source: Frost & Sullivan

As the digital transformation is taking place across the automotive industry, car manufacturers' decision is no longer to find a place where large numbers of qualified automotive workers are available,

but to focus on getting as many IT professionals hired as possible. The need to employ blue collar workers will decrease, implying that car manufacturers are likely to shed jobs en masse and divest non-core assets for high expenses. However, this transition process will take place gradually over the next decade. Investment decisions are driven by pure business logics for development, and car manufacturers will continue to dish money out to developments in the field of modernization of the conventional technology at the expense of their earnings and cash balance, while also putting emphasis on the development of future technology. That will leave time for car dealers to undergo their own business model transformation.

In this fast-developing world car manufacturers will continue to rely on car dealers as a key component of successful vehicle sales in the future. But car dealers will need to reposition themselves to keep revenue and profitability from falling. New ideas need to be explored to find ways to profit from an audience demanding instant satisfaction, on-going services, and more personalization. As the industry players struggle to thrive, consolidation is likely to accelerate, among European original equipment manufacturers (OEMs) and city-based car dealers, in particular. The winners of this consolidation process will be those dealers who will place less reliance on new car sales and more on services and customers' preferences as well as streamlining their business by cutting fixed costs, renegotiating agreements with car suppliers, while also having access to financing and keeping a close eye on cash flow generation.

A recent study compiled by Brandwatch, the world's leading social intelligence company, shows that customers when asked about what attributes are most important for car brands, quality is the most popular opinion representing a third of the vote, while affordability followed as the most important attribute.



Source: Qriously

Car is considered as the second most expensive durable good one will ever buy. Cars never appreciate. Every dollar put into a new car will never be returned back unless it is a kind of rare luxury car that can beat the hearts of car collectors over time. Even if one sells a car he or she will likely buy another car. Today more than half of the vehicles are sold to business users whose purchasing decisions are more rational, based on utility versus cost i.e., what is the most cost-effective vehicle that will meet the customers' needs. Furthermore, utility versus cost comparison is still a key element in the decision-making process among individual customers, especially where the main intended use of the vehicle will be commuting.

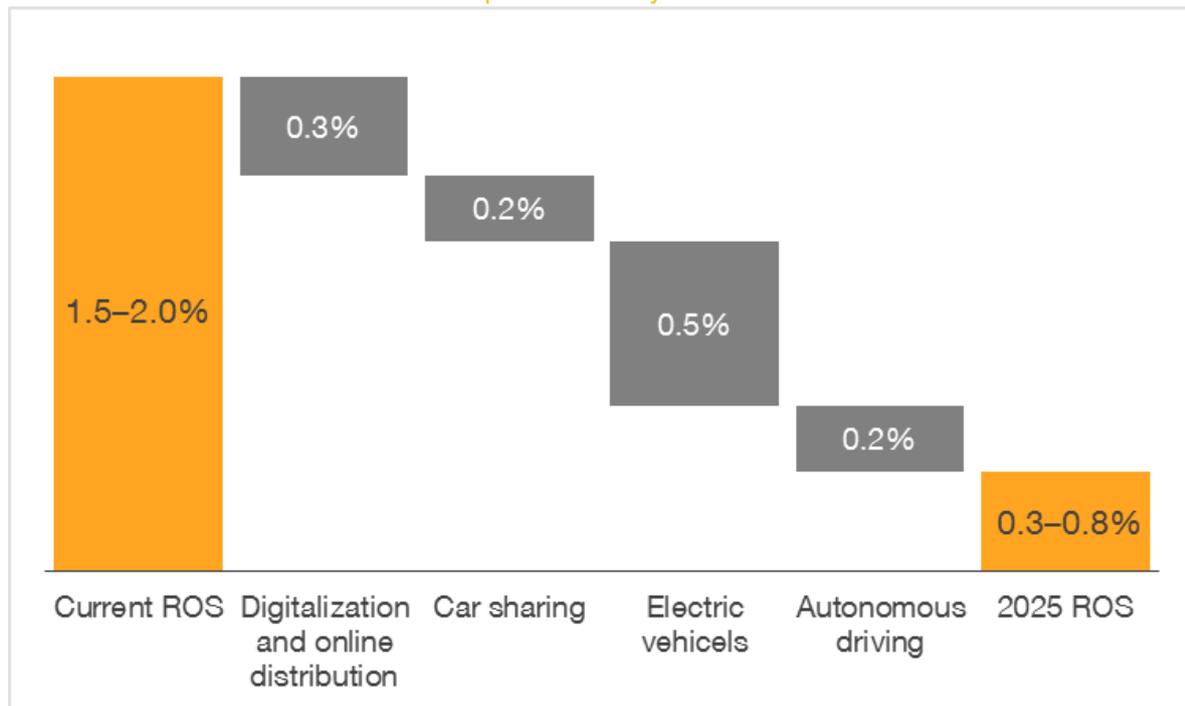
The prospects for growth in the automotive sector depend on the development of customer demand, which is definitely changing in line with the growing economies and purchasing power of the population (mostly in emerging Asia). In mature markets (developed world), vehicle penetration appears to have leveled off, while low penetration still offers plenty of upside in emerging markets, in our view.

We think the same is true for the car dealership sector. We predict the sector will see fewer but potentially stronger dealer networks providing greater levels of quality and professionalism. Dealers who already achieved a cross-border presence, will have appetite to continue to expand, adding new business streams (such as real estate, rental and leasing options, financial services) to their offer, enlarging their geographic scope, and accepting new members in their partnerships. We believe AutoWallis will belong to the camp of those dealers who can creatively adapt to the new market trends in the CEE car dealer market.

Increasingly stringent environmental regulations are also affecting the car trade. The dominance of diesel cars in recent years seems to be retreating and the focus is clearly shifting towards petrol, hybrid and electric cars. An increasing number of models and manufacturers are experiencing shorter model life, although not always to the same extent. Furthermore, there is also a well-observed trend, the permanent transformation and growth of the size and weight of motor vehicles. Of the trends in the car rental market, it is worth highlighting the demand for quality services and products.

We believe car dealers' role in direct sales and as an information channel and contact point for vehicle configuration will conceivably decline in the future, as digital channels for purchasing cars grow, but they definitely remain in interface with customers. Car manufacturers' websites, search engines, online shops, car review and advice sites, and customer forums will become more central in the selection and purchasing processes. Although connectivity and digitalization will offer new opportunities to compensate for shrinking profitability, car dealers will likely still be unable to completely protect themselves from a likely wane in earnings and margins.

Evolution of return on sales due to disruptive trends by 2025



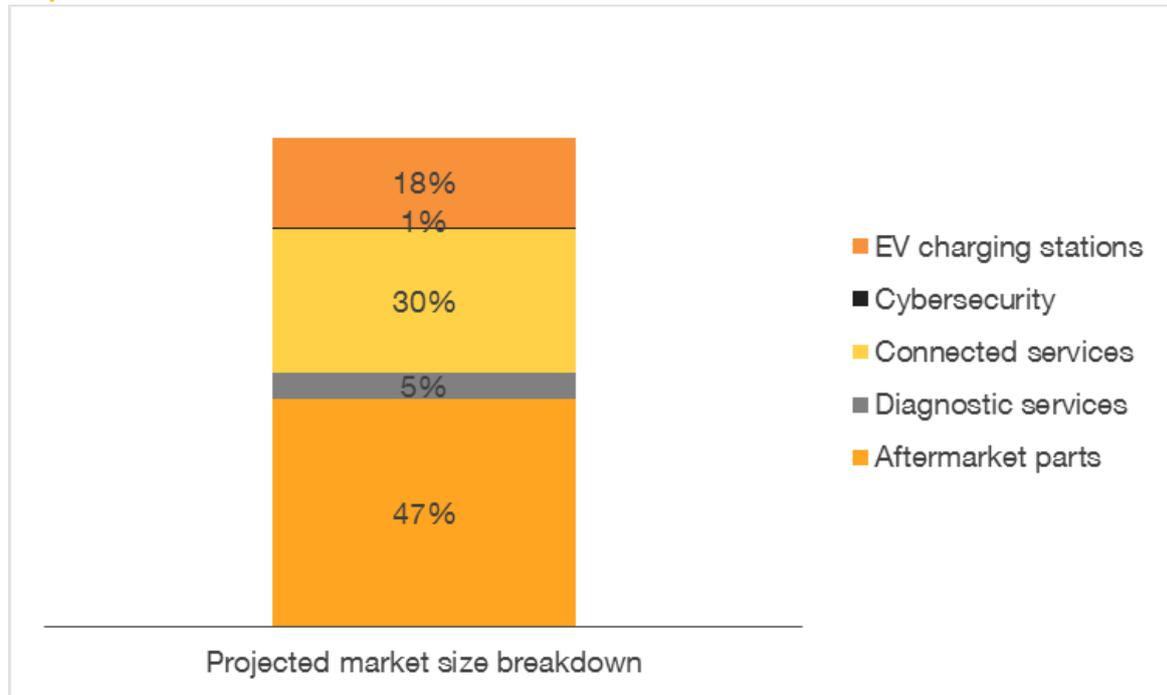
Source: Bain & Company

In a nutshell, digitalization will likely prompt an increasing number of customers to purchase vehicles directly from auto manufacturers, instead of buying cars from traditional car dealers. New mobility services in urban regions are expected to narrow the volume of new car sales, especially to younger customers. Sales of electric vehicles (EVs) are also growing, and since EVs require less maintenance and fewer replacement parts, the steady increase in EVs sales will tend to eat away at car dealers' service revenues. In addition, the expansion of autonomous driving will result in fewer accidents but also reduce the profitability of car repair shops. To be sure, combining autonomous and non-

autonomous vehicles in a single traffic mix will be a significant challenge. The most difficult time is likely to be the transition period, while both kinds of cars learn to share the road before self-driving ones prevail. The technology, though, is almost at hand.

In all, it is expected that retail car sales may drop by millions of units per year, while their service income will also succumb to the decline, which will likely lead to profit squeeze and the demise of thousands of dealerships in Europe, in our view. Lower sales will inevitably result in consolidation of today's dealership structures, although it is fair to assume that dealers will continue to play a key role in managing customer satisfaction and retention, test drives, car deliveries and maintenance.

Projected breakdown of overall service revenues in 2025



Sources: CapIQ, IHS

We believe that those franchised dealers that can offer any brand of new or used vehicle through a local showroom or online in a customer-friendly process will outperform smaller, less capitalized independent traditional dealers. Car manufacturers and dealers should opt for efficiency improvements by merging servicing operations and digitalizing core processes, delivering considerable efficiency gains. Those who want to survive should embrace technology (like digital marketing) to boost sales and reduce expenses. By prioritizing customer satisfaction and improving the customer experience by reducing the length of time and creating more transparency in a car deal, car dealers will be able to tap into new sources of revenue. Software technology companies will also make further inroads into the industry through services like usage-based insurance, new finance and leasing services, and connected car services.

In today's competitive new and used car markets, auto dealers today need real-time access to comprehensive data to make fast decisions and radical changes with confidence. Intense competition, effective control of the entire sales cycle, the need to create a true digital experience for customers, and apply a new, customer-centric approach in the business model while increasing sales velocity and profitability impose additional challenges to dealers. Complex supply chain, new type of sales process, efficient inventory management, keeping complete history of each vehicle, discrepancies between sales budgets and dealers' actual sales performance, spare parts overstocking, large number of substitute products, lack of information on the effectiveness of service and customer satisfaction are just a few more factors to push dealers look for innovative ways to survive.

Car dealers aiming to invest in and actively promote new retail formats will benefit the most. Those car dealers who own multiple stores can create economies of scale offering a large selection of vehicle brands to consumers. Scale will also allow them to improve customer retention and reduce advertising costs. And scale will allow them to invest in their brands and new technologies to compete. Car dealers will be able to achieve additional gains by streamlining processes and services (for example, by outsourcing their repair activities to service facilities in the surrounding area), and by strengthening customer experience by employing big data analysis, addressing individual customer needs and offering new loyalty and incentive models. To that end, they must attract and retain caring, career-minded staff members, and access to financing.

Traditional car dealership is based on activity-based compensation models. Traditional car dealers are focusing on customer interactions, in order to improve satisfaction and enhance the car-buying experience. In the future, car dealers will rather be responsible for arranging test drives and car services and for receiving vehicle deliveries. Requiring fully commissioned compensation, or letting desk managers fight for high grosses, and service departments charge premium prices for common services do not seem to be the best way to remain in the race. Car dealers will have no other option but to develop new retail formats, such as pop-up stores or experience centers in urban locations, and efficient car-servicing facilities on the outskirts. Manufacturers will largely abandon the current dealer compensation model, based on scaled incentives for new car sales, and they will likely offer fixed fees plus premiums for specific activities undertaken during the sales process. Dealers will act as the car manufacturer's agent during the vehicle handover and will be compensated on the basis of various activities, such as the number of test drives or handovers.

Against these industry backdrop, we claim that the overwhelming ability to adopt to changing customer needs can provide a material and structural positive development in future earnings of car manufacturers and dealers, while the ability to offset mounting costs is what is required to sustain earnings at current levels.

Simplicity

We believe the importance of simplicity in customer experience will predominate. That said, making a service simple is well worth seeing but it does not necessarily mean that it becomes simplistic. Services offered by Netflix and Amazon are highly complex in terms of digital capabilities, but ultimately offer solutions that allow customers to have brand experiences easier via simplicity. Simplicity is achieved when two key components are combined: clarity and surprise. Taking the time and effort to identify consumer needs to understand just how much information it is indispensable to get customers know about a service or product – the clarity component with the ultimate value of “time saved”, and then conveying the product or service in a way that is really exceptional, “the surprise component” (e.g. Volvo Reality). Combining these two elements fosters to make a brand acceptable both logically and emotionally. Surprise does not always require using novel technology.

Consumer trends

Values and aspirations of a modern consumer:

- Time
- Serenity
- Emotions
- Upgrade/development



Source: Ipsos

An effective way for car dealers to remain in contact with customers between purchase cycles, ensure a positive customer experience and generate additional revenues is by adopting a sales and service strategy for cars with any types of alternative powertrain including both hardware and software updates (also for used cars), delivery services, car-sharing options (even for holidays) and other offerings (such as front office consultations in experience centers, individualized marketing activities based on big data analysis) that can allow a dealer to become known for.

Big data

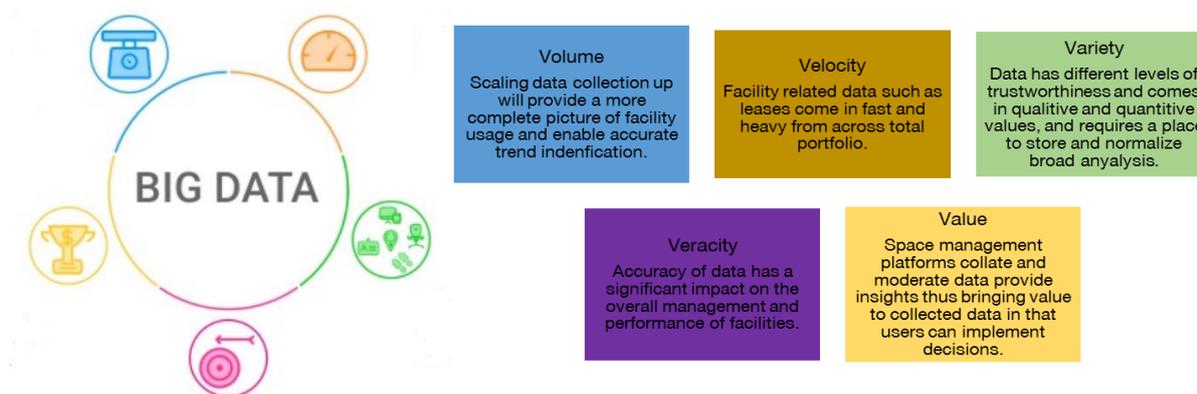
By using big data, dealerships can get to know their customer base in great detail. They are dealing with them directly, so they can get a sense of their preferences and their habits, and thus their business can respond quickly to that. They are also able to see who their best customers are, so they could target them with a personalized offer. Knowing customers based on their buying habits allows dealerships to personalize services, which their customers will notice and presumably appreciate.

New business models built around central online elements (sales and marketing, software updates, help desk) will likely be based on mobility services and integrated omni-channel offerings, such as maintaining and operating car-sharing fleets and online sales. Acquiring data will become increasingly critical for the design and operation of systems, powertrains, safety features, etc. Big data analysis will allow car manufacturers to acquire significantly more knowledge about their customers, helping them better address individual customer needs, and will enable car dealers to continually tailor offerings to individual buyers and retain existing customers. Even the interiors of vehicles may give car manufacturers opportunities to generate revenue from the users' connectivity and car time.

The task of realigning sales and marketing will lie for the most part with car manufacturers and their national sales companies. But independent car dealers will also need to rethink commercial operations—ideally in close coordination with their respective manufacturers—and adapt their business model to a changing landscape, and thereby generating alternative source of future income. The combination of supplementary digital and physical services should improve sales efficiency and customer focus, and will help keep potential online competitors at bay.

The digital connection will allow car dealers to interact effortlessly with customers after the car purchase—for example, by arranging the next service check. Car dealers can also boost efficiency and profitability by digitalizing core retail processes, both in the front office (e.g., consultations) and in the back office (e.g. data management). Embedded data sensors should enable more precise monitoring of the performance of vehicles and components, suggesting new opportunities for lean-manufacturing techniques to eliminate anything customers do not value.

The Five V's of Big Data



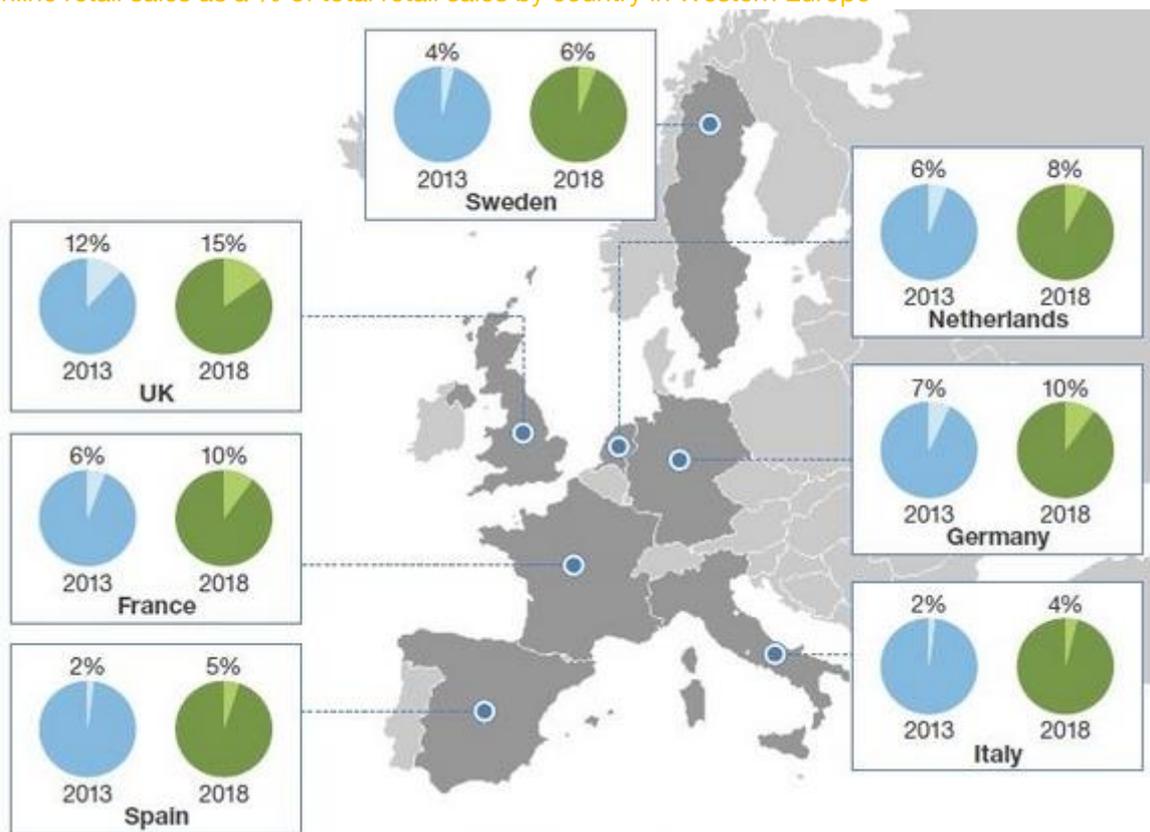
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Imbuing with the digitization of operations will boost productivity, including the productivity of suppliers. The ability to analyze real-time road data should improve the efficacy of sales and marketing. At the same time, big data simulations and virtual modeling can lower development costs and speed up time to market. The result should be higher average sales and profit per customer. Manufacturers will offer greater compensation to dealers that excel at creating loyal customers.

Online retail sales

Today online sales of new cars are still relatively rare in Europe and are usually arranged through online portals or individual car dealers. Many online platforms operate as intermediaries. So far, measures adopted by the EC allow manufacturers to impose restrictions on the activities of these intermediaries, such as a rule that no intermediary is allowed to buy more than a certain per cent of a dealer's total sales volume. These rules obviously hamper what is a perfectly legitimate trade, and they will in future be prohibited. The only rule that car manufacturers will be able to impose will be a requirement that the intermediary must produce a mandate from the consumer.

Online retail sales as a % of total retail sales by country in Western Europe



Source: Forrester Research Online Retail Forecast, 2013 to 2018

Implication for car dealerships: Internet distributors who sell vehicles exclusively over the Internet could be seen as free-riding on other distributors who have an obligation to invest in a showroom, demonstration vehicles and trained sales staff who give advice to consumers. Consumers would presumably take advantage of all of these facilities but would then turn to an Internet dealer for the actual purchase of their new vehicle. In view of these risks and the fact that consumers are not yet much attracted by the idea of buying a car from a pure Internet distributor, it seems - for the time being - inappropriate to force manufacturers to give them full and unconditional access to distribution networks. Having said that, the Internet is clearly a low-cost medium and should in the medium term reduce both distribution costs and consumer prices. Internet operators will continue to act as an intermediary for consumers, and establish privileged relationships with car manufacturers and dealers all over the EU.

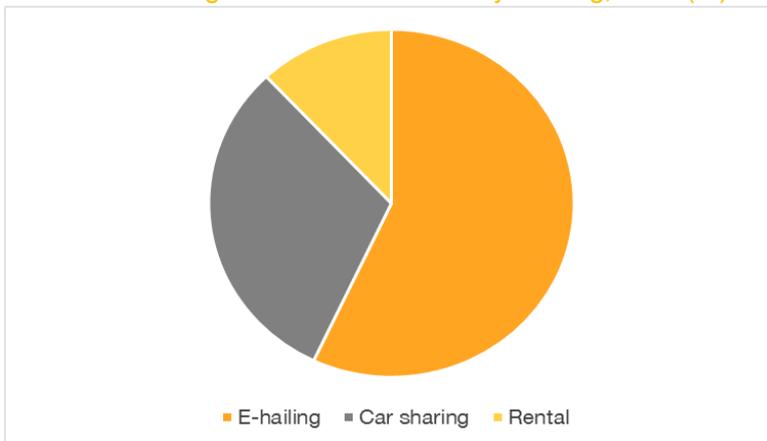
We believe the interest in using online channels for car purchase will gradually rise. Customers will use Internet platforms not only to search for pricing information but also to find vehicle specifications and view customer ratings. OEMs will increasingly imitate the online car sales activity of Amazon and Tesla and adapt to customers' behavior change. Initially, most online purchases will take place in urban areas, at the expense of sales volume at brick-and-mortar dealerships. Despite that inevitable shift, car manufacturers will continue to rely on dealers to manage the interactions customers initiate online—for example, by arranging test drives and conveying the experience of the brand. Some of the existing stores will be shut down or used only as showrooms or information centers for online purchases.

Under a new distribution system, national car dealers will likely tend to operate national online shops, including offering customer advice and online purchase financing. At the same time, they will support independent car dealers in implementing store formats developed centrally by car manufacturers aligned with local conditions. These formats include brand stores, pop-up stores, test-drive centers, experience centers focused on new digital features in cars, and small city stores in prominent locations.

Ride-hail

Technology and connectivity pose the question of whether it's necessary to own an automobile. Car sharing has the benefit for the consumer of using vehicles only as needed while foregoing the responsibilities of individual ownership. In urban areas, car sharing and networked transport are believed to reduce urban car ownership, with fewer private individuals purchasing new cars. Technology companies like Uber and Lyft hacked the world years ago by saying that people would no longer need to own cars. They predicted that the number of households without cars will grow dramatically and sooner than anyone would have foreseen. Big cities joined the chorus saying that such moves can help take emissions-spewing cars off the street, make it easier to get around by foot or by bike, while saving costs of car maintenance and ownership. Ride-hail can also have a profound impact on driver safety and behavior over time. Recent studies highlighted that the expansion of ride hailing services has reduced the instances of drunk driving, which makes these vehicles a safer option. Another major factor positively influencing the growth is the increasing use of digital money. With governments across the globe focusing on digital payments, ride hailing services have evolved as the medium of public transport. These companies accept payment by digital wallet, unified payment interface, net banking, and various other e-payment methods.

Global ride hailing services market size by offering, 2018 (%)



Source: Grand View Research

Recent statistics in the U.S. (USDOT's FHWA) showed that youngsters under the age of 19 increasingly opted out of obtaining a driver license relative to the prior decades. That can be considered as a clear sign of broader attitude changes towards obtaining a driver license, particularly in light of growing popularity of alternative and cost-effective transportation options in big cities where population is permanently growing, the public transport systems are overcrowded and traffic congestion issues are getting more and more serious (i.e. causing a huge amount of money lost). In Europe, a middle-class privately-owned vehicle runs an average of 12,000 kilometers per year, and an average Uber car runs 40,000. Newer app-based mobility options are hoped to have the potential to dramatically alter the costs for growing urban centers over time, as they could have explicit impacts to public parking real estate projects and expenditures, providing city planners optionality in solving public transportation and traffic issues.

However, these hopes are dashed by evidence that car ownership is constantly rising. The number of vehicles has grown faster than the population in some of the cities where ride-hail is most popular, even in urban places where Uber's car-sharing service has become part of everyday life. Evidence shows that millennials, the city-loving generation that was supposed to prefer renting and sharing to car ownership and who got used to make a reservation at the tap of a personal mobile device, appear to delay the decision on owing cars because of fears of economic troubles and not because of their changing behavior, or preferences. The fact that today's young people are less enthusiastic about

starting families may have more to do with their lower rates of car ownership than a reluctance to own cars.

The profitability of running ride-hailing companies has also some questions. Technology advancements is certainly key for making ride-hailing companies profitable in a sustainable way, just as network efficiency, driven primarily by density of driver supply and rider frequency. Major companies in the community motoring industry, such as Uber, Didi, and Lift that deploy their existing capabilities to support new mobility services—for example, in the car servicing business. They are all in the process of strategic thinking and investing to exploit the synergies generated by electrification. Just recently, Car2Go, the car-sharing company jointly owned by Daimler and BMW, said it would pull out of half of the North American cities where it operates for low profitability and disappointing performance indicators (poor take rates, in particular). BMW-owned ReachNow, a ride hailing and car rental company, closed down its operation in the U.S. this summer, and General Motors did the same with its Maven car-sharing service in eight of its 17 North American cities. Lime also terminated its experimental LimePod car-share service in the U.S. Uber and Lift also posted incredible losses in recent quarters versus some shrinking numbers. Bosch's electric scooter sharing service Coup has just announced that it will discontinue its service in the German Berlin and Tübingen by mid-December 2019. The Paris and Madrid locations are also to be closed at short notice, blaming the highly competitive sharing market with high costs at the same time.

Implication for car dealerships: Although frenzy around ride-hail appears to have ebbed, customers operating car-sharing fleets and limousine services will presumably buy more cars in the future (the fleet market accounting for roughly one quarter of annual new car sales in Europe). Shared mobility while squeezing sales volumes and margins, especially for urban car dealers, should create new opportunities in areas such as maintaining and operating car-sharing fleets, which could become a significant new source of income.

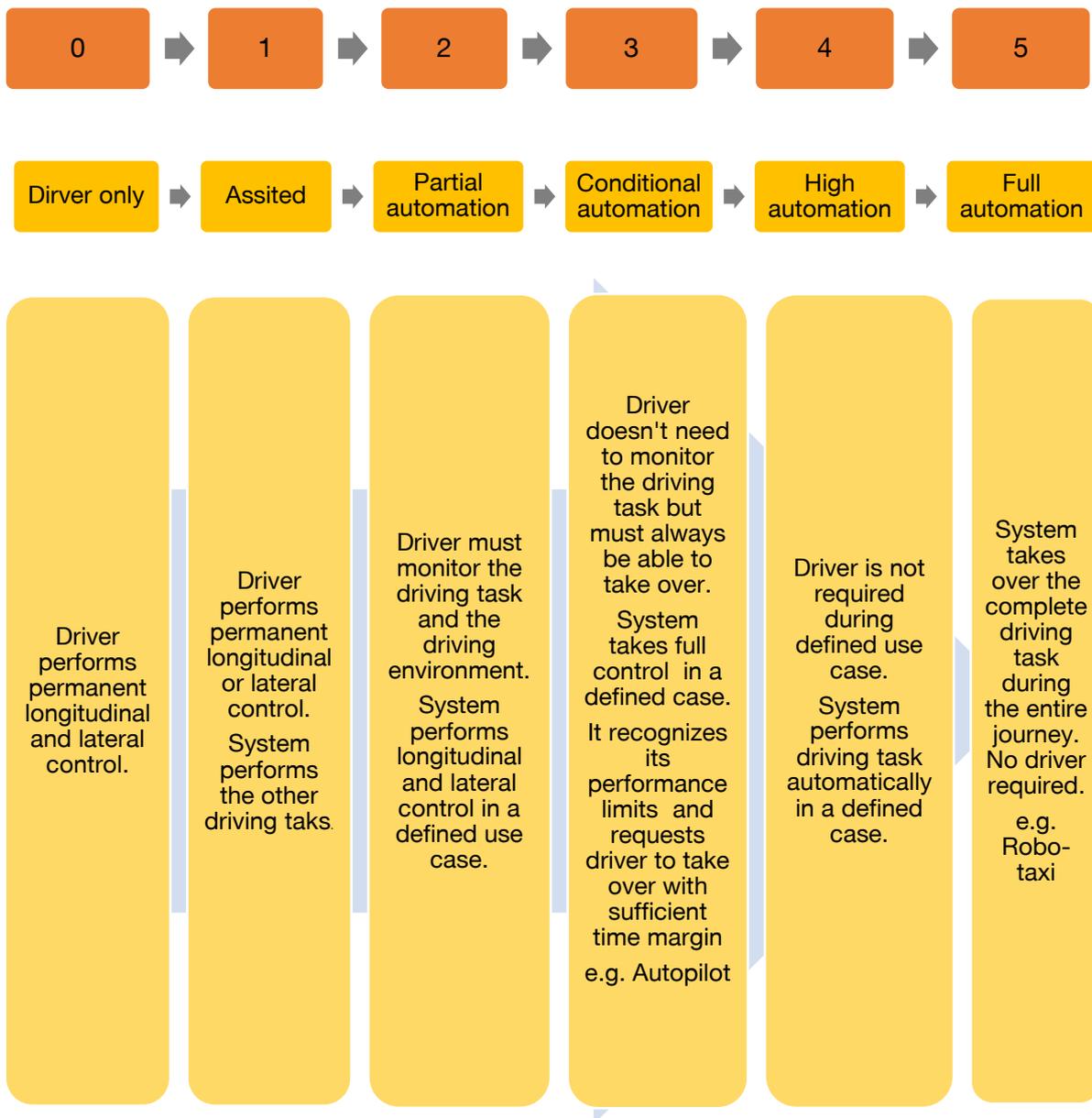
Increasing car sharing does not necessarily translate into fewer car sales. Car usages and service needs for fleet cars are likely to keep on rising. The average distance driven per person probably will not decrease; in fact, it may increase in the foreseeable future. There will be people who will want to enjoy being behind the wheel and there will be those who take shared rides. Essentially, we believe the decline of car ownership will be a very gradual process given a car's average lifespan. We also acknowledge that increased ride-hailing options will drive licensed drivers to decline slightly over-time; along with this, we expect vehicles per licensed driver to eventually see pressure as multi-car families downshift their fleet size.

The net outcome of all this is the beginning of improved vehicle usage efficiency (secularly increasing traveled kms per vehicle in operation). We project that vehicle km traveled should continue to grow at an average rate of approximately half the rate of GDP growth. Vehicles in operation growth is expected to slow down and for normalized seasonally adjusted annual rates to trend higher – at least until cost per kms declines materially from the advent of autonomous vehicles or utilization rates improve faster.

Autonomous drive technology

While the rate of adoption of autonomous vehicles will vary by technology and region, penetration is set to increase over coming decades and technologies which are viewed as leading today (Level 2 assisted driving, for example) are likely to become mainstream over time (ie. normal constituents of the car price), as witnessed with prior technologies within the car, from air bags to parking sensors to satellite navigation systems.

The five stages of autonomous driving



Source: Volkswagen

Continental and EasyMile technology used in CUBe is ready for serial production and has already been applied in many countries around the world, including the United States, Japan, China, Singapore, and Germany. It is currently used in a variety of test programs on well-managed public roads as well as in confined areas of corporate sites, on campus, or during professional exhibitions. However, within a few years, self-propelled robotic taxis may become an important complement to existing mobility systems, as they are environmentally friendly, flexible, safe and thus capable of handling many transport tasks. The CUBe roboict taxi is equipped with laser sensors, cameras and sensors enabling it to pinpoint locations, while still recognizing obstacles and potentially dangerous situations.

Driverless transport systems, such as CUBe, offer a solution that responds to both situations: robotic taxis, which are both emission-free and flexible, can contribute to improving air quality in cities and can also help reduce congestion. In addition, stand-alone shuttle buses reduce the risk of accidents, reduce parking space and, thanks to the electric drive, reduce noise pollution. In addition, robotic taxis in rural

areas can significantly improve the situation of individual mobility, especially for those who do not have their own vehicle. In an era of megacities and congested urban areas, personal-mobility services will help transportation become more flexible. Disabled, elderly, and visually impaired people will certainly enjoy much greater mobility.

Autonomous drive technology with an increasingly intelligent roadway infrastructure can theoretically help solve traffic jams in smart cities because cars will communicate with one another, for example, when vehicles are looking for an alternative route with a traffic jam. Also importantly, adoption of autonomous vehicles also has the potential to reduce energy consumption. If a robotic car is set to run evenly under a speed limit of 50 km /h, it is almost certain that this car will consume less along the same route than that of a car that changes its speed frequently. Throughput on roads can be optimized, easing congestion and shortening commuting times. The bad news is that with an increasing use of low-cost cars equipped with autonomous drive technology, aggregate traffic in cities can even increase significantly. In principle, it might be easier and cheaper in an autonomous drive technology system to get a car around the city permanently than to find a parking space for it. If so, vehicle traffic is likely to increase dramatically and there is a very serious concern that self-driving technology will partially replace public transport.

Whilst we will leave it to others to predict when autonomous vehicles will be allowed to operate across big European cities (it seems even farther for us is to assume them to pop up in CEE cities in the foreseeable future), or if there will be a valid business model to justify their expense at all, it is an undeniable fact that billions of euros are being invested by public OEMs and other nameplates to develop autonomous driving and other new groundbreaking technologies. As funds become increasingly available to spend on developments, the penetration of cars with novel technologies will rise. Costs of expensive parts (e.g. LiDAR) could run up, given it is the core technology in autonomous vehicles, but later the cost will go down as there are so much R&D going into the new technology and autonomous vehicles achieve commercial scale. Although OEMs' cash flows are posed to be heavily burdened for a while now by necessary transformational CapEx, there is no way back in revolutionizing the car manufacturing industry. The winners will be the low-income people to whom cheaper cars and services will be offered, contributing to widening affordability thereof.

Apparently, as a driver is removed from the car, there remains, naturally, no one to report a vehicle malfunction. To tackle this problem, predictive maintenance concept will likely be introduced during the manufacturing process. Predictive maintenance involves constantly analyzing streaming data in order to maximize uptime and predict failure. Also, as time evolves, machine learning algorithms is likely to provide more sophisticated and precise failure predictions. But this is not necessarily a good news for independent shops and services. OEMs are going to hold all the data in terms of what is happening with the vehicles. There are OBD-II systems used today (on-board diagnostics systems which is a vehicle's self-diagnostic and reporting capability). OBD systems give the vehicle owner or repair technician access to the status of the various vehicle subsystems, but, in the future, that might be obsolete. That way, the car manufacturer will hold all the data, and the best way for dealer service centers to have access to these data will be to partner with the OEMs, likely through certifications.

Implication for car dealerships: Hybrid and electric vehicles will likely continue gaining traction in the next few years, and later vehicles autonomous driving technology, which will force repair shops to upgrade. In terms of the new technology getting embedded, if repair services work like a software company and hire more software engineers. The problem, however, is that there is practically fully employment in CEE countries, hence the bottleneck of skilled staff, IT professionals, in particular.

As services intervals are constantly being extended by the car manufacturers, we believe in the world of autonomous vehicles, auto repair shops will also see majority of their customers less frequently. Furthermore, autonomous vehicles will mostly be deployed in fleets—for example driverless taxis—reducing the overall demand for private car ownership, especially in urban areas, the automotive industry gradually shifts from individual car ownership to fleet ownership. Owners of autonomous fleets often will buy directly from car manufacturers, and require specific technical features in their fleets.

Therefore, independent repair shops should start partnering with companies that operate fleets, be it autonomous or just a smaller fleet. Obviously technology is going to change a lot, but it is not going to change the human aspect and the trust factor with it (relationship).

Regulation – Block Exemption Regulation

The EC Treaty lays down a basic rule, banning agreements which have anti-competitive effects. Of course, many common agreements which are procompetitive and benefit the consumer contain clauses which limit one or other of the parties' ability to compete, and the Treaty therefore gives the EC the power to exempt such agreements from the ban. Rather than read through every individual agreement notified to it, the EC often through a regulation exempts a whole category of agreements, on condition that they respect certain requirements. Regulation for the motor vehicle sector is an example of such a "block exemption".

Since the 1st June 2010, new rules for competition in the automotive sector have been in application. Following the review of the former Motor Vehicle Block Exemption Regulation (MV-BER), the European Commission (EC) enacted a new Block Exemption Regulation and accompanying sector-specific guidelines specifically for the automotive aftermarket. New regulation contains rules, notably on access to technical information for all independent operators, the freedom to source and supply spare parts, and the prevention of misuse of vehicle manufacturers' warranty terms and related consumers rights.

The so-called general vertical restraints block exemption regulation does not allow suppliers to require its customer to resell the product at a fixed or minimum price. As a general rule (to which few exceptions apply), the customer may determine the resale price on its own, without being pressured by the supplier. The supplier may however issue non-binding recommendations. There can be limits on customer and territory allocation - the supplier may have the ability to require the distributor to operate out of an agreed place of establishment, or the right of members of a distribution system to cross-sell goods between them.

Vehicle manufacturers supply their authorized network with their own branded spare parts. The spare parts producer, however, may not be hindered from placing its own trademark on the part (either exclusively or in parallel as "double branding"). The members of the vehicle manufacturers' authorized network have the obligation to use parts that are at least of matching quality. It is worth noting that independent repairers, as they are not members of the 'franchised' network, are of course not subject to such obligations.

In practice, authorized repairers usually source spare parts from the vehicle manufacturers with whom they have an agreement. Nevertheless, in order to stimulate competition in the spare parts market, the new legislative framework continues to provide for the possibility of authorized repairers to source original parts" or parts of matching quality from parts suppliers or independent parts distributors. This freedom may however be subject to an obligation to source a minimum quantity of spare parts from the vehicle manufacturer. This obligation is nonetheless limited. In most cases vehicle manufacturers will enjoy such a position in the market that this minimum sourcing requirement should be as low as not to endanger competition in the market.

In order to be considered as being of "matching quality", parts must be of a sufficiently high quality that their use does not endanger the reputation of the authorized repair network. The burden to prove that a part does not fulfil this requirement falls upon the vehicle manufacturer who must bring evidence to that effect in case it wants to discourage authorized repairers from using such parts. A part of matching quality does not refer per se to the quality of the part originally fitted into the vehicle. It may match the quality of the spare parts of a specific range supplied by the vehicle manufacturers to its authorized network, including spare parts from a vehicle manufacturer's assembly line. Even though vehicle manufacturers bear this burden of proof, in order to facilitate sales from independent distributors to the members of the authorized networks and to avoid possible legal challenges from the

vehicle manufacturers, parts suppliers are invited to issue – on demand – a (self-) certificate for the quality of their parts (e.g. in the packaging, as a separate declaration, or a notice on the Internet).

The new competition law framework confirms that vehicle manufacturers may not prevent their original equipment suppliers from also supplying their products as spare parts to independent distributors or directly to independent or authorized repairers requiring these for the repair or maintenance of a specific customer vehicle. To satisfy consumer demand, part producers also supply the independent aftermarket with spare parts adapted to the age of the vehicle; provided that these parts should fulfil all legal requirements as to the product safety and environmental legislations. Even so, some parts are exclusively produced by vehicle manufacturers themselves (e.g. chassis, engine blocks or certain body parts) or are parts on which vehicle manufacturers hold a valid industrial property right. These are only supplied to the aftermarket by the vehicle manufacturers themselves. However, access to these is essential in order to allow independent repairers to properly maintain and repair vehicles and to compete with the authorized repair networks.

The general principle of competition law provides that the higher the market share of the vehicle manufacturer in the market for spare parts suitable for the repair and maintenance of vehicles of its own brands in a given national territory, the lower the percentage of minimum spare parts procurement it will be allowed to impose on the members of its authorized repair network. Furthermore, since authorized repairers may also have to carry out repair or maintenance services on vehicle of other brands, they also need to purchase parts from other sources. In this situation, they are to be considered as independent/multi-brand repairers and therefore may source any spare parts from independent parts producers or spare parts distributors, as long as these fulfil legal requirements.

Parts codes and any other information necessary to identify the correct car manufacturer branded spare part to fit a given individual motor vehicle should be made available to independent operators if it is made available to the authorized network. For new vehicles on the market, vehicle manufacturers are asked to give independent operators access to technical information at the same time as to its authorized repairers. Access to technical information (software and reprogramming, tools, diagnostic equipment, garage equipment and training) should be given upon request and without undue delay, in a usable form, and the price charged should not discourage access to it by failing to take into account the extent to which the independent operator uses the information. The principle is that such access must be given on non-discriminatory terms to both the authorized and all other repairers: if the former have to pay for a specific software or share the cost of a training course, the latter should be quoted the same price. Independent repairers, even those qualified that wish not to become authorized repairers, will thus be able to compete on the same level with authorized repairers. There are currently more than 100.000 independent repairers in the EU, while authorized networks hold 50% market share of all repairs (and even 80% for cars under 4 years). Similarly, parts producers will have better access both to the authorized and independent repairer. These producers manufacture ca. 80% of all components and parts of a new car, while the car manufacturer produces only ca. 20%. These are impressive market shares justifying stricter conditions on the repair market.

The competition law framework differentiates between motor vehicle sales channels, the trade in spare parts and the repair and maintenance services. Accordingly, vehicle manufacturers have the option to offer to the members of their authorized network three separate contracts whereby their contractual partner can carry out all three functions, two functions or just one of the three functions:

- distribution contract for new vehicles (official dealer)
- distribution contract for replacement parts (authorized parts distributor)
- contract for service, maintenance and repair (authorized repairer)

When it comes to the distribution of the original spare parts, if an independent parts distributor fulfils the qualitative criteria of the vehicle manufacturer (with regard e.g. to possible stock keeping

requirements or the qualification of the personnel), he or she could have a good chance of applying successfully for an authorized parts distribution contract.

Also importantly, within the warranty period, any defect originating from the car manufacturing process must be corrected by the vehicle manufacturer. However, they may not make the warranties conditional on the repair and servicing of a vehicle within their network, or on the use of their own branded spare parts. In fact, consumers have the right to use any repair shop for non-warranty work, during both the statutory warranty period (2 years in most EU member states) and any extended warranty period. Of course, every service operator is subject to statutory product and service liability. Thus, anyone who damages a vehicle as a result of negligent work or use of defective parts is responsible for it. Furthermore, the necessary infrastructure, which meet the quality standards of a car manufacturer needed for the honoring of warranties and carrying out of recall operations and free servicing, exists throughout Europe. Warranties which are in fact insurance policies and purchased separately, may not be covered. Leasing or financing contracts may also provide for additional limitations.

In 2019, the EC has launched its review of the MV-BER to assess its relevance, its coherence and its EU added value. Depending on its final evaluation, expected in May 2021, the EC will or will not consider prolonging the MV-BER after its expiry date, currently in 2023.

We believe the new regulation will create a more complete environment. Competition is expected to intensify between authorized repairers, between authorized and independent repairers, and between the vehicle manufacturer and the part manufacturer for the supply of original spare parts. Eventually, this increased competition should result in more competitive prices for the consumer and for increased quality of the after-sales services, thereby affecting car dealers' profitability and probably resulting in a decrease in their number. At the same time, regulation prohibits imposing ceiling on the number of repairers which fulfil the qualitative criteria for joining the network, and that allows dealers to continue to operate within the network as authorized repairers. In this way, the regulation should at least partly contribute to moderate the expected decrease in dealer numbers as well as the staff employed by the dealers, compensating for the ongoing sales networks rationalization initiated by the car manufacturers.

Moreover, the new regulation is deemed to ensure market conditions which will lead to a reduction of the existing high regional price differentials that are due to the rigidities of the current distribution systems in the EU and to more competitive prices on the sales and after-sales markets. Indeed, this is already in the luxury car segment cars in the Eurozone. It is too early to predict at which level this price harmonization will occur. This will depend on the level of effective competition between the various brands. If competition gets cut-throat on prices and innovation, potential convergence should lead to prices below the actual average prices across the EU. On the other hand, regarding price increases in countries with high car taxes (such as Denmark, Finland, Greece, Ireland, or Hungary) car manufacturers will take into account the risk of losing local market share, or reduced demand for new cars.

There is no doubt that dealer markets are extremely fragmented in the CEE countries. The highest market share held by a single undertaking is about 2-3% (this undertaking operates several dealerships of various brands). For example, as statistics previously showed, over half of Hungary's professionally managed car dealerships were located in smaller cities with populations between 10,000 and 100,000, and slightly less than a third of professionally managed dealerships stayed in larger cities with more than 500,000 inhabitants. In Hungary, where AutoWallis considers expanding in an inorganic way, the vast majority of car dealers operate under a contractual agreement with their national car distributor, and only a minority of car dealers are actually owned by the car national distributor. The rest runs under some other form of cooperation such as individual import, or being a sub-dealer. Multi-branding is very popular business model of dealership, which is a means of reacting to increasing competition on the car sales market. The multi brand dealers are quite independent in selecting their suppliers, although different brands are not usually sold in the same showroom.

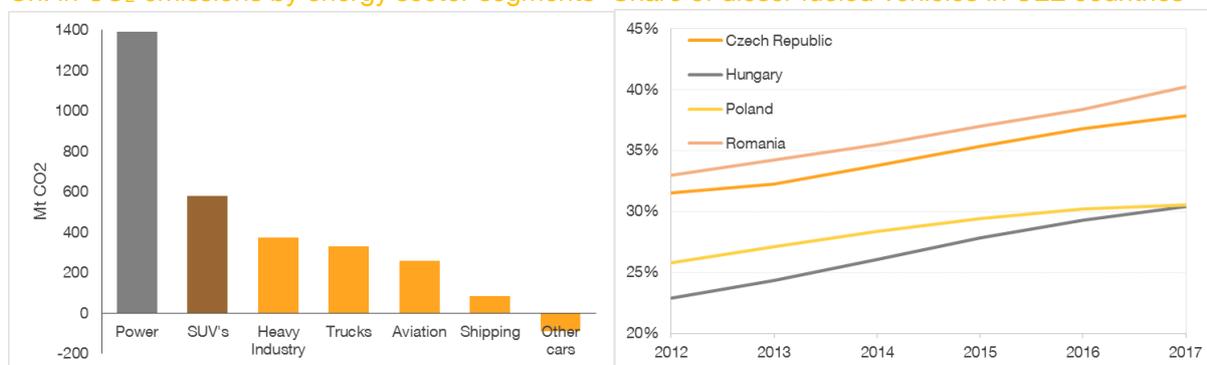
A majority of all car dealers in Hungary has had dealerships for more than 10 years, and there are less than 10% that have been around for more than 20 years. Despite the fact that business conditions in Hungary are expected to become tougher for dealerships, the majority of car dealers do not appear to plan to withdraw from the market. Only less than 10 pc may opt to leave the industry in the next few years on our estimate.

Regarding the dealer size, a good-runner car dealer sells on average hardly more than 200-300 cars per year. There is potentially scope for economies of scale at the retail level that could be passed on to consumers. Moreover there does not seem to be a correlation between concentration and prices. Moreover, car manufacturers may impose maximum retail prices if they feel that dealers are abusing their local market power.

Regulation - CO₂ emission performance standards for new passenger cars

With the level of urbanization increasing, regulation on vehicles-use is expected to become more stringent. Regulatory approach to the social impact of automobiles will pay more and more attention to an integrated assessment of the costs and effects of extracting, processing, and delivering a fuel or energy source to automobiles and of using that fuel or energy source and generating emissions. The Paris Agreement sets out, inter alia, a long-term goal in line with the objective to keep the global average temperature increase to 1.5 °C above pre-industrial levels in an attempt to limit global warming. This is roughly equivalent to the fact that humanity can release 800 bn tons of carbon dioxide into the air from now on, which increased by 500 mn tons last year. In order to contribute to this objective and reach net-zero greenhouse gas emissions by 2050, the transformation of the entire transport sector towards zero emissions needs to be accelerated. As part of measures aimed at achieving the transition to net-zero greenhouse gas emission target, emissions from conventional combustion engine vehicles should be further reduced after 2020. Zero- and low-emission vehicles will need to be deployed and gain significant market share, together with setting new EU fleet-wide CO₂ emissions reduction targets for passenger cars and light commercial vehicles for the period up to 2030.

Ch. in CO₂ emissions by energy sector segments* Share of diesel-fueled vehicles in CEE countries

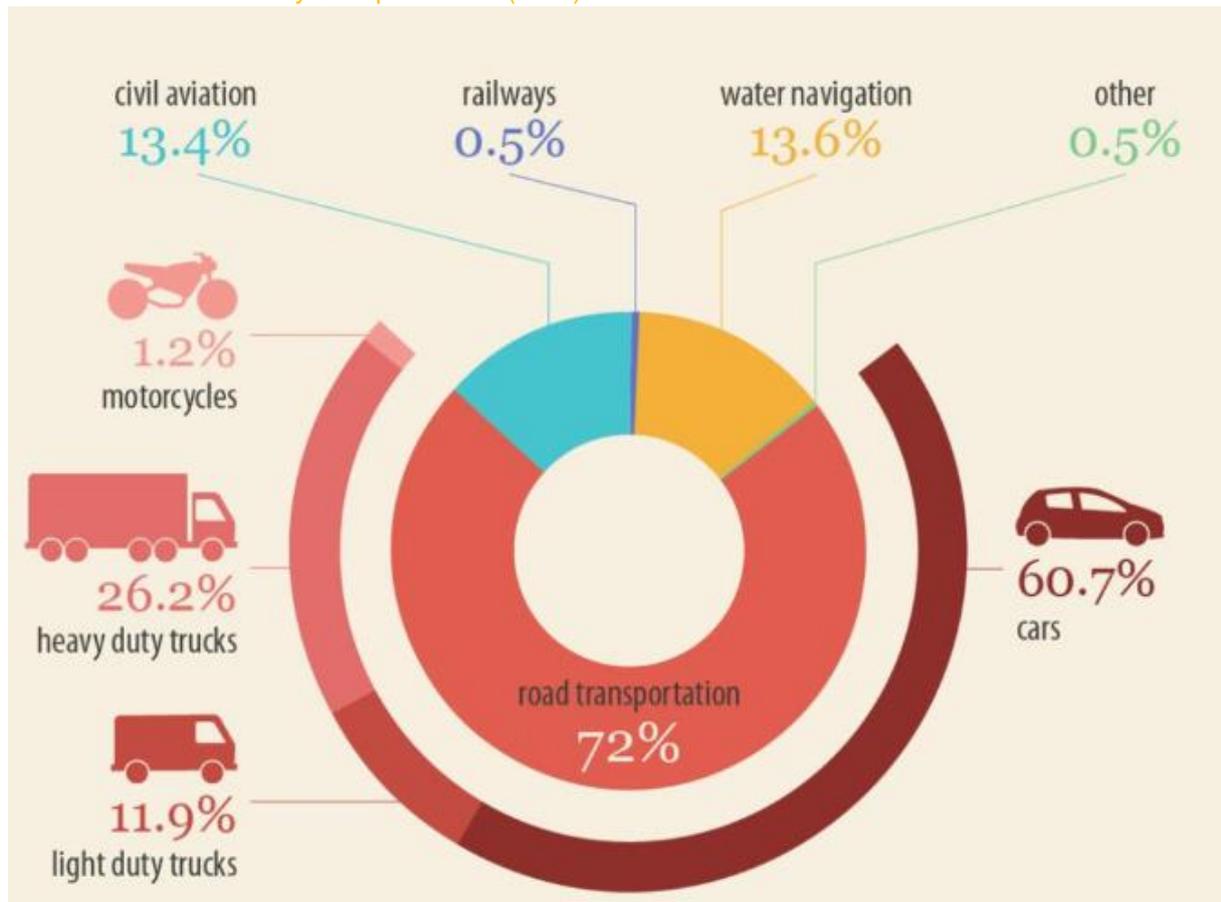


Data for the period of 2010-18, Source: IEA

Source: Eurostat

Also, a significant increase in the price of carbon quotas would contribute effectively to address the problem. Certainly, in order to reach the climate targets defined in the Paris Convention, it is not enough to have only the Dutch and Danish support, serious carbon pricing should be applied in most of the world economy. In the sustainable development scenario, a carbon quota price above USD 100/ton (vs. USD ca. 28/ton currently) can be necessary to persist, and even Russia may need to introduce a carbon tax to reduce emissions.

Emissions breakdown by transport mode (2016)

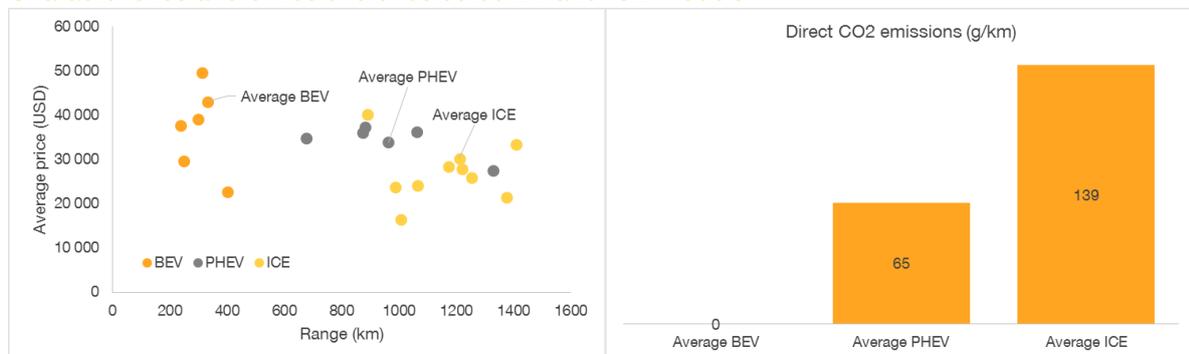


Source: European Environment Agency

From 1 January 2020, new CO₂ emissions regulation sets an EU fleet-wide target of 95 g CO₂/km for the average emissions of new passenger cars and an EU fleet-wide target of 147 g CO₂/km for the average emissions of new light commercial vehicles registered in the EU until 31 December 2020. For reference the European-wide fleet reduced CO₂ by 1.2% (from 119.5g to 118.0g) in 2016, but rose 0.4% in 2017 (to 118.5g) as lower diesel limited the progress.

This regulation will, until 31 December 2024, be complemented by additional measures corresponding to a reduction of 10 g CO₂/km. Average specific emissions of CO₂ means, that the average of the specific emissions of CO₂ of all new passenger cars or of all new light commercial vehicles of which it is the manufacturer.

Characteristics and emissions of selected EV and ICE models



Source: LMC, Smart EV

For the purposes of determining each manufacturer's average specific emissions of CO₂, the following percentages of each manufacturer's new passenger cars registered in the relevant year shall be taken into account:

- 95 % in 2020,
- 100 % from 2021 onwards.

In calculating the average specific emissions of CO₂, each new passenger car with specific emissions of CO₂ of less than 50 g CO₂/km shall be counted as:

- 2 passenger cars in 2020,
- 1,67 passenger cars in 2021,
- 1,33 passenger cars in 2022,
- 1 passenger car from 2023

In other words, these so-called super-credits will be phased-out by 2023, when no multiplier will be awarded for the sale of low-emission vehicles. In addition, from 1 January 2025, the EU new passenger car and light commercial vehicles fleets-wide targets will be further reduced. In our opinion, to reach these targets a mixture of both powertrain penetration and improvement in combustion engine efficiency will be required. As of September 2017, the old NEDC (New European Driving Cycle) lab test for cars have gradually been replaced by the new WLTP test (Worldwide Harmonized Light Vehicle Test Procedure), but we are afraid that the shift from NEDC to WLTP will make efficiency improvements more difficult to achieve, let alone the continued rise in demand for larger, and therefore heavier, vehicles like SUVs. From 2019, WLTP will be supplemented by RDE (Real Driving Emissions) as an additional testing method to verify that legislative caps for pollutants such as NO_x are not exceeded, and EVAP (Evaporative Emission Control System), the latter focuses on emissions not released via the exhaust pipe.

We note that since 2015 the rate of progress towards becoming compliant with EU CO₂ targets has clearly diminished from roughly 3% p.a. to 0 as consumers have turned away from diesel after the VW diesel crisis (gas engines have higher CO₂ emissions than diesel). Consequently, based off 2018's reported numbers, the industry remains 25g short, at 120g CO₂/Km, of the 95g target.

The conversion ratio the EU will apply to the NEDC 95g to get a corresponding WLTP value for the industry is 1.2x, which would see the NEDC 95g/km CO₂ target increase to a WLTP equivalency of 114g. The International Council on Clean Transportation (ICCT) believes a more aggressive conversion ratio will be used for WLTP, with a 2021 WLTP target potentially as low as 109g. If it turns out to be the case, then the challenge to OEMs to achieve CO₂ targets could be materially different, as it will prove more punitive on small capacity engines, which are expected to see a larger relative step up, ~25%, than large capacity engines, ~10-12%. Diesel will have a larger relative and absolute step-up than gasoline on a like for like basis. However, given diesel mix is more exposed to large capacity engines than small capacity engines, diesel may fare well better than other fuels.

As for car manufacturers, we think it is fair to assume that German players are better positioned to benefit from the shift from NEDC to WLTP (Daimler and BMW, in particular), as they produce cars with larger engines than other manufacturers in Europe (eg. French ones) whose product mix is being tilted toward smaller engines. Our claim still remains true even after adjusting for German carmakers' relative larger exposure towards diesel.

It is worth adding, however, that vehicle manufacturers may form a pool for the purposes of meeting their emission obligations. An agreement to form a pool may relate to one or more calendar years, provided that the overall duration of each agreement does not exceed five calendar years, and must be entered into on or before 31 December in the first calendar year for which emissions are to be

pooled. The manufacturer nominated as the pool manager who will be the contact point for the pool and will be responsible for paying any excess emissions premium imposed on the pool.

In respect of each calendar year, vehicle manufacturers or the pool manager shall pay an excess emissions premium, if a manufacturer's average specific emissions of CO₂ exceed its specific emissions target.

The excess emissions premium shall be calculated using the following formula:

Excess emissions × EUR 95 × number of newly registered vehicles.

New regulation are believed to provide a clear pathway for CO₂ emissions reductions from the road transport sector and contributes to the binding target of at least a 40 % domestic reduction in economy-wide greenhouse gas emissions by 2030 compared to 1990.

A recent series of decisions imposing fines on Volkswagen and DaimlerChrysler underlines that the car manufacturers have not always respected the current regulation.

In our opinion, tighter CO₂ emission performance standards for passenger cars and light commercial vehicles will be a strong driver for innovation and efficiency, though it may lead to a price increase, especially in the category of small class passenger cars with low cylinder engines due to the high costs of investing in new technology. Differences in the ability to reduce CO₂ can vary by OEMs depending on their vehicle line mix, powertrain mix and technology solutions already deployed and planned for the future.

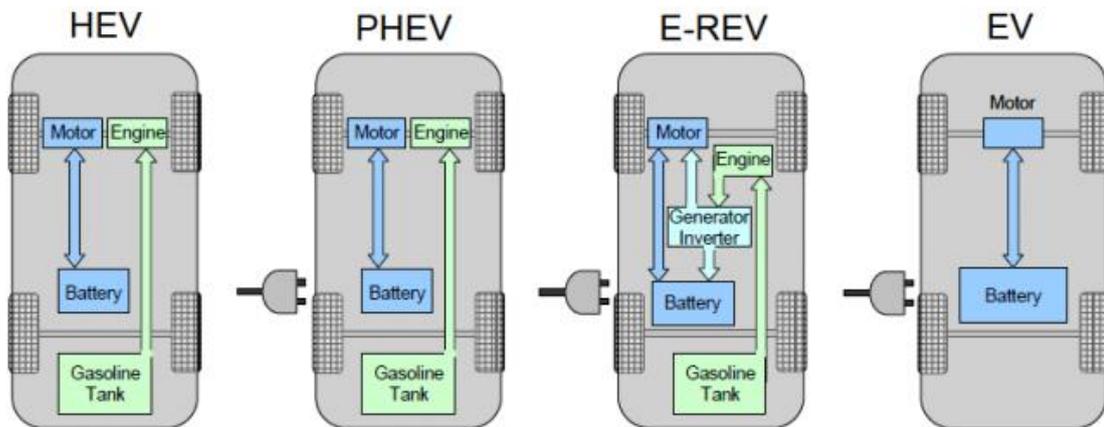
Despite all the efforts to achieve CO₂ emissions targets, consumers' insatiable appetite for bigger and heavier cars (SUVs) is permanently growing. The global fleet of SUVs increased from 35 million in 2010 to over 200 million in 2018, adding extra barrels to global oil consumption, and thus becoming a major source of CO₂ emissions growth since 2010. SUVs are more difficult to electrify fully, and conventional SUVs consume 25% more fuel per kilometer than medium-sized cars. If the popularity of SUVs continues to rise in line with recent trends, this could add another 1-2% to daily oil demand by 2040, according to IEA's estimate.

In order to meet the 2021 95g/km CO₂ emissions target the penetration of EVs should need to increase to ca. 5% (from less ca. 1% today). While we are in no doubt that EV penetration will accelerate in the next decade, we are less optimistic about the pace of ramp in the next few years. The end of 2021 is a little over two years away. Although there are market estimates that the number of EVs will triple in that time, we expect it to still only account for a little over 2% of total car sales.

Electric Vehicles

Tighter emissions rules leave global carmakers and some consumers with little choice but to embrace plug-in vehicles. Technology advances, and the preferences of many consumers make the end of dominance of vehicles with an internal combustion engine (ICEs) more a matter of "when" than of "if." An obvious alternative might be to use EVs that will deliver much lower CO₂ emissions than the best diesel or gasoline engine. Car electrification is an irreversible trend. But, in order to encourage adoption of EVs at this stage, financial incentives have been necessary. In Europe, green cars benefit increasingly from subsidies and tax breaks, while ICEs face mounting penalties including driving and parking restrictions. China, struggling with disastrous pollution levels in major cities, is aggressively pushing plug-in vehicles. Its carrot-and-stick approach combines tens of billions in investment and research funding with subsidies, and regulations designed to discourage driving fossil-fueled cars in big cities. The road ahead for EVs in the U.S., however, could be a little bit more bumpy, with the administration rolling back environmental and climate rules.

Four categories of EVs (three of them include ICEs)

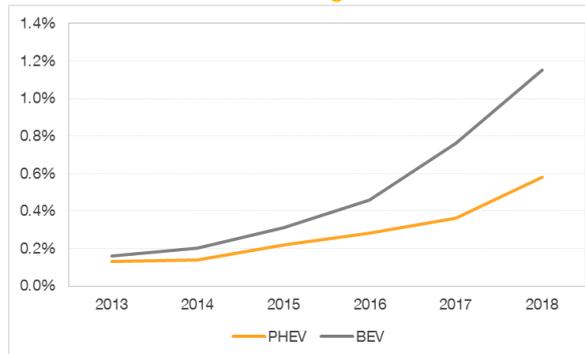


Note: The distinction between HEVs and PHEVs is that the batteries for the HEVs are charged from energy recuperation, while PHEVs, like BEVs, are charged from the main electricity networks.

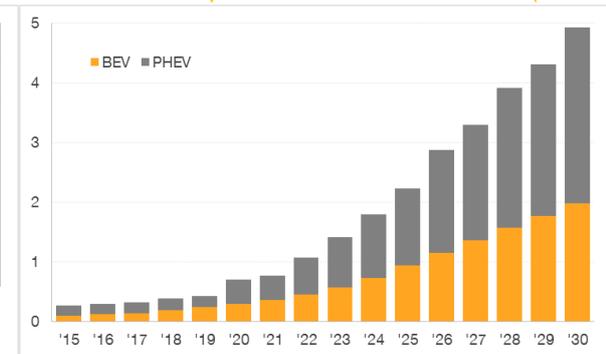
EVs adaptation: We believe mass adoption of EVs will be reached when neither regulation nor financial incentives are needed to spur OEMs to supply, or consumers to purchase, EVs. The primary reason why OEMs are currently working hard on changing customers' perception of EVs is the tighter regulatory environment in which they operate forcing them to do so to comply with emissions targets, whilst R&D expenditures are relatively high putting pressure on cash flows, and EVs are rather margin-dilutive (they are about half as profitable as their ICE equivalents at least initially). Regardless of what drives EV penetration consumers will eventually need to be comfortable with range, infrastructure, battery dilapidation, and cost.

EsV adoption is still in the early stage with battery EVs (BEVs), Hybrid Electric Vehicles (HEVs), Plug-in Hybrids Electric Vehicles (PHEVs), and Hybrid Vehicles (HVs) making up just 1% of new car sales globally.

Share of PHEV and BEV in global car sales



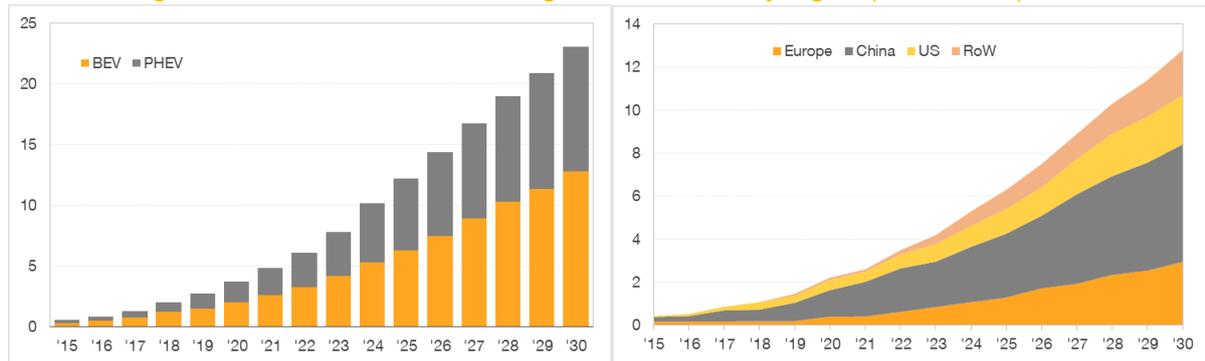
Forecast of European PHEV and BEV sales (mn cars)



Source: IEA

Global BEV penetration is likely to reach 2% by 2021, 4% by 2025 and 8-10% by 2030. If we include PHEVs our estimate rises to 15-18% in 2030 and when also including full-hybrids, we expect global BEV penetration to go beyond 20%. According to general market opinions BEV penetration (of new car sales) will reach around 14% in Europe, China, and the U.S. by 2030.

Forecast of global PHEV and BEV sales and global BEV sales by region (mn vehicles)



Source: IEA

The number of new BEV and PHEV models being launched in Europe’s top five markets is expected to grow significantly in the coming years. New BEV models to be launched should bring the BEV segment mix in terms of electric product ranges and vehicle size closer in line with ICE mix. Currently, the BEV market is dominated by small and medium sized cars (combined ca. 55% of global BEV market share) and only ca. 5% of BEV units sold are SUVs. By comparison, the segment mix of ICE vehicles is dominated by larger vehicles; small and medium sized vehicles represent less than 20% of sales.

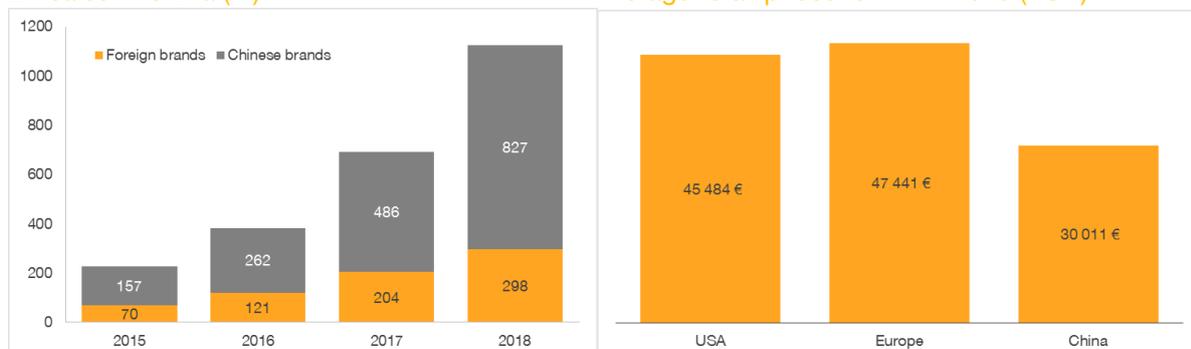
From supply point of view, the sale of EVs is expected to remain subdued as long as cost parity between EVs and ICEs is reached. With tighter emissions standards in place following the diesel crisis and technology advancing fast we hope cost parity can be reached before mid-2020s. The challenge, until then, is that EVs are considerably more expensive to manufacture than ICEs (and therefore the price to buy them is prohibitively higher), with poor investment returns relative to cost of capital.

From demand point of view, the perceived disadvantages of an EV lie in the price, the total cost of operating it, infrastructure constraints, limited range, refueling time and battery longevity (the latter is being treated by warrants offered by car manufacturers on the batteries), relatively lower residual value, which seem more prominent when it comes to purchasing decisions than environmental benefits, fuel efficiency and quitter drive experience. Despite all these disadvantages we expect that consumers will soon have the choice between conventional and fully-electric powertrain without being restricted by choice of model.

China is slowing becoming the world’s leader in terms of electrification technologies driving the BEV market in the medium term due in part to the giant size of the local market but also the government’s commitment and ambitious targets for the number of new energy vehicles, i.e. 2 million by 2020 and 7 million by 2025. Chinese government has indicated that it favors EVs, even though burning domestic coal to power them can leave a larger carbon footprint. Licenses are much easier to get for people who buy state-proved EVs.

EV sales in China (th)

Average retail prices for EV in 2018 (EUR)



Source: IEA

IHS Automotive predicts that more than 30 million vehicles a year will be sold in China by 2020, up from nearly 22 million in 2013. China's emergence as a dominant market and production center should have major implications for how cars are designed and powered. Growth has been possible thanks in part to affordable and small electric cars. In contrast to trends in Europe and the USA, where most alternative fuel vehicles are quite expensive, China has been working on developing cheap electric cars for the masses. The average retail price of EVs sold in China in 2018 was 37% lower than their European counterparts.

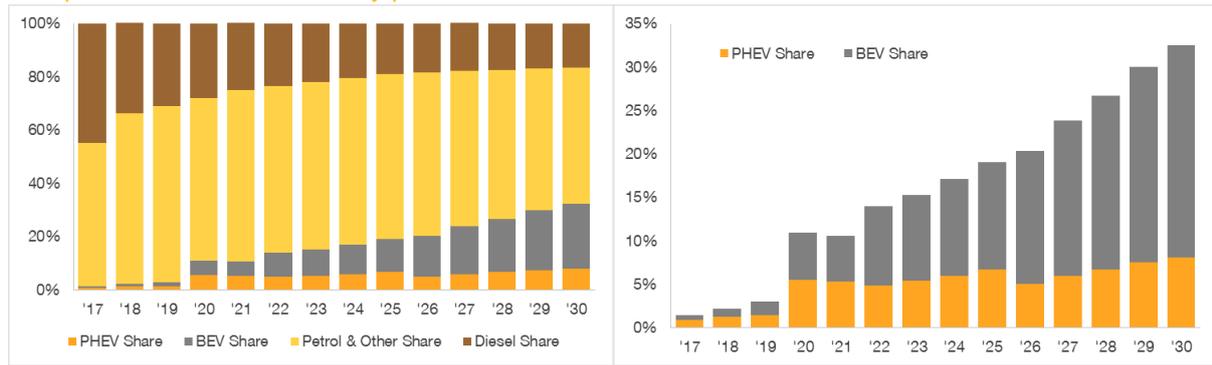
So far, China has focused its production to satisfy the domestic demand, and the very few attempts to export its cars have failed (with the exception of some South American markets, Russia and South East Asia). They cannot simply be competitive enough in Europe and USA because of poorer quality, the lack of heritage, awareness and the bad reputation Chinese products have in the Western world.

European EVs demand: European passenger BEV penetration currently lags China, and it is highly unlikely that it will catch up until 2030. Demand up until now has been driven primarily by government support via the use of taxes and incentives, which have driven up the cost of ICEs and made EVs more affordable for consumers. There are several reasons why EV penetration is still minor relative to global vehicle production:

- costs primarily driven by battery prices and depreciation that are currently the biggest hurdle for the mass-production of passenger EVs and still make it difficult today for EVs to displace ICEs in meaningful way - we note that the Tokyo Institute of Technology and the Toyota Group's research team have together developed an all-solid-state battery with three times the power density and twice the energy density of existing lithium ion batteries that we think will make all-solid-state batteries have the potential to overcome the disadvantages of EVs;
- shortcomings of current battery technology (ie. poor energy density – the amount of energy stored in a given system or region of space per unit volume; using a larger battery would increase range but weight as well, let alone the fact that the charge time would also be longer for a larger battery, it would make the vehicle heavier and exposed it more for fire propagation),
- relationship between cost and convenience (ie. high total cost of ownership vs. limited range and charging infrastructure, time-consuming refueling, battery longevity);
- car manufacturers' reluctance to earmark more resources for R&D and marketing to support EV development (just few examples: VW plans to spend an average EUR 6 bn p.a. on electrification, while Cruise Automation has raised funds over EUR 6 bn to deploy on autonomous driving while Uber spent EUR 1.3 bn on R&D in 2018 alone) – CapEx for the industry will continue to grow, and the same is true for R&D spending in new technologies while old technologies still persist, so we think it is critical for OEMs to consider scope, and we believe narrowing the scope of legacy activities (ICE car production) will be the most important part of capital allocation decisions going forward.

In this market environment, BMW has articulated its ambition to be a world leader in e-mobility and planned to launch a fully electric Mini and X3 in 2019, 3 Series BEV in 2020 (it already offers PHEV powertrain), and the iNext and i5 in 2021. It aims to offer a range of 12 BEV models by 2025.

European car sales estimate by powertrain



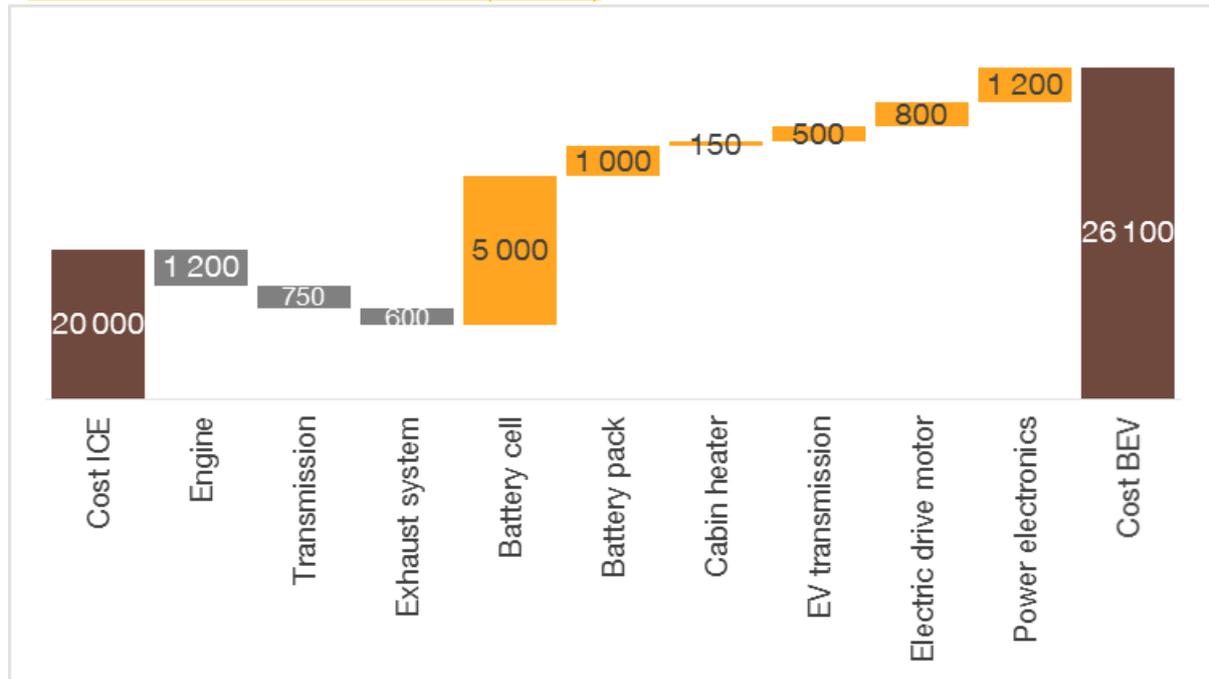
Source: ACEA

Tighter emissions rules ahead: Although there are widely different views on how fast the penetration of passenger EVs will evolve in the future, one thing everyone agrees on is the direction: sales of EVs, PHEVs and HVs are set to expand gradually and globally toward 2030 as countries around the world move to tighten future emissions standards and new market disruptors get one step ahead in vehicle electrification. It is also worth mentioning, however, that electric bus and commercial electric vehicle penetration in Europe and U.S. is negligible today, but these market segments are expected to grow as well at a high double-digit annualized rate (40-50%) in the coming years.

It is almost certain that by 2040 the environmental rules for diesel vehicles will be even stricter than today. Many European cities are thinking of banning or scrapping diesel cars, because diesel particulate emissions have very harmful health effects and social awareness of which is significantly increasing. OEMs have already started to adopt to some form of electrified vehicles, yet it remains to be seen whether range-extended electric vehicles, battery electric vehicles, or fuel-cell electric vehicles will prevail. Stricter regulation clearly prompts car manufacturers to consider investments across the value chain—such as developing alternative fuels or investing in wind farms to generate power for electric vehicles—to offset the emissions created by the vehicles they sell.

Cost implication of EVs: An electric vehicle is less complex than a conventional vehicle. It has 10 times less moving parts than a traditional model (200 vs. 2,000). At this stage of development, lower complexity does not mean lower cost. For models where the same car is available in both electric and petrol versions, such as the Volkswagen Golf, the average price difference is about EUR 5,500 in the initial amount to be paid for the car. Later, however, the cost of running an electric car (fueling and maintenance w/o taking into account the depreciation of battery) is only one-third the cost of running ICEs. It seems to be obvious that the longer the car runs, the more economical it is to switch to electric powertrain.

Cost differences between ICE and BEV (USD/car)

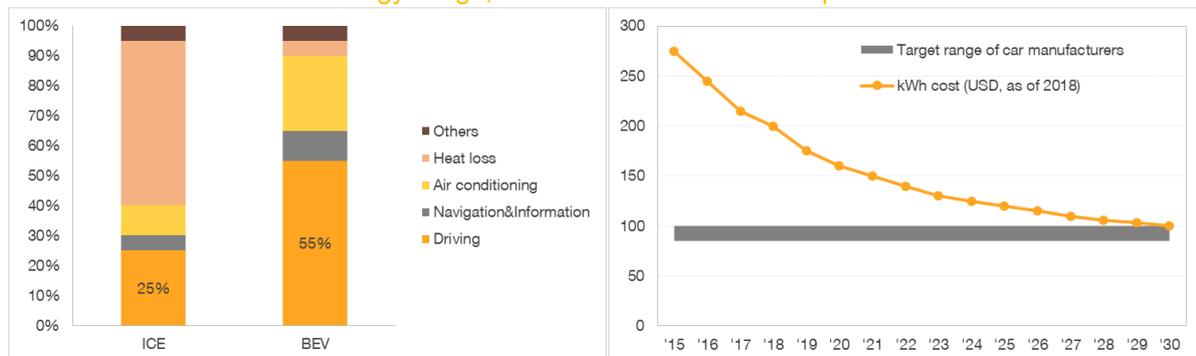


Source: ACEA

An electric car consumes approximately 1.5 liters of gasoline per 100 kilometers because electric motors do not have the thermodynamic heat loss characteristic of ICEs. Therefore, as a very simple rule of thumb, it can be said that an electric car can use 2 MWh a year, which would mean annual electricity consumption of 6 TWh for 3 million passenger cars currently used in Hungary, while the country's electricity consumption is now around 35 TWh p.a.. In a typical, middle-income European country, it comes down to the fact that electrifying the entire car fleet would only add 10-20% to total electricity consumption, which can easily be manageable.

In the event that battery prices, which account for around 30-50% of the cost of an EV depending on capacity, were to fall sharply or governments around the world were to introduce punitive policies and continue to subsidize EV purchases to a more generous manner (like recently in Germany) penetration of EVs would certainly get a boost. Technological innovation is also taking place in another expensive components of EVs like motors and inverter, which add another 5-10% to EVs' total price, to improve efficiency, reliability and durability of EVs (e.g. in linear coil motors, which account for around 55% of EV energy consumption).

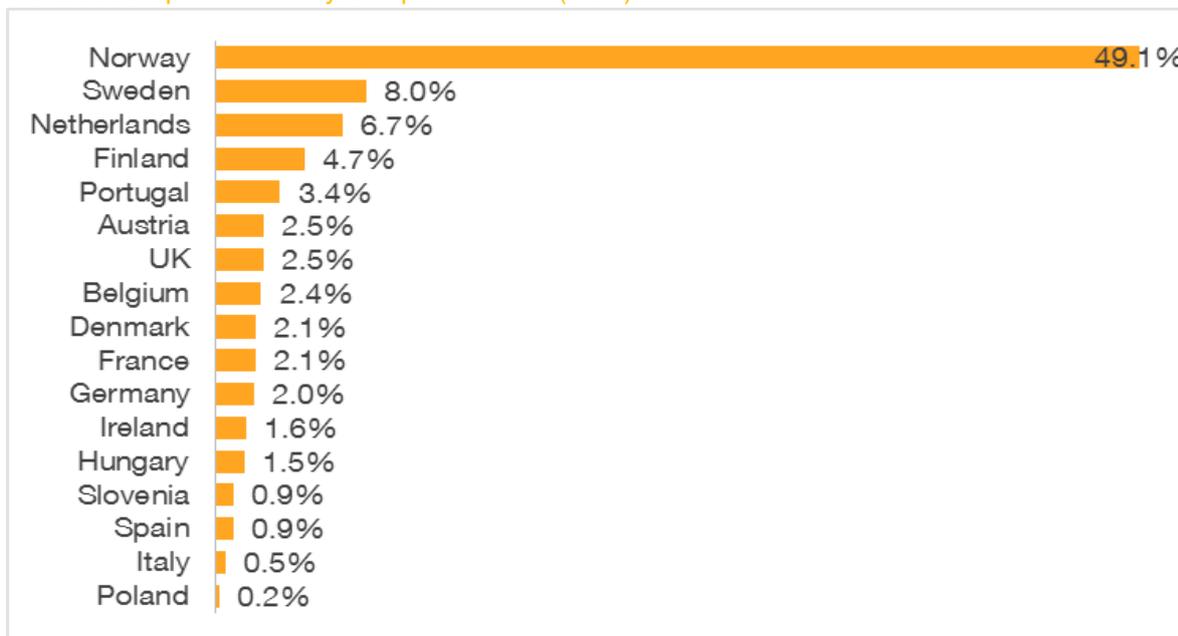
Breakdown of automobile energy usage; and the evolution of batter prices



Source: Bloomberg

Penetration: In order for penetration of battery EVS to increase fast, consumers need to believe that the utility of a battery electric vehicle (BEV) is higher than for an ICE. For this to happen, the price of batteries and other components has to come down enough, or government's intensives need to be increased so that cost parity with ICEs is reached. Nevertheless, there is the risk that battery prices will remain high for a while (the general view is that cell costs are unlikely to be materially below USD100/kWh), which are essential for electrification, due to sharply higher prices of input materials for battery (lithium, nickel, cobalt).

BEV + PHEV penetration by European market (2018)



Source: ACEA

At USD100/kWh, we see that BEVs will still cost ca. EUR 5,500 higher than a comparable vehicle with ICE, and that a breakthrough in technology will be required (including eg. solid state and silicone anodes) to drive costs further down to reach parity, and that BEV will work economically better for larger premium cars than for non-premium mass passenger vehicles. Of course, it is conceivable that the all-solid-state battery paradigm will be replaced if there are further innovations with currently widely used lithium-ion batteries in key areas such as charging times, range, battery depletion, and costs. As things stand, the possibilities of any future propulsion technology cannot be completely disregarded.

Estimated cost breakdown by powertrain

	Gasoline	Diesel	48V	PHEV	BEV
Engine	2 000	2 200	1 800	1 200	
Transmission	1 600	1 600	1 600	1 840	800
Fuel System	400	800	400	400	
Axles	800	800	800	800	800
GPF*	100		100	100	
SCR/LNT		500			
Electric Motor			380	842	1 684
Additional Battery			400	2 838	11 350
DC/DC convertor			50	50	
TOTAL	4 900	5 900	5 480	8 020	14 634
<i>Cost vs ICE-gas</i>		<i>+1 000</i>	<i>+580</i>	<i>+3 120</i>	<i>+9 734</i>
Battery size (kWh)			0.2	12.5	50

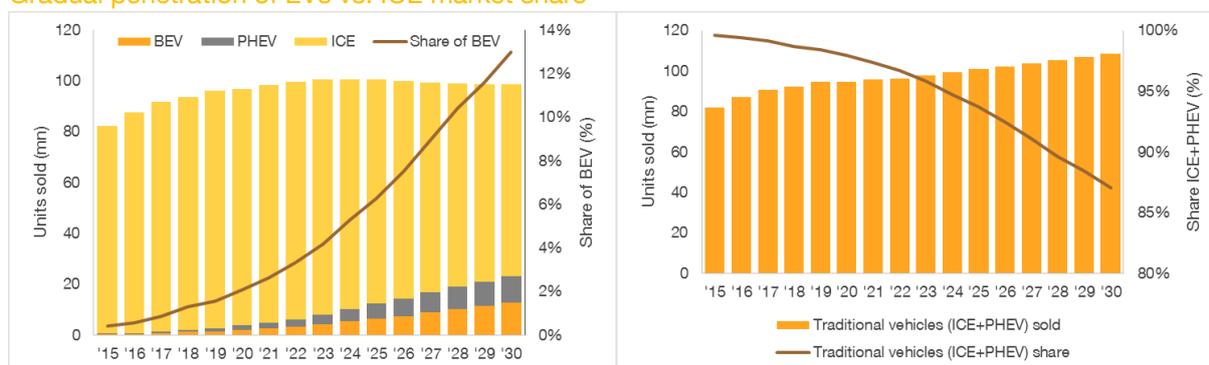
Source: BorgWarner, Delphi, IHS, McKinsey

Increasing penetration of passenger EVs will inevitably have implication for maintenance intensity. We estimate that EVs may have less than half of the maintenance costs of ICE powered cars based simply on the fact that fully electric vehicles have significantly fewer moving parts and do not require engine oil. Consequently, car dealers’ revenue from servicing business will decline, also reducing profitability, especially in urban areas, forcing them to adopt a new service strategy for EVs, including hardware and software updates (also for used cars), car-sharing options (such as for holidays), etc..

Nevertheless, the transition to electric vehicle technology is happening slowly in Europe at least for now, tempered down by the inadequate level of nationwide charging infrastructure, high costs of replacing EVs’ batteries, funding constraints and yet lower affordability than in case of ICE cars –truly giving car dealers sufficient time to adapt their business model. During this transition period of time those dealers who has the ability to offer simplicity in consumer experience that is easier, frictionless, and more desirable will have a competitive advantage.

In 2030, at least 20% of vehicles sold are likely to have a battery pack (in excess of 60-volts), while 80% of vehicles will contain conventional ICE powertrains, of which 20% will have some form of electrical assistance, over and above the standard 12-volt battery.

Gradual penetration of EVs vs. ICE market share

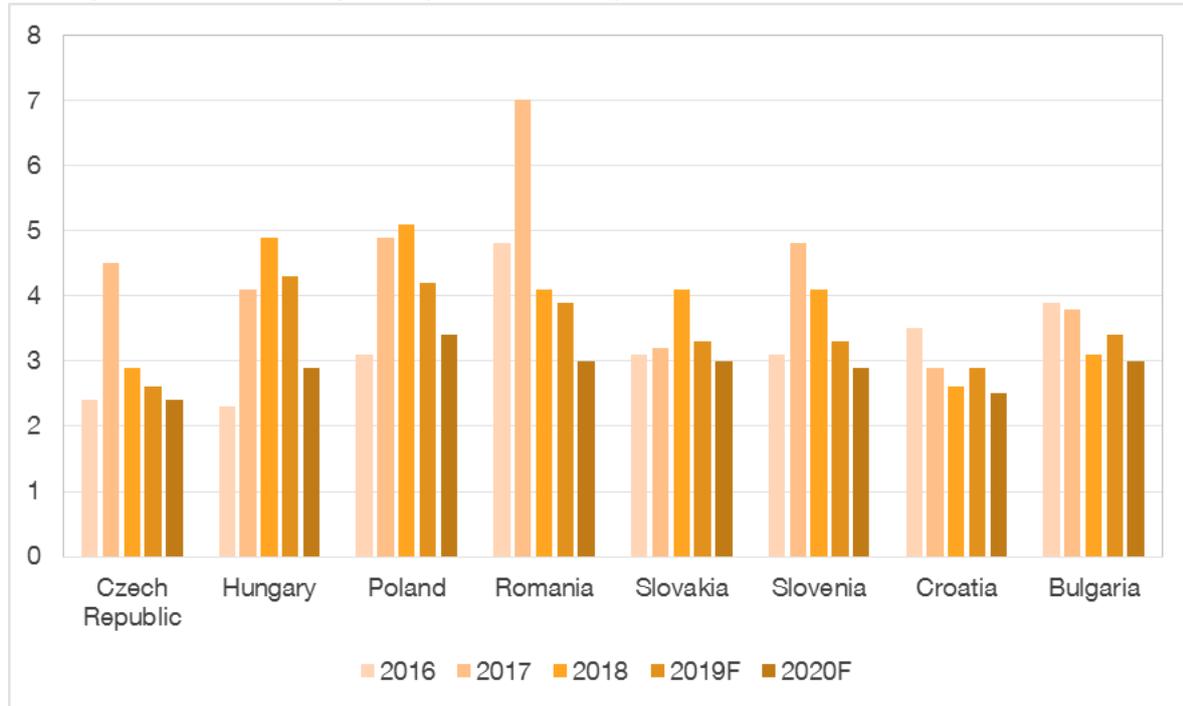


Source: ACEA, Bloomberg IEA

CEE macroeconomic environment

Following the great financial crisis of 2008/09, painful but very successful structural adjustments were made to Central and Eastern European (CEE) economies. The CEE region has become much more competitive with other low cost regions (e.g. Asia) due to tight wage control and depreciated currencies, both in nominal and real terms.

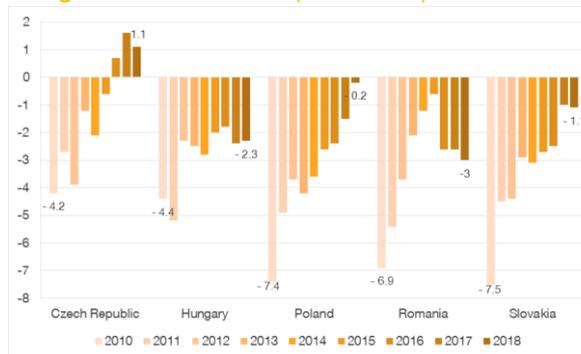
Developments in real GDP growth (annual ch. in %)



Source: FocusEconomics

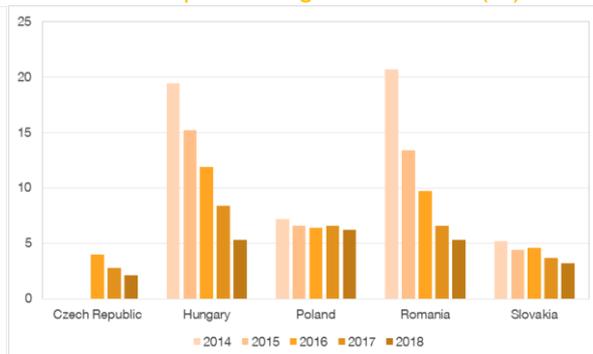
Economic fundamentals have improved significantly, leverage in the private sector has declined, external imbalances have virtually disappeared, and debt-to-GDP and government deficits have fallen meaningfully. The decline in energy prices also had a positive effect on CEE countries' external positions.

Budget balance in CEE (% of GDP)



Source: Eurostat

Share of non-performing loans in CEE (%)

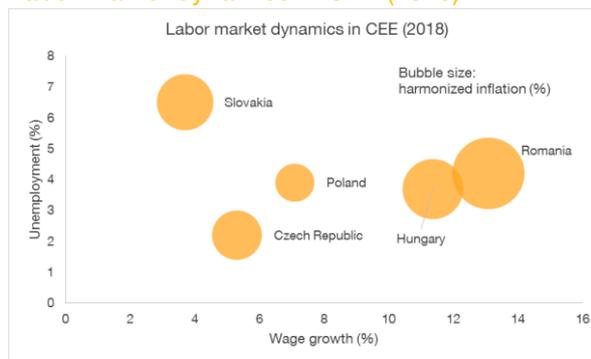


In the meantime, banks have also reduced their external liabilities, their loan-to-deposit ratios have declined substantially, as well as NPLs reverting from a peak, and the share of bad loans within banks' loan portfolios shrunk considerably.

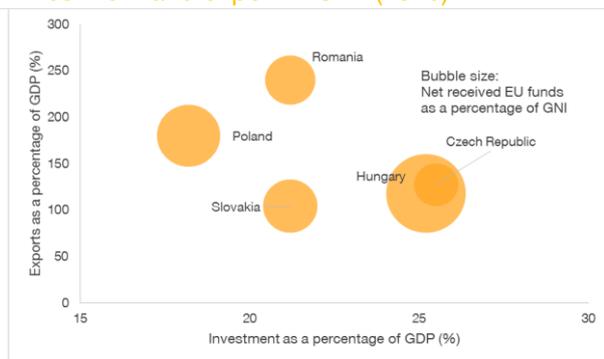
The reduction in leverage in previous years, the adjustment of corporate balance sheets, the more favorable economic conditions across Europe, cheap currencies, low import prices and financing costs, as well as the replacement of deferred consumption all have provided room for economic convergence towards the developed European countries. This process was also supported by independent monetary policy, significant EU transfers and increasing remittances from abroad.

Industrial production soared supported by stronger external (Eurozone) and growing domestic demand. The performance of the construction industry has also improved a lot, but the absolute levels (outside Poland) still remained rather low. After a prolonged decline, house prices have risen by 50 percent in a few years but are not yet peaking. The unemployment rate has fallen to a lower level than in previous cycles. Nominal wage growth has increased, while real income growth has also been significant due to low inflation. Increasing employment, higher wages, low energy prices and falling debt service costs have all contributed to an increase in households' disposable income and consumption. Financial repression in advanced markets led to globally depressed real interest rates, supporting housing prices and consumer goods purchases in emerging economies as well.

Labor market dynamics in CEE (2018)



Investment and export in CEE (2018)



Source: Eurostat, European Commission

CEE countries tend to remain supply-side economies characterized by high investment / GDP and capital / GDP ratios (20-30% and 200-250% respectively). CEE economies are mainly export-driven and are integrated into the supply chain of Western European (mainly German) companies by providing a competitive, flexible and skilled workforce. As a result of their specialization and increased openness, they are highly exposed to fluctuations in external demand. A global recession, if occur, would certainly adversely affect the growth prospects of the CEE countries, though the impact would be more moderate than in other regions given the relatively more favorable equilibrium indicators of the CEE economies.

The region is not a typical EM (and is in another phase of the business cycle) and is more similar to countries on the periphery of the EU, but with better fundamentals (less imbalance, more resilient economy).

CEE countries have entered the late stages of their cyclical growth, with profit levels in the region apparently peaking. Regional growth is expected to slow down, but may remain relatively healthy in the next two years. Lack of workers is another growing problem in CEE economies, which can lead to high wage growth and potentially higher inflation (see Hungary and Romania). In some countries (e.g. Romania), the budget balance has deteriorated significantly in the last two years. Ideas for levying sector taxes and reducing contributions to mandatory pension funds have been re-emerged in order to increase revenues and avoid the EU's excessive deficit procedure (Romania, Poland). The temporary decline in EU net transfers in 2016 highlighted the importance of EU funds, especially in investment, and the fact that the economies of the CEE countries are too dependent on EU transfers. This is a long-term risk that will likely become tangible after 2020, in our view.

The region is a net importer of energy (1.5-2% of GDP), which makes it particularly vulnerable to rising energy prices (e.g. gas). If there were a shock to energy prices and simultaneously rigid wages central banks would feel the need to tighten and put pressure on the profit margins of labor-intensive sectors.

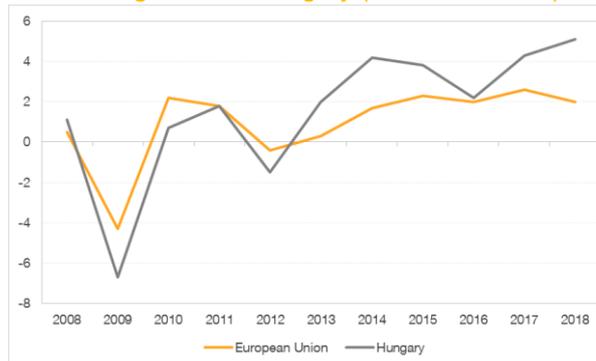
Hungarian macro environment

After 2010, Hungary has gone through a successful period of adjustment and stabilization. Fiscal reforms and the turnaround in monetary policy (e.g. the settlement of households' foreign currency loans) restarted economic growth from 2013 onwards. Increased employment, tax reform (high tax wedge and corporate tax cuts, consumption taxation), restoration of macro-financial balance, and monetary and "self-financing" macro prudential policies underpinning the economy by new non-conventional instruments have helped to improve internal balance and alleviate debt and external vulnerability.

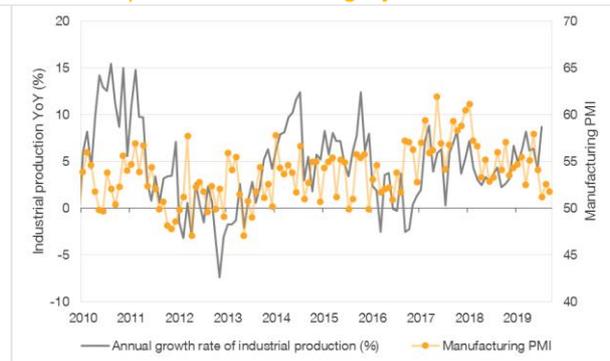
Integration into global value chains has been truly beneficial for the manufacturing industry, and car manufacturing in particular (6-8% of GDP), even though the sector has a relatively low value-added capacity and this value added is even lower than in other countries of the region.

The growth rate of the Hungarian economy has been one of the fastest in the EU since 2013. Growth was based on the employment turnaround, while real income growth was significant due to low inflation, and the middle class, which provided the basis for consumption, was broadening. GDP grew by an average of 3.4% per annum between 2013 and 2018, vs. EU's average growth rate of below 2%.

Real GDP growth in Hungary (annual ch. in %)



Industrial production in Hungary

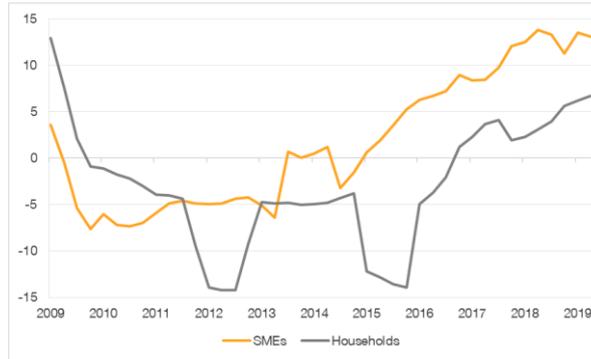


Source: Bloomberg, Eurostat

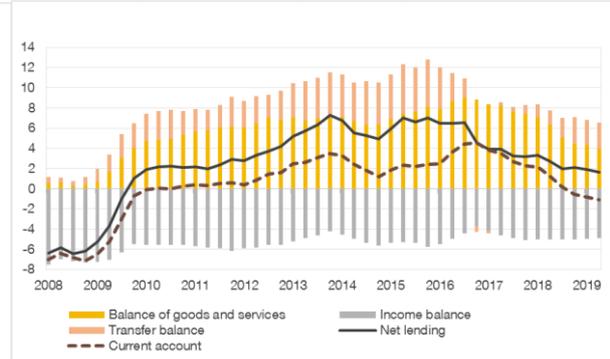
We believe Hungary's growth prospects look better than the EU average. GDP is projected to grow by 4.5% in 2019 and by 3.3% in 2020 and 2021. Growth is driven by domestic consumption, supported by low interest rates and wage outflows, and by EU-funded investments. Output from manufacturing and agriculture can also make a significant contribution to overall growth, whereas contribution from the construction industry is likely to let up.

The profitability of the banking system rose along with the improving quality of loans. The outflow of credit has accelerated and the stock of loans to households is expanding along with higher household income and consumption. The expansion of the SME loan portfolio has reached the growth rate deemed necessary for long-term sustainable economic growth.

Lending growth in Hungary (annual ch. in %)



Net lending and its components (% of GDP)



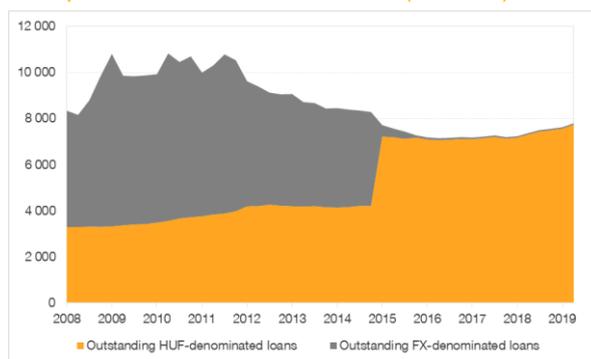
Source: National Bank of Hungary, Concorde's estimate

Due to rising domestic consumption and slowing external demand, the balance of payments has narrowed to almost zero this year, external financing capacity gradually deteriorated and the decline in net external debt came to a halt. EU fund flows are likely to decrease from 2021 which also poses a risk to growth ahead. Increasing government investment spending is expected to shore up economic growth, while FDI may continue to be also significant, with foreign companies generally reinvest their profits due to the relatively favorable corporate tax environment and competitive wages.

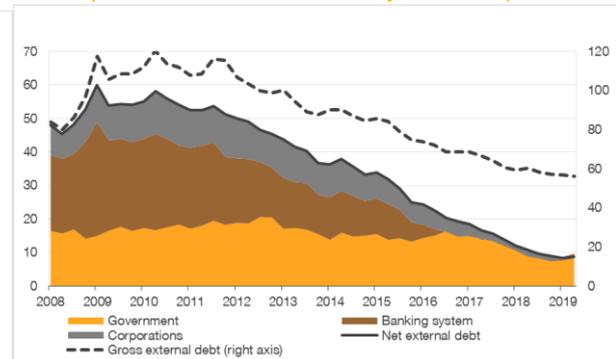
Nevertheless, the gap between GDP and GNI may increase in the future given the dual structure of the Hungarian economy (multinational vs. fragmented SME sector). The productivity gap between large companies and SMEs will also remain significant in international comparison (domestic SMEs have a relatively smaller size than their EU counterparts, there are a smaller number of exporting SMEs, the SME sector are generally struggling with serious weaknesses in management capabilities, low technology and innovation capacity, financing constraints, as well as unreasonable and inefficient capital utilization, increasing dependence on state subsidies and EU funds, while their access to financial resources is, in some cases, driven by political and not economic considerations.

Domestic service companies make only a small contribution to services exported (domestic producers and suppliers have a low value creation capacity and thus a low position in global value chains). Importantly, the structure of the SME loan portfolio is not healthy enough. The share of long-term and FX-loans is low by international standards, and the ratio of floating-rate loans is relatively high.

Composition of household loans (HUF bn)



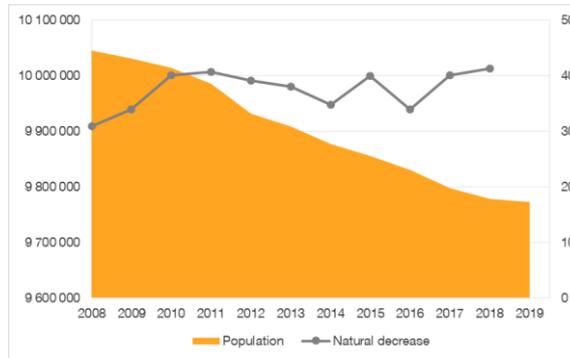
Development of external debt by sectors (% of GDP)



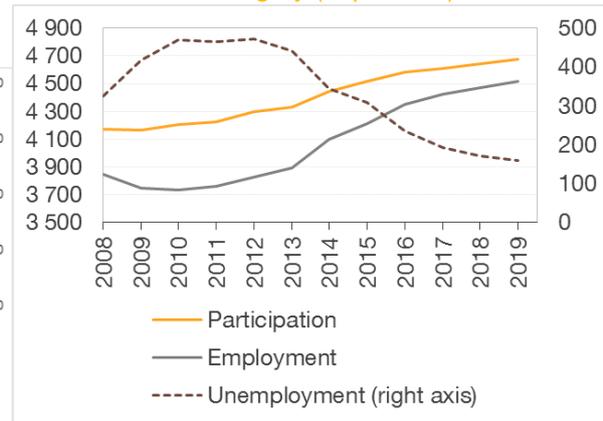
Source: National Bank of Hungary and Hungarian Central Statistical Office

Income disparities are glaring and widening, with poverty though on the decline yet is one of the highest in the EU. The declining and aging population, coupled with mass emigration of Youngers and experts also mean a major constraint to long-term economic growth. In addition, higher old-age dependency rates can pose challenges for large welfare systems (pension systems, health care). A pension reform resembling the Polish model would certainly be burdensome for employers.

Population and its natural decrease in Hungary



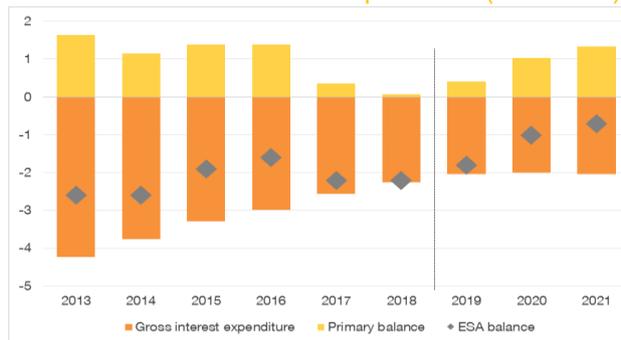
Labor market in Hungary (th persons)



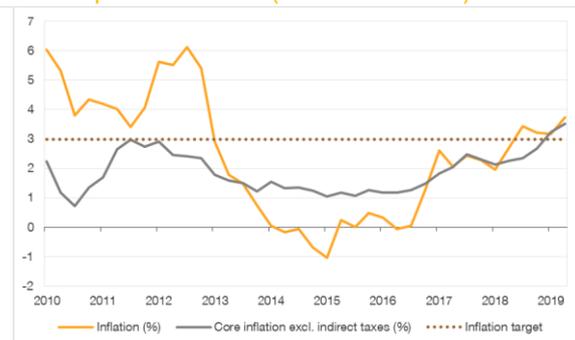
Source: National Bank of Hungary and Concorde's estimate

A global recession or debt crisis could put the HUF under pressure and lead to a significant increase in domestic interest rates, which in turn could slow down economic growth, domestic consumption and even vehicle purchases, especially when internal resources for anti-cyclical government measures are limited. Inflation is accelerating and is expected to go beyond 3% in 2019 and stay at this rate in 2020 and 2021. At the same time, the monetary conditions seem to remain benign, but largely depend on developments in external factors (e.g. global growth prospects and the real interest rate environment).

Fiscal balance and interest expenditure (% of GDP)



Developments in CPI (annual ch. in %)



Source: National Bank of Hungary

Appendix

MAIN INDICATORS

	2018	2019E	2020E	2021E
EPS (HUF)	3.1	4.6	7.0	8.8
EPS growth (%)	-58.4	45.7	54.1	25.1
DPS (only common shares; HUF)	0.0	0.0	0.0	0.0
BVPS (HUF)	17.7	20.2	27.2	36.0

VALUATION

	2018	2019E	2020E	2021E
P/E (x)	32.6	22.3	14.5	11.6
P/BV (x)	5.8	5.1	3.7	2.8
EV/EBITDA	17.9	14.9	11.4	9.3
EV/Sales	0.6	0.5	0.4	0.4
FCFY (%)	-1.0	6.3	3.7	5.0
DIVY (%)	0.0	0.0	0.0	0.0

MARGINS (%)

	2018	2019E	2020E	2021E
Gross margin	4.7	5.3	5.5	5.6
EBITDA margin	3.2	3.3	3.7	3.8
EBIT margin	2.2	2.4	2.9	3.2
Net profit margin	1.3	1.6	2.2	2.5

PROFITABILITY RATIOS (%)

	2018	2019E	2020E	2021E
ROE	21.4	24.1	29.7	27.9
ROA	3.9	4.6	6.6	7.6
ROIC	10.7	14.4	16.5	18.2

OTHER OPERATING RATIOS (%)

	2018	2019E	2020E	2021E
Sales growth (%)	1.7	15.6	12.5	12.8
Revenue/IC (x)	5.3	5.6	5.8	6.0
NWC/sales (x)	0.1	0.1	0.1	0.1
Current ratio (x)	1.1	1.1	1.2	1.3

LEVERAGE RATIOS (%)

	2018	2019E	2020E	2021E
Net debt/Equity (x)	0.6	0.7	0.6	0.5
Net debt/EBITDA (x)	4.6	3.7	2.6	1.8
Interest cover ratio (x)	8.0	7.9	11.5	15.9

OPERATIONAL HIGHLIGHTS

	2018	2019E	2020E	2021E
No. car sold (new + used)	5 019	5 595	6 114	6 716
Fleet of cars	535	610	689	772
After sales service (hours)	44 099	49 391	55 318	61 956

SALES BREAKDOWN BY SEGMENTS (%)

	2018	2019E	2020E	2021E
Domestic distribution	47	44	43	42
International distribution	43	46	47	48
Automotive services	10	10	10	10

PROFIT AND LOSS (RON MILLION)

	2018	2019E	2020E	2021E
Net sales	65 450	75 661	85 096	96 030
Cost of sales	-57 308	-65 534	-73 547	-82 840
Gross profit	1 770	2 469	3 111	3 661
EBITDA	2 082	2 467	3 109	3 659
DD&A	-621	-625	-622	-621
EBIT	1 461	1 842	2 487	3 038
Financial results	-391	-355	-196	-171
Pre-tax profit	1 070	1 487	2 291	2 867
Tax payable	-223	-253	-389	-487
Profit after tax	847	1 234	1 901	2 379
Income from subsidiaries @ equity method	-18	-8	-13	-10
Net comprehensive income	829	1 226	1 889	2 369
Dividend	575	0	0	0

BALANCE SHEET (RON MILLION)

	2018	2019E	2020E	2021E
Fixed assets	7 632	7 627	7 585	7 564
PP&E	1 711	1 562	1 411	1 259
Leasing equipment	5 348	5 493	5 601	5 733
Goodwill & other intangible assets	553	553	553	553
Other assets	19	19	19	19
Current assets	17 614	20 214	22 227	25 009
Inventories	9 758	11 453	12 829	14 454
Receivables	5 781	6 759	7 562	8 494
Short term receivables & debt investment	541	0	0	0
Cash and equivalents	1 535	2 002	1 836	2 061
Total assets	25 246	27 841	29 812	32 573
Shareholders' equity	4 793	5 452	7 353	9 732
Share capital	3 383	3 383	3 383	3 383
Reserves	1 409	2 068	3 970	6 349
Long-term liabilities	4 155	4 433	3 922	3 460
Long-term debt	243	381	379	378
Long-term lease obligations	3 876	4 015	3 506	3 045
Other long-term liabilities	36	36	36	36
Short-term liabilities	16 299	17 957	18 537	19 381
Short-term debt	5 409	4 500	4 000	3 500
Short-term lease obligations	2 147	2 224	1 943	1 687
Advanced payables	1 119	1 293	1 454	1 641
Account payables	6 484	8 623	9 659	10 882
Other short-term liabilities	1 139	1 317	1 481	1 671
Total liabilities	25 246	27 841	29 812	32 573

CASH FLOW (RON MILLION)

	2018	2019E	2020E	2021E
Pre-tax profit	1 070	1 487	2 291	2 867
DD&A	621	625	622	621
Non-cash charges	179	77	87	98
Cash flow earnings	1 870	2 190	3 000	3 586
Working capital change	-1 786	-183	-1 318	-1 456
Cash flow from operation	-481	1 754	1 292	1 643
Cash flows from investing	101	553	36	77
Free cash flow	-380	2 307	1 328	1 719

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