

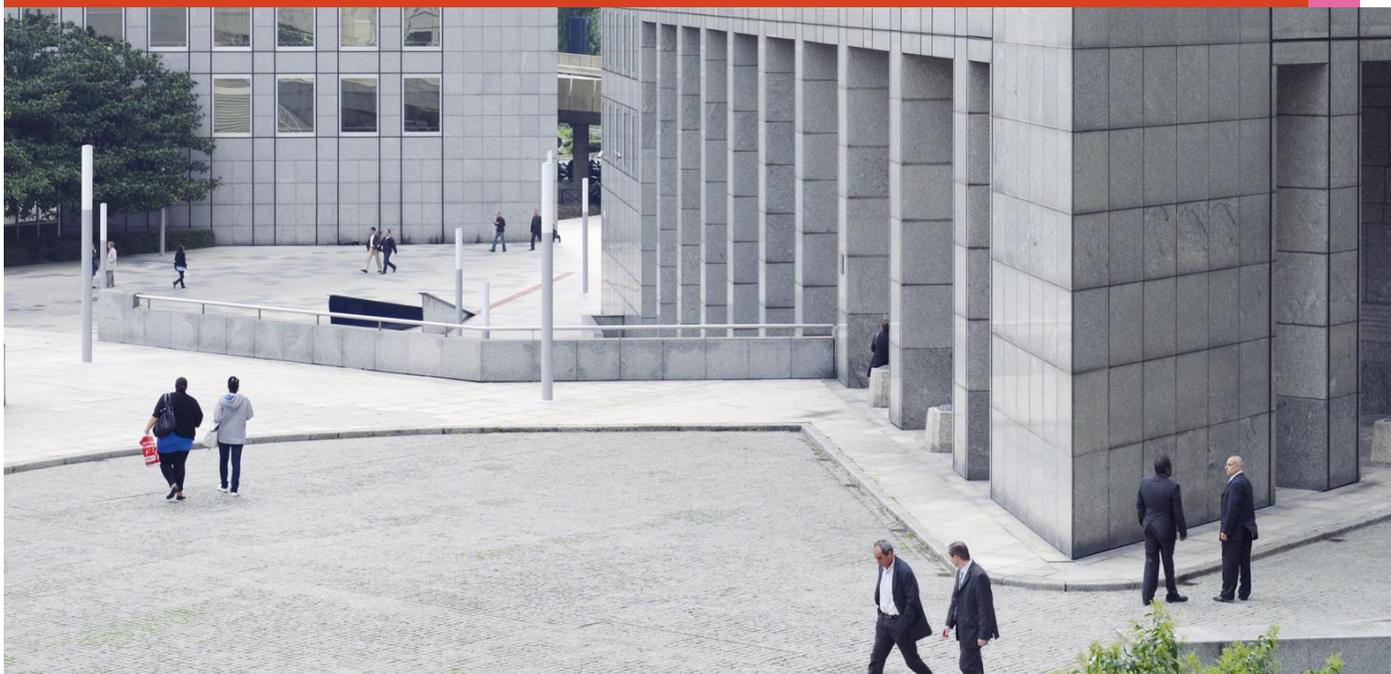
Corporate Finance

# *Magyar Villamos Művek Zrt.*

## Project ST2 - MEIP test

*Strictly private  
and confidential*

*18 December 2019*



**pwc**



**MVM Magyar Villamos Művek Zrt.**  
1031 Budapest, Szentendrei út 207-209.

18 December 2019

Dear Sir,

This report (“Report”) has been prepared by PricewaterhouseCoopers Magyarország Kft. (“PwC”) for Magyar Villamos Művek Zrt. under the terms and conditions of Magyar Villamos Művek Zrt.’s contract with PwC.

As requested, we performed an economic analysis in order to test whether any economic advantage regarded as state aid was implied by the transaction related to the acquisition of the 100% equity of Status Power Invest Kft. by Magyar Villamos Művek Zrt. In our Report we determine whether the transaction is in line with the Market Economy Investor Principle pursuant to Article 107(1) of the Treaty on the Functioning of the European Union.

This Report consists of a comprehensive presentation of our scope of work, methodology, information sources, key assumptions and the results of our analysis.

The hereby Report constitutes a whole and none of its parts or pages should be read and interpreted without reading the entire Report, particularly its disclaimers and limitations.

If you require any clarification or further information, please do not hesitate to contact us.

Yours faithfully,

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## Executive summary

*In this report, an economic analysis was performed in order to verify the non-existence of economic benefits of the related transaction. Based on the evaluation of the Company, it can be assumed that if the transaction value will be equal or below the estimated market value of the Company's equity than the transaction may not be expected to fail the MEIP test.*

<b>Background</b>	<p>Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) declares the fundamental guideline regarding the aids granted by states (in short, state aid). It follows that, as the main rule, a measure constitutes state aid and shall be incompatible with the internal market if the following conditions are all met: 1) It is granted by a member state or through state resources; 2) It distorts or threatens to distort competition; 3) It favours certain undertakings or the production of certain goods; 4) It affects trade between member states.</p> <p>In the practice of European law, the Market Economy Investor Principle (MEIP) has been formulated and employed to test whether a given measure constitutes state aid by violation of bullet no. 3 above in particular. The economic analysis of the MEIP test is to investigate whether the transaction is such that a private investor would accept.</p>
<b>Scope</b>	<p>The transaction under examination is to acquire the 100% equity of Status Power Invest Kft. („Company”), which acquisitions would be made by the state-owned Magyar Villamos Művek Zrt. („NKM”).</p> <p>Our scope of work was to provide an economic analysis in order to test whether any economic advantage was implied by the transactions. The related analysis was performed considering the so-called Market Economy Investor Principle test under Article 107(1) of the Treaty on the Functioning of the European Union. Our scope of work did not include any analysis from legal perspectives.</p>
<b>Sources of information</b>	<p>Our report contains information obtained or derived from a variety of sources described within the report in more detail. PwC has not sought to establish the reliability of those sources or verified the information so provided. Accordingly no representation or warranty of any kind (whether express or implied) is given by PwC to any person (except to Magyar Villamos Művek Zrt. under the Contract) as to the accuracy or completeness of the report.</p> <p>While our work has involved analysis of financial information and/or accounting records, it has not included an audit in accordance with generally accepted auditing standards. Moreover, except where otherwise stated in the Report, we have not subjected the financial information in the Report to checking or verification procedures. Accordingly we assume no responsibility and make no representations with respect to the accuracy or completeness of any information provided to us, except where otherwise stated herein, and no assurance is given.</p>
<b>Limitations</b>	<p>PwC will not undertake any Management Function, You will take responsibility for all decisions and judgments (regardless of significance), to evaluate the results of PwC's services; and to decide what (if any) action You should take. All PwC advice and recommendations are matters for consideration and decision by You.</p> <p>All recommendations as to equity value set forth in this Report are based on the facts and data available as of 31 December 2019, the Valuation Date. No facts or events which occurred between the Valuation Date and the date of the issuance of the Report were considered for value measurement purposes, except where stated otherwise. Therefore, the conclusions contained in the Report are only valid as of the Valuation Date.</p>

## Executive summary

*In this report, an economic analysis was performed in order to verify the non-existence of economic benefits of the related transaction. Based on the evaluation of the Company, it can be assumed that if the transaction value will be equal or below the estimated market value of the Company's equity than the transaction may not be expected to fail the MEIP test.*

### MEIP test

In this MEIP test, it is to be investigated whether the price paid in the transaction does not exceed the sum of the intrinsic (market) value of the equity.

In order to perform the analysis, we determined the key value drivers of the market value indication and underpinned the related assumptions from MEIP point of view. Our analysis was based on the related business valuation performed during the M&A assistance assignment, which was complemented with the analysis of the potential transaction value. Considering that the Company operates as a holding company, we performed the valuation of the Company using the net asset approach. The following key value drivers were contemplated in the analysis:

- Definition of value: it was confirmed by detailed arguments that the kind of value analyzed in this report is applicable to the MEIP, because the market value applies to the general market investor and the characteristics of market value also hold;
- Valuation methods of the subsidiaries: during the estimation of the market value of the subsidiaries we used the net asset approach for the holding companies (Mátra Energy Holding Zrt., Status Geo Invest Kft.) and the income approach for the Mátrai Erőmű Zrt. and Geosol Kft.;

<b>Company</b>	<b>Valuation method</b>
Status Power Invest Kft.	Net asset approach
Mátra Energy Holding Zrt.	Net asset approach
Mátrai Erőmű Zrt.	Income approach
Status Geo Invest Kft.	Net asset approach
Geosol Kft.	Income approach

- 
- Based on current market trends (ageing power plants, growing number of photovoltaic electricity generation plants), it may be an acceptable assumption that Mátrai Erőmű Zrt. may acquire higher market share on the auxiliary power generation market on the long term.

## Executive summary

*In this report, an economic analysis was performed in order to verify the non-existence of economic benefits of the related transaction. Based on the evaluation of the Company, it can be assumed that if the transaction value will be equal or below the estimated market value of the Company's equity than the transaction may not be expected to fail the MEIP test.*

### MEIP test

- According to the technical due diligence report of technical experts, capital expenditure need of the forecasted period amounts to HUF bn while the reclamation expenses are subject to be in the same range considering prices. The MEIP test analysis assumes that these assumptions are adequately reflected in the technical DD reports and the related technical experts were able to assess the related expenses appropriate.
- We received the information that according to an international consulting firm, the current operation includes a saving potential of HUF bn annually. A market investor may be of the opinion that consideration of 10% annual savings on material and personnel type expenditures (HUF ~ bn p.a.) may be a conservative assumptions during the market value estimation.
- Transaction value: the purchase price was derived as an outcome of the commercial negotiations between the parties to the transaction (the current majority owner of the Company and Magyar Villamos Művek Zrt.).

### Conclusion

Based on our analysis, the Transaction value is not higher than the market value of the Company, therefore the net present value (NPV) of the Transaction is considered to be positive, it can be assumed that the transaction may not be expected to fail the MEIP test.

Data in HUF million	Transaction value	Market value of the Company	NPV of the transaction
Status Power Invest Kft.	(17 440)	17 526	86

# ***MEIP test***

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## Introduction

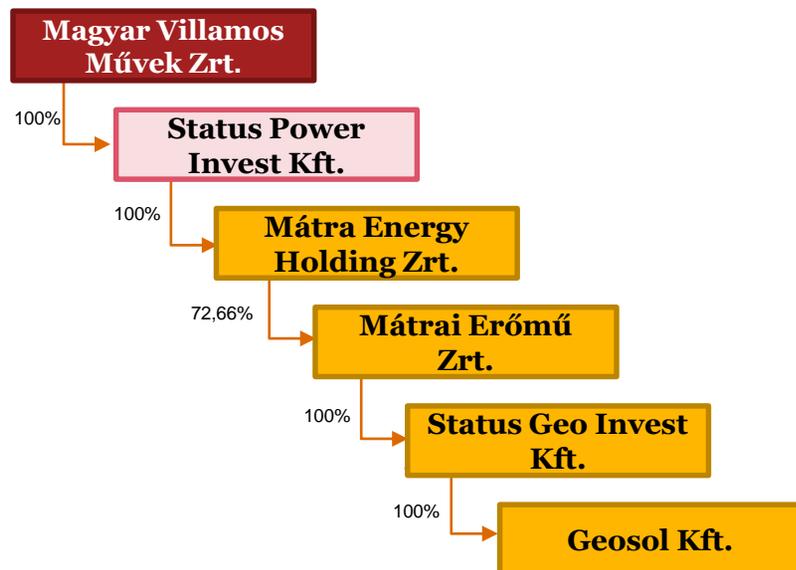
*The transaction under examination is to acquire the 100% equity of Status Power Invest Kft. The acquisition is to be made by the state-owned Magyar Villamos Művek Zrt.*

### Transaction under examination

The transaction under examination is to acquire the 100% equity of Status Power Invest Kft.. The acquisition is to be made by the state-owned Magyar Villamos Művek Zrt.

The purchase price was derived as an outcome of the commercial negotiations between the parties to the transaction (the current owner of the Company, and Magyar Villamos Művek Zrt.).

### Structure of the transaction



Source: Magyar Villamos Művek Zrt.

It has to be noted that PwC Hungary was involved as buy-side financial advisor of the related transaction including due diligence, business valuation and M&A assistance to Magyar Villamos Művek Zrt.

In this subject assignment, our scope of work was to provide Magyar Villamos Művek Zrt. with an economic analysis in order to test whether any economic advantage was implied by the transaction. The related analysis was performed in align with the so called Market Economy Investor Principle test under Article 107(1) of the Treaty on the Functioning of the European Union.

The subject analysis was carried out by considering the related deliverables of the above assistance, especially the valuation report for the market value indication of 100% equity of Status Power Invest Kft. for the valuation date of 31.12.2019.

In practice, prior to conducting a MEIP test, it is typically examined first whether there are any legal barriers to the transaction.

- If yes, the state obviously must not proceed with the transaction and the investigation of any economic advantage is consequently irrelevant.
- If there are no legal barriers to the transaction, then an economic analysis is performed to verify the non-existence of economic benefits provided by the state and that the state acts like a private investor would act.

We assumed that Magyar Villamos Művek Zrt. performed the related analysis from legal perspectives (competition law) and so no legal barriers were assumed related to the above mentioned transaction.

## Guideline for testing

*In this report, an economic analysis is to be performed in order to verify the non-existence of economic benefits of the related transaction.*

### TFEU's fundamental guideline

Article 107(1) of the Treaty on the Functioning of the European Union (TFEU) declares the fundamental guideline regarding the aids granted by states (in short, state aid). It follows that, as the main rule, a measure constitutes state aid and shall be incompatible with the internal market if the following conditions are all met:

1. It is granted by a member state or through state resources;
2. It distorts or threatens to distort competition;
3. It favours certain undertakings or the production of certain goods;
4. It affects trade between member states.

In the practice of European law, the Market Economy Investor Principle (MEIP) has been formulated and employed to test whether a given measure constitutes state aid by violation of bullet no. 3 above in particular.

In the framework of a MEIP test, it is investigated whether the measure provided such advantage to (that is, favoured) the beneficiary that disaccords with market conditions.

According to the MEIP, there has been no such advantage provided if the measure was one that a rational private investor would have also taken based on normal market conditions and the same information set available at that time.

Examination of state aid may also involve assessment of potential distortions regarding competition, separately from the economic analysis, reflecting on bullet no. 2. The criteria stated in bullets no. 1 and 4 are typically implied in capital investments made by the state.

### Market Economy Investor Principle

The economic analysis of the MEIP test is to investigate whether the transaction is such that a private investor would accept.

Regarding a capital investment in particular, the evidence has been that typically a discounted cash flow (DCF) analysis is made. This implies estimation of future expected cash flows generated by the investment and estimation of a required rate of return corresponding to the risk of the cash flows, by which rate the estimated future expected cash flows are discounted to arrive at their present value.

The MEIP is considered fulfilled if:

- either the present value of the transaction exceeds the funds sacrificed for making the investment; that is, the investment has positive net present value (NPV);
- or including the initial invested funds, the internal rate of return (IRR) of the investment exceeds the discount rate (often referred to as weighted average cost of capital (WACC)).

## Our scope of work

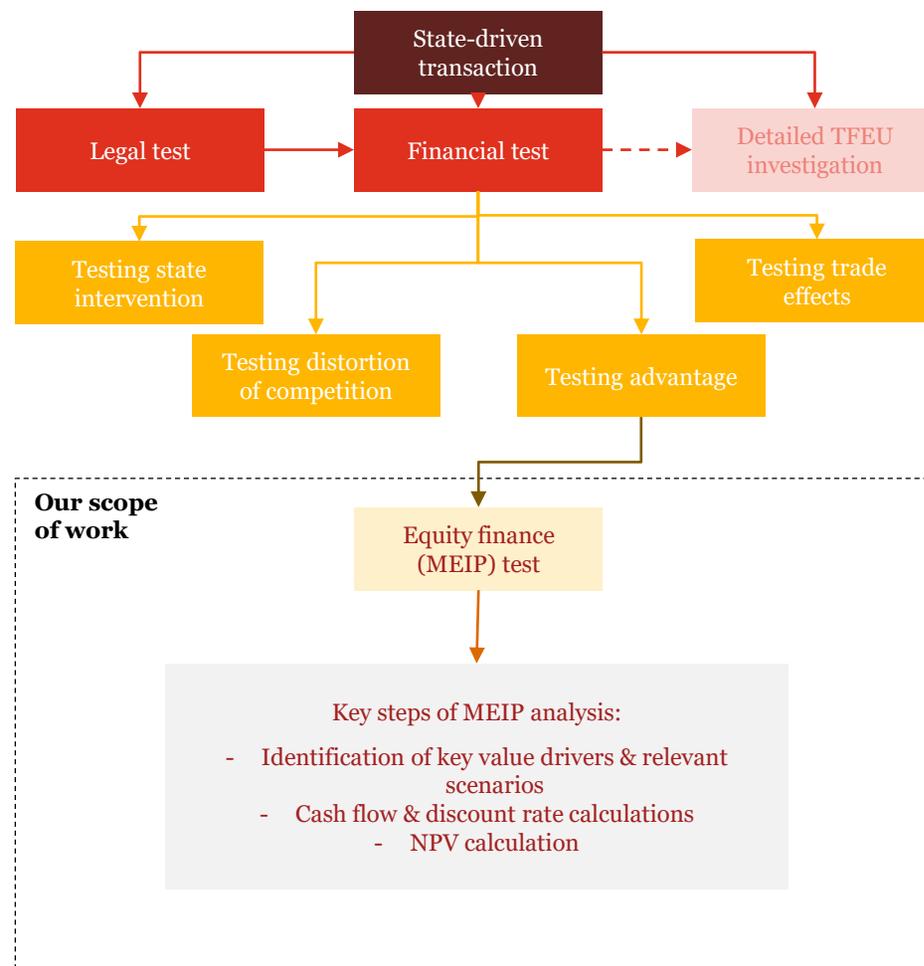
It can be stated that the MEIP test is applicable in the subject transaction under examination. It is to be investigated whether the price paid for the equity does not exceed the intrinsic (market) value of the equity.

Our related scope of work is summarized on the right, while our findings are detailed in this report.

In order to perform the MEIP test, we determined the key value drivers of the market value indication and underpinned the related assumptions from MEIP point of view. Our analysis was based on the related business valuation performed during the M&A assistance assignment, which was complemented with the analysis of IRR.

While our work has involved analysis of financial information and/or accounting records, it has not included neither legal analysis nor an audit in accordance with generally accepted auditing standards.

*During the analysis, we contemplated the key value drivers of the market value indication and underpinned the related assumptions from MEIP point of view.*



## **MEIP test**

### Analysis of key value drivers

#### **Valuation approach to determine market value**

There are three generally accepted valuation approaches which may serve as the basis of the estimation of market value of subject business enterprise: income, market and net asset approaches.

Considering the Company operates as a holding company the net asset approach was selected as the valuation approach.

During the related work, a standard of market value was used as a basis for the valuation in accordance with customs and interpretative practices assumed going concern principle holding true.

- **Going-concern:** The valuation was based on the concept that the enterprise will continue operations in the future and its future operation is not immediately threatened. This assumption relates to the existence of the intangible elements that are consequence of such factors as trained workforce, production resources, the necessary systems or procedures or work licenses.
- **Market value:** the market value was defined in line with International Valuation Standards, i.e. as: “the estimated amount for which a property should exchange on the date of valuation between a willing buyer and willing seller in an arm’s-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently, and without compulsion.”

*The market value indication was performed on the basis a generally accepted valuation methodology (net asset approach).*

*The MEIP test was performed in line with the above method mainly focusing on the key valuation drivers of the market value estimation.*

During the MEIP test, we relied on the market value estimation performed during the M&A advisory assignment.

Our main scope of work in the current analysis was to analyse the Transaction value is below the estimated market value.

#### **Analysis performed in light of MEIP test**

As PwC performed several analyses during the M&A assistance, the MEIP test was performed on the following key value drivers:

- **Definition of value:** in order to confirm the fairness of the transaction, definition of market value has to be analysed in details considering each element of the definition in light of market conditions of the transaction.
- **Valuation method of the subsidiaries:** during the valuation of the market value of the subsidiaries we used the net asset approach for the holding companies (Máttra Energy Holding Zrt., Status Geo Invest Kft.) and the income approach for the Mátra Erómű Zrt. And Geosol Kft.
- **Valuation assumptions for estimating the market value of Mátra Erómű Zrt. and Geosol Kft.**
- **Transaction value:** the purchase price was derived as an outcome of the commercial negotiations between the parties to the transaction (the current owner of the Company, and Magyar Villamos Művek Zrt.).

Other valuation inputs were determined on the basis of historical figures and considered as non-material from sensitivity perspectives and were out of this scope.

## **MEIP test**

### Analysis of key value drivers

#### **1) Definition of value**

##### *Definition of market value*

Since the MEIP refers to a general market economy investor, it is implied that the market value is the kind of value to be assessed in the related test. The question might arise if it is indeed the market value that has been analysed in this report. To this issue, we provide the following justification.

We approached the notion of market value based on the definition according to International Valuation Standards, which is widely accepted in valuation practice. Examining the elements of the definition cited earlier, we confirm that:

- There were a willing buyer and a willing seller, none of them was coerced or in other ways obliged to enter the transaction;
- The seller was certainly knowledgeable because of having run the business for many years, and the buyer was also knowledgeable because of the in-depth analyses that preceded the transaction;
- Several rounds of negotiations took place before the transaction, which increased knowledgeability and implied proper marketing and prudence because the price was not hastily set but was well contemplated;
- The arm's length nature of the transaction is confirmed by the fact that both parties commissioned independent, disinterested professional advisors who used generally accepted valuation methodologies that would be used by a market participant to determine the price.

*Our calculations show that the planned Transaction value for the 100% equity is not higher than the estimated market value of the Company, therefore the NPV of the Transaction is considered to be positive. It can be confirmed that the transaction may not be expected to fail the MEIP test.*

#### *Potential investors*

The question, partly also related to market value, might arise if there were other potential buyers; i.e., the buyer was not in a monopolistic situation.

It can be established that:

- The seller was not obliged (by law or other means) to sell to the given buyer;
- There were no (legal or other) barriers for other market participants to enter the bid and compete;
- The transaction process was not unusual in the market, which implies no advantage in conditions compared to other market participants;
- There are several examples of similar transactions between non-governmental entities in Europe and globally.

The above confirm that the buyer cannot be regarded to have been in a monopolistic situation.

#### **2) Valuation methods of the subsidiaries**

During the valuation of the market value of the subsidiaries we used the net asset approach for the holding companies (Mátra Energy Holding Zrt., Status Geo Invest Kft.) and the income approach for the Mátrai Erőmű Zrt. and Geosol Kft.

## **MEIP test result**

### Analysis of key value drivers

#### **(3) Valuation assumptions**

- 
- 
- Based on current market trends (ageing power plants, growing number of photovoltaic electricity generation plants), it may be an acceptable assumption that Mátrai Erőmű Zrt. may acquire higher market share on the auxiliary power generation market on the long term.
- According to the technical due diligence report of technical experts, capital expenditure need of the forecasted period amounts to HUF bn while the reclamation expenses are subject to be in the same range considering prices. The MEIP test analysis assumes that these assumptions are adequately reflected in the technical DD reports and the related technical experts were able to assess the related expenses appropriate.

*Our calculations show that the planned Transaction value for the 100% equity is not higher than the estimated market value of the Company, therefore the NPV of the Transaction is considered to be positive. It can be confirmed that the transaction may not be expected to fail the MEIP test.*

- According to an international consulting firm, the current operation includes a saving potential of HUF bn annually. A market investor may be of the opinion that consideration of 10% annual savings on material and personnel type expenditures (HUF ~ bn p.a.) may be a conservative assumptions during the value estimation.
- Because of the great uncertainty of the circumstances (current status of the legislation, development of the related project), a normal market participants may consider a huge development risk discount on the potential future cash flows. We are of the opinion that the 90% discount used in the related valuation may properly reflect the related risks as in its current status.
- Because the uncertainty of the circumstances, 90% development risk discount was assumed on the possible future cash flows. We are of the opinion that this discount may properly reflect the related risks as in its current status.

## MEIP test result

### Analysis of key value drivers

*Our calculations show that the planned Transaction value for the 100% equity is not higher than the estimated market value of the Company, therefore the NPV of the Transaction is considered to be positive. It can be confirmed that the transaction may not be expected to fail the MEIP test.*

- According to public information, proper waste treatment is one of the priorities of the national energy and environmental strategies. As so, it may be stated the long term assumptions related to the brown premium may be supported in the long term and may be unchanged after 2022 with the same conditions.

#### 4) Transaction value

The purchase price was derived as an outcome of the commercial negotiations between the parties to the transaction (the current majority owner of the Company and Magyar Villamos Művek Zrt.).

#### MEIP test results

We performed an analysis with focus on key value drivers to determine if the price paid in the transaction was in line with market conditions.

Our calculations show that the planned Transaction value for the 100% equity of the is not higher than the estimated market value of the Company, therefore the NPV of the Transaction is considered to be positive.

**Because the NPV of the Transaction considered to be positive, it can be confirmed that the transaction may not be expected to fail the MEIP test.**

In HUF mn	Transaction value	Market value of the Company	NPV of the transaction
Status Power Invest Kft.	(17 440)	17 526	86

# *Appendices*

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## *Limiting conditions*

This report (“Report”) has been prepared by PricewaterhouseCoopers Magyarország Kft. (“PwC”) for Magyar Villamos Művek Zrt. under the terms and conditions of MVM Zrt.’s contract with PwC. This Report is strictly confidential and (save to the extent required by applicable law and/or regulation) must not be released to any third party without our express written consent that we may at our discretion grant, withhold or grant subject to conditions.

Our report contains information obtained or derived from a variety of sources described within the report in more detail. PwC has not sought to establish the reliability of those sources or verified the information so provided. Accordingly no representation or warranty of any kind (whether express or implied) is given by PwC to any person (except to MVM under the Contract) as to the accuracy or completeness of the report.

We have not carried out any work or made any enquiries of the Management since the date of the Report. The Report does not incorporate the effects, if any, of events and circumstances which may have occurred or information which may have come to light subsequent to that date. We make no representation as to whether, had we carried out such work or made such enquiries, there would have been a material effect on the Report.

We draw your attention to important comments regarding the scope of our work, the purpose for which the advice is to be used, our assumptions and limitations in the information on which the advice is based set out in our report. Our Report is not intended to be the sole basis of any investment decisions and any action you take must ultimately remain a decision for you, taking into account matters outside the scope of our work of which you are aware.

By its very nature, valuation work cannot be regarded as an exact science and the conclusions arrived at in many cases will of necessity be subjective and dependent on the exercise of individual judgement. There is, therefore, no indisputable single value and we express our opinion as falling within a likely range. Although our conclusions are in our opinion reasonable and defensible, others might wish to argue for a different value.

All recommendations as to market value set forth in this Report are based on the facts and data available at the Valuation Date. No facts or events which occurred between the Valuation Date and the date of the issuance of the Report were considered for market value measurement purposes, except where stated otherwise.

This is particularly important to note given the current economic circumstances when the business environment is changing rapidly and could significantly impact the results of the analysis. Therefore, the conclusions contained in the Report are only valid as of the Valuation Date.

You may not make copies of this report available to other persons except as described in the Contract, and subject to the conditions described therein. PwC accepts no duty of care to any person (except to Magyar Villamos Művek Zrt. under the Contract) for the preparation of the report. Accordingly, regardless of the form of action, whether in contract, tort or otherwise, and to the extent permitted by applicable law, PwC accepts no liability of any kind and disclaims all responsibility for the consequences of any person (other than Magyar Villamos Művek Zrt. on the above basis) or for any decisions made or not made which are based upon this report.

## *Limiting conditions*

### **Important message to any person not authorised to have access to this report**

Any person who is not a recipient of this report or who has not signed and returned a Release Letter to PricewaterhouseCoopers Magyarország Kft., is not authorised to have access to this report. Decision making governmental and state bodies, MVM, companies operating within the ownership of MVM, companies under the ownership control of MVM constitute an exception.

Should any unauthorised person obtain access to and read this report, by reading this report accepts and agrees to the following terms:

1. The reader of this report understands that the work performed by PricewaterhouseCoopers Magyarország Kft. was completed in accordance with instructions provided by our client and was carried out exclusively for our client's sole benefit and use.
2. The reader of this report acknowledges that this report was prepared at the direction of our client and may not include all procedures deemed necessary for the purposes of the reader.
3. The reader agrees that PricewaterhouseCoopers Magyarország Kft., its partners, principals, employees and agents neither owe, take nor accept any duty or responsibility to the reader, whether in contract or in tort (including without limitation, negligence and breach of statutory duty), and shall not be liable in respect of any loss, damage or expense of whatsoever nature which is caused by any use the reader may choose to make of this report, or which is otherwise consequent upon gaining of access of the report by the reader.

Furthermore, the reader agrees that this report is not to be referred to or quoted and not to distribute the report without prior written consent of PricewaterhouseCoopers Magyarország Kft.

## Information base

In the course of our analysis, we relied upon financial and other information obtained from the Management. Our conclusion is dependent on such information being complete and accurate in all material respects.

The principal sources of information used in performing our analysis included:

- Statutory balance sheets, income statements, and supplementary reports and general ledgers of 2017-2019;
- Company information available via Virtual data rooms;
- Supplementary information via management expert sessions with the Management of the Company;
- Analyst reports and market studies on the related industry including market studies of ;
- BMI's on-line database which covers long term macro economic forecasts for Hungary;
- Publicly available information of Hungarian National Bank and Statistical Offices;
- ISI Emerging Markets, Mergermarket and Capital IQ's on-line database covering financial markets, commodities and news.

While our work has involved analysis of financial information and/or accounting records, it has not included an audit in accordance with generally accepted auditing standards.

Moreover, except where otherwise stated in the Report, we have not subjected the information in the Report to checking or verification procedures.

Accordingly, we assume no responsibility and make no representations with respect to the accuracy or completeness of any information provided to us, except where otherwise stated herein, and no assurance is given.

## Glossary

<b>Term</b>	<b>Definition</b>
<b>ÁKK</b>	Államadósság Kezelő Központ Zrt.
<b>CAPM</b>	Capital Asset Pricing Model
<b>Client</b>	Magyar Villamos Művek Zrt.
<b>Company</b>	Status Power Invest Kft.
<b>DCF</b>	Discounted cash flow
<b>EBITDA</b>	Earnings before Interest, Tax, Depreciation and Amortisation
<b>IRR</b>	Internal Rate of Return
<b>MEIP</b>	Market Economy Investor Principle
<b>MVM</b>	Magyar Villamos Művek Zrt.
<b>NPV</b>	Net Present Value
<b>PwC</b>	PwC Magyarország Kft.
<b>TFEU</b>	Treaty on the Functioning of the European Union
<b>Valuation date</b>	31 December 2019.
<b>WACC</b>	Weighted average cost of capital