General overview for investors in Hungary's Manufacturing sector

WHY INVEST?

Over recent years, hundreds of new industrial investments have been carried out in Hungary. Mercedes-Benz, GM, Audi, Apollo Tyres, Hankook, Continental, Bosch, Knorr Bremse, Magna Automotive, Grundfos, Lego, Rehau or Nestlé, to name just a few of the international top enterprises who have opened or extended factories in Hungary in the last years. All of them (and an increasing number of the Hungarian companies also) have realized the competitive advantages of opening a Hungarian manufacturing plant, company, logistics center or headquarter. Besides the stable economy and government support, Hungary has unique benefits, even compared to other CEE countries.

- Development and support of the Hungarian manufacturing sector is a strategic focus of the Government
- Great Central European location within the Schengen zone, logistically ideal to supply the whole European and Middle East market
- Competitive and enterprise friendly tax system, Hungary's corporate tax rate is 10-19% low
- Average wages in Hungary are ca. 60% less than the average of the EU countries
- National and municipal incentives (both refundable and non-refundable cash subsidies, tax allowance, land available for reduced price or for free)
- Wide range of national and EU grants available, with attractive conditions
- Developed transportation systems, extensive highway and railroad network
- Developed and active industrial property market, with well-built and stable utility networks; moderate and regulated energy prices

MANUFACTURING SECTOR OVERVIEW

In harmony with the re-industrialization strategy of the European Union, the Hungarian Government has placed the industrial and manufacturing sector into the focus of the economic development strategy. Hungary wants to utilize EU funding (with maximum intensity of 50%) and national incentives to enterprise development and help expand major production oriented sectors. Within that, special emphasis will be placed on the support of high-tech industrial sectors, due to their multiplier effect. Potent high-tech industrial sectors can and will have a positive impact on stakeholders in supplier chains and the industrial services sector. Eventually, headcount is expected to rise in these sectors, including low-skilled jobs as well. From the aspect of foreign trade, motor vehicle manufacturing, related sub-sectors as well as pharmaceutical and food industry exports may constitute the axis of future growth.

To support the re-industrialization strategy the Hungarian Government introduced Irinyi Plan, a long-term development plan named after the Hungarian innovator János Irinyi. The program outlines main directions of the economic development. Through the implementation of these priorities the Hungarian Government adds further incentives to the industrial sector, supports innovation, helps create jobs and promotes the competitiveness and export of potential domestic enterprises and SMEs. In order to have a more modern industrial production structure, capable of creating more added value the Government shifts towards an innovation-focused economy and the industrial sector must be supported by up-to-date market and technical knowledge, R&D activity, and education.

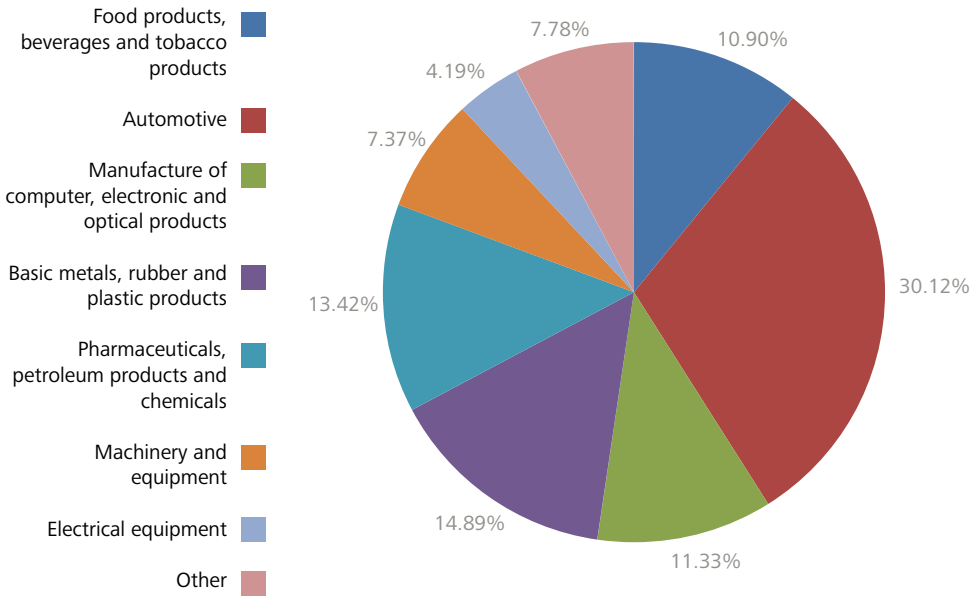
The government identified seven priority areas within industry sector: motor vehicle manufacturing, manufacturing of specialized machinery and equipment, health industry, and tourism, food industry, green economy, info-communication industry and defense industry.

Consequently, Hungary is always open to support foreign investors, and to form strategic cooperation with international enterprises. This governmental commitment for increasing the competitiveness of the manufacturing sector helps the dynamic development of both SMEs and large enterprises. The Hungarian Government is planning to increase the actual part of the industrial and manufacturing sector from the 26% to 30% within the GDP.

The reduction of administrative burdens is another goal to support investors. The deregulation-focused attitude in the legislative process will result in a homogenous, pro-competitiveness regulatory environment. The tools to achieve this are the rationalized competencies of institutions, which will permit direct interference and sanctions only in fully justified cases. Recently, the introduction of the Electronic Trade and Transport Control System (EKÁER) and on-line cash registers were among major steps in this direction.

The main and growing fields of manufacturing are the automotive (with 17.8% growth rate in 2015), machinery and equipments, pharmaceuticals & medical technology, ICT and the food industry.

SUBSEGMENTS OF THE HUNGARIAN MANUFACTURING SECTOR (2015)



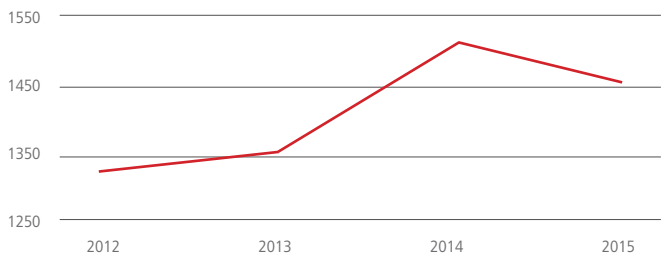
Source: HCSO

In general, the recovery of Hungarian manufacturing was slow after the 2008-2009 financial crisis, but following 2012, a clear upward trend can be seen in all main manufacturing indicators. Manufacturing sector's growth rate was 8.1% in 2015; 26% of the Hungarian GDP was generated by the manufacturing sector in 2015. Decreases were recorded only in two of the thirteen subsections of manufacturing in 2015. Out of the three greatest subsections, the production of transport equipment rose the most by 17.2%, while the output of computer, electronic and optical products went up by 6.4%. The manufacturing of food products, beverages and tobacco products was characterized by a moderate growth (4.3%) mainly due to an upturn in exports representing more than 40% of total sales; the volume of domestic sales only slightly increased.

The total growth of the manufacturing sector's export activity was 8.7% in 2015 which was the main pulling force of the segment. The domestic sales of the manufacturing sector's products increased by 6.7% in that period.

Investment trends in the manufacturing sector are also an indicator of the manufacturing sector's reliable growth. The investment index similarly shows a clear upward trend from 2012. Developments in manufacturing, representing more than a third of investments in the national economy, were 12.4% higher than a year earlier in the second quarter of 2016.

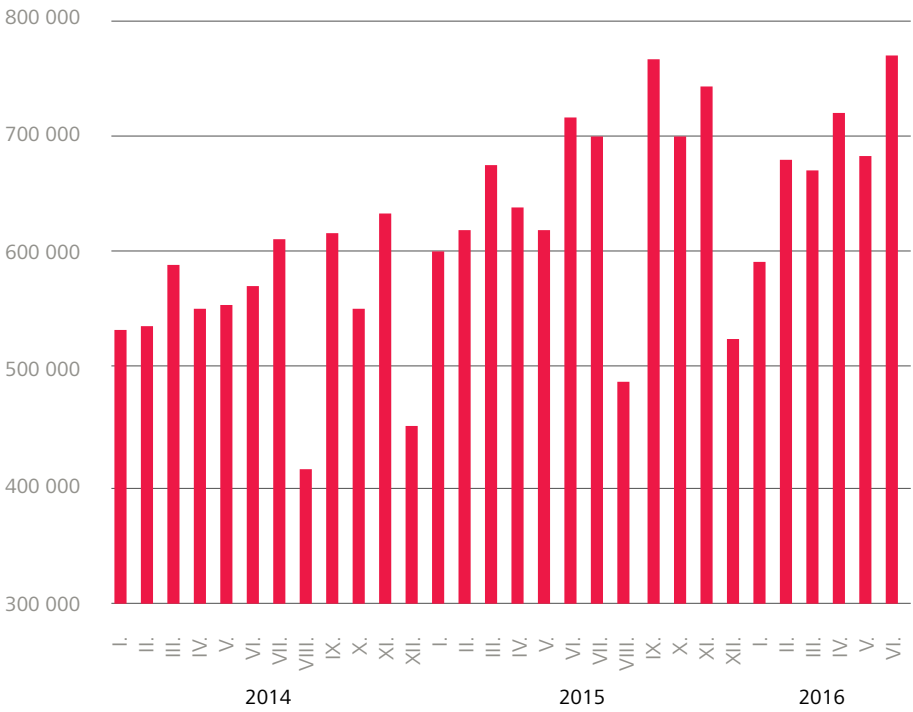
MANUFACTURING SECTOR - INVESTMENTS (BILLION HUF)



Source: HCSO

Two manufacturing subsections gave more than half of all export sales. The export volume of vehicle production representing 36,5% of manufacturing exports - along with a continuous increase over the year - rose at the fastest rate of 15.6%. The second largest subsection, the manufacture of computer, electronic and optical products had 14.6% share within the export of manufacturing sector.

PRODUCTION OF THE AUTOMOTIVE SECTOR 2014-2016 (MILLION HUF)



Source: HCSO

Beside the Original Equipment Manufacturers (OEMs), a large number of the world's top suppliers are present on the Hungarian market, like Bosch, Knorr Bremse, Continental, Delphi, Denso, tire manufacturers. Some leading international companies and Hungarian suppliers have already set up R&D centers (like Bosch, Knorr-Bremse, Continental) beside their production capacity.

One of the main benefits of the Hungarian manufacturing sector is the wide range of the available national incentives – both refundable and non-refundable ones – to support investors coming to or expanding in the country. The following national investment incentives are available in Hungary:

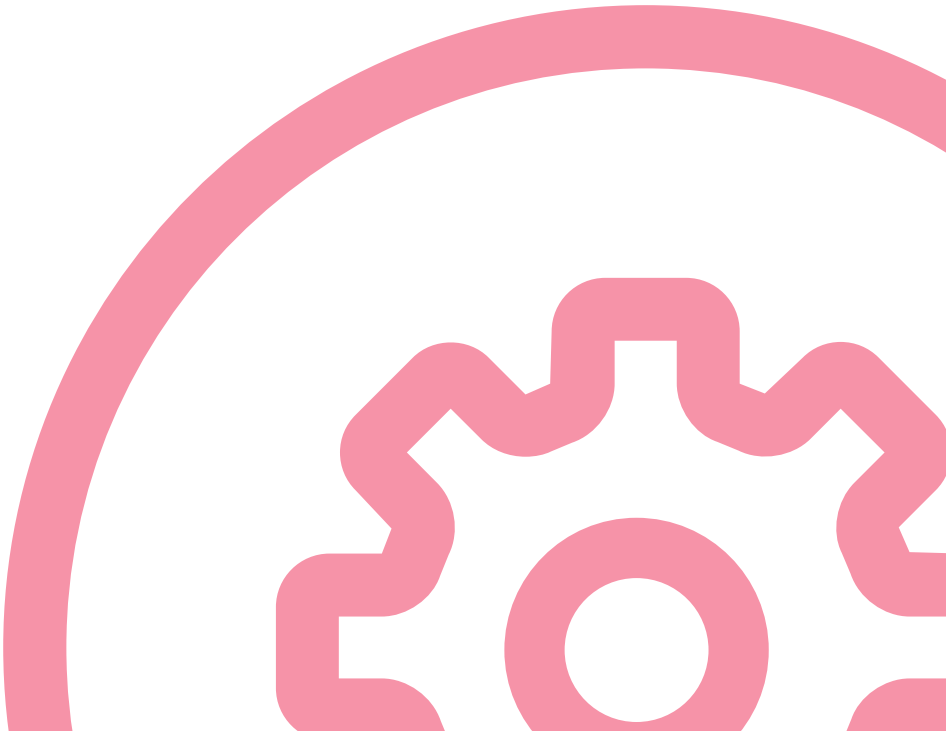
- Cash grants – subsidies based on individual governmental decision for job creation and asset investment
- EU co-financed tenders
- Development tax allowance
- Training subsidy
- Workshop establishment aid
- Social tax allowance
- Job creation subsidy

The corporate income tax rates are also an attractive aspect of the investment: the tax rate is 10% of the positive tax base up to five hundred million forints and 19% for the part above five hundred million forints (cc. 1.6 million euros).

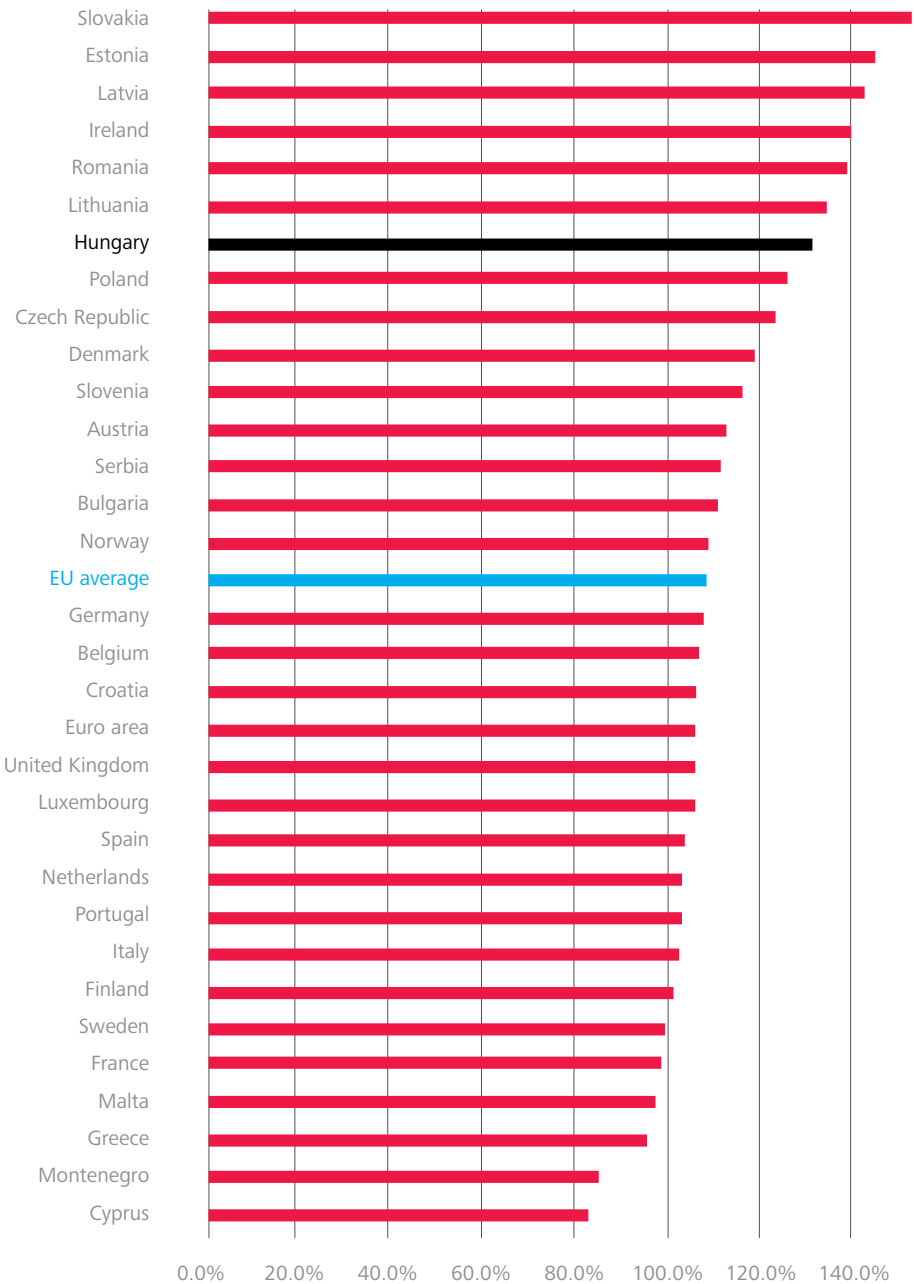
In the manufacturing sector a digital revolution is in progress. In the next few years manufacturing enterprises and SMEs will need major investments with the focus on digital technologies like sensors, connectivity devices and software licenses to preserve their competitive advantages. The R&D activity within the sector is also increasing partly due to the available tax allowances and EU funds. The Hungarian Government has launched the Industry 4.0 National Technology Platform with the participation of research institutions, education institutions and companies having R&D activity in Hungary. This program provides a framework for companies to support high added value research and development work, all of the newly established or Hungarian companies can generate profit from that Industry 4.0 program. With this program the government would like to motivate Hungarian SMEs and large enterprises especially in the application and development process of the digital manufacturing and the internet of things.

ACQUISITION OPPORTUNITIES IN THE MANUFACTURING SECTOR

25 years after of the regime change in Hungary, several company owners are in the age of retirement. These market participants would like to sell their companies and because of this impact, the Hungarian M&A activity will increase in the manufacturing sector as well. This trend generates attractive opportunities to acquire functioning businesses (with established capacities, skilled and well-trained labor) and to complete new investments. Some of these potential manufacturing companies are working for the world's largest enterprises as suppliers.



VOLUME INDEX OF PRODUCTION, MANUFACTURING SECTOR IN THE EU COUNTRIES MAY OF 2016 (2010=100%)



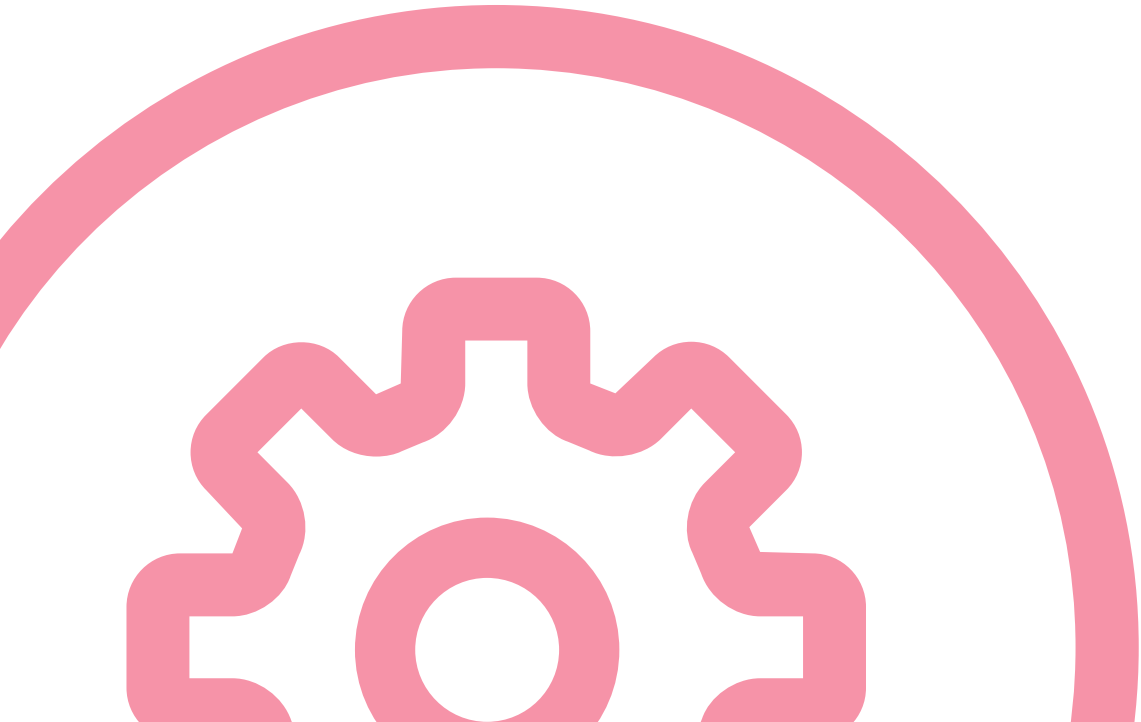
Source: Eurostat

COST-EFFECTIVE AND SKILLED LABOR MARKET

The Hungarian unemployment rate shows a slight decline at around 6.5%, with a wide variation by region. The highest rate (10.7%) was in Northern Hungary, while the lowest rate was in the West-Transdanubian Region (3.2%). The investors in the less developed regions with higher unemployment rate are especially supported with governmental and municipal incentives, cash subsidies and tax allowances.

Hungary has one of the cheapest labor markets in the EU: the Hungarian average wage is almost the lowest in the EU (5th lowest average salary in EU, 2015). Based on the average labor cost per productivity ratio, Hungary is still one of the best locations for manufacturing plants. The official minimum wage in the country is also one of the lowest in the EU, ca. 360 euro / month.

The Hungarian labor market has skilled workers employees. Almost 90% of employees leave school at 18 with at least a medium level final examination (this indicator is among the best within the EU), and over a quarter have a university level degree. The Hungarian educational institutions are flexible and ready to cooperate with industry players. For example Audi, Mercedes-Benz and Bosch have set up dual training cooperation with local universities to prepare students for working life. In these dual training cooperations carmakers and other companies are paying students to take more practical, job–oriented training in special programs designed to improve the supply of Hungarian workers. Audi operates programs in 11 departments in cooperation with Széchenyi István University in Győr, with Budapest University of Technology and Economics, with University of Miskolc, and with Óbuda University. Since 2012 Mercedes has a partnership with the Kecskemét College. The company started with mechatronic maintenance, vehicle mechatronics, and vehicle coating and now also includes a program for toolmakers and a management program.



SUCCESS STORIES FROM THE MANUFACTURING SECTOR

- With the most developed pharma sector in the region Hungary provides an ideal base for life science companies. For example the Hungarian leading pharmaceutical company, Richter Gedeon Nyrt. is spending 50 million euros on an investment project to expand its biotechnology plant founded in 2012 to develop and manufacture biosimilar products, which has a unique, cutting edge technology in the region.

- The Hungarian health protection product manufacturer Béres Gyógyszergyár invests 3.2 billion HUF (10 million EUR) into a new production department in Szolnok. The company receives a non-refundable 50% state support with creating 60 new jobs. Béres would expand the size of their base by 1,640 sqm, the size of their logistics warehouse by 800 sqm, they would install new technologies, improve infrastructure and nearly double production capacity.

- The automotive industry is the leading and most dynamic segment of the manufacturing sector in Hungary. Automotive production accounts for 30% of Hungarian manufacturing and represents 18% of exports. Over 700 companies work in this field with the top four Original Equipment Manufacturer companies (Audi, Mercedes, Opel, Suzuki) employing over 20 000 people.

- Within the automotive subsector, Mercedes and Audi have invested the most into the production. Mercedes-Benz Hungary is building a new plant next in 2017 to its existing factory in Kecskemét; 150 thousand cars-a-year will be manufactured here, which is being built with an investment of 1 billion euros.

- Borgwarner Turbo Systems Kft., the U.S.-based supplier of turbocharger systems and other automotive components is investing 15.5 billion HUF in Komárom-Esztergom county, Hungary. The approximately 51 million EUR investment is supported with a 1.7 billion HUF (5.5 million EUR) state subsidy.

- Suzuki: one of the first international car brands to open a Hungarian plant. Founded in 1991, manufacturing started in 1992. Until the financial crisis of 2009, it was the domestic market leader with a 20% market share. It is still one of the biggest car producers with an annual production of ca. 150 000 vehicles.

- Robert Bosch Elektronika Kft. (part of Bosch Group) is creating 600 new jobs in Hatvan, Hungary. Backed by a dedicated government decision, the project run between 2016 and 2018, with a total capital cost of 18.9 billion HUF, including a 4.7 billion HUF(15 million EUR) grant provided by the Hungarian government. This project will involve both the purchase of machines to produce automotive electronic parts and the expansion of existing capacity.