PZU - presentation of financial results for Q1 2016: 12 May 2016

Piotr Wiśniewski – Manager of the Investor Relations Team at the PZU Group:

Good morning.

I would like to welcome you to the meeting devoted to the discussion of PZU's results after Q1 2016. I would also like to present to you Mr. Sebastian Klimek, the CFO and Member of the PZU SA Management Board, who is responsible among others for the financial division and who will also lead today's meeting.

Sebastian Klimek, CFO, Member of the PZU SA Management Board

Good morning, I would like to welcome you to the conference summarizing the results of the PZU Group in the 1st quarter of 2016. I would also like to welcome those participating online. Well, I should perhaps start with an introduction. This is my first meeting with you. I will not get into details, because you must have read my resume already. As you know, I started working for the Company one and a half months ago. I was appointed by the Supervisory Board on 18 March. Since then, I've been serving as and discharging duties of the Group's CFO. So I believe the best thing to do in the next item would be to tell you about the entire Management Board. President Krupiński delivered a presentation on 15 March. He has already presented new Management Board Members to you. As of now, some other changes have been made, me being one of them, obviously. On this slide you can see that there are two, or actually rather 3 new persons appointed to the Management Board of PZU. This is naturally me, responsible for the financial and accounting division, Mr. Maciej Rapkiewicz appointed at the same time, currently responsible for strategy and risk and Ms. Aleksandra Agatowska, who became a Management Board Member at PZU Życie, responsible among others for marketing. Before I go on to present the results, I will say a few words about myself. As you already know, I spent more than a decade recently working for Philips, most of the time outside of Poland. In the United States, Africa and the Netherlands. I was responsible for finance in those regions. Over the last 2.5 years, I was responsible for the financial matters in Philips Polska, where I was responsible more specifically for accounting and finance operations and for internal control. And now for the new challenge, PZU. The PZU Group is a really fantastic organization – this I can say after being here for a month and a half – with a huge potential for growth. At least that is how I see it, as well as other Management Board Members. In the coming months, we will work with the other Management Board Members on defining and finalizing the strategy. I am sure you will have questions about it and we will most certainly talk about it today. So that would be it about myself. The slide you can see now is a general slide, so you must have already seen it at earlier conferences; I will not go through this again. We are the leader of the insurance segment, market in Poland and in the Central and Eastern Europe, and we have the 1st place in Lithuania and Latvia. 2015 was quite a good year in terms of our performance in the two countries, and what is very important for me as the new person in the Management Board responsible for finance, I am very happy with the 1st place in Poland in terms of gross written premium in property and other casualty markets, which obviously is reflected in the financial performance of the whole Group. This is the agenda and the plan; as the Director mentioned earlier, we will now quickly go through the slides that you have before you. I will try to answer most of your questions. I hope I will be able to. Please excuse me if I do not know the answers to some of the past issues concerning the Company, that is the 4th quarter or 3rd quarter results of 2015. For a month and a half, I tried to become familiar with most of the information and absorb it somehow but I bet that there are some issues for analysts, it is possible that I may not be able to provide some answers; but I can assure you that I will come back to you as soon as possible. Ok, let's move on to the results now. The results were published today, so most of you have probably seen them already. Let us start with the very general slides, which I do like, but I will show you my favourite slide a bit later; it shows the financial results in which I'm interested the most.

The property insurance market in Poland, as you can see: year-on-year (2014) increase in gross written premium, the leader with 34.3%, strong market position of the Group in MOD and TPL insurance and certainly the technical result – this is quite an interesting slide for me, because it shows a trend since 2009, where in 2010 we had the effect of the flood, then the beginning of the so-called price war, 2013 – this is what I'd call a peak, and now the prices are starting to fall. Let's look at 2015; here we can see quite a positive effect for the PZU Group compared to the rest of the market. The entire market is 344 million, where the market without PZU is below at 277. The PZU Group reported a technical result of 621 million, so I personally believe that this is a positive trend. Life insurance – the situation is similar here, but when it comes to regular gross written premium, despite the 0.1% increase, the growth in this premium item is much lower than in the 2013/2014 period. Nevertheless, the market share of PZU Życie in regular premiums remained stable at 40.9% at the end of Q4 2015. For me personally, as a new person in the sector, this is a really very high market share that I hope and believe we would be able to maintain as the Group. Technical result – a decline was recorded here; the margin earned by PZU Życie is 22.3, while other insurance companies have 5.4. Compared to the market, the entire market is 2,841 million, while the PZU Group is 1,792 million. A bit more about the Central and Eastern Europe. Last year, as far as I've managed to check, the results on the Baltics markets and in the Ukraine were not outstanding by any means. In 2015 however we can see quite a positive upward trend and we hope that it is maintained in 2016 and 2017. This will certainly entail potential further investments on those markets. Let us move now to the summary report of PZU Group's results in the 1st quarter of the year. Net profit, ladies and gentlemen, net profit; gross written premium, a year-on-year increase from 4,681 million to 4,801 million. Net profit – everybody has been talking about this since this morning – net profits have fallen. What was the cause? There are really two issues; one is the agricultural insurance – we had quite a significant wintering effect in Q1 at (if I'm not mistaken) 213 million – this is quite a large contribution for the aggregated result. And a very significant decline in investment portfolios where this decrease was also about 200 million, which has contributed to the difference that you can see in 2015, at 941 million, and this year 536 million. This net profit, I do hope that we will no longer see the agricultural effects in the 2nd and 3rd quarters, however we really don't know what the future holds for us here. In the 2nd and 3rd quarters we will work to reverse the trend in net profit and achieve growth. When it comes to equity, there is a natural consequence of the parent company's results: a decline of 4.9% and ROE by 12.8 percentage points. This is quite a significant drop and this is also, as I have said, a consequence of the net result. Ladies and gentlemen, and now the slide that I am, and as far as I know the Management Board and the President are also, very pleased with. This is the first result of the message given to you, I believe, on 15 March by the President, about the Company and the plans to optimize costs by 20%. I would like to draw your attention to one thing in this slide. The 243 here is the cost of Alior. I personally consider it as a one-off and I would not take it into account in total costs. Total costs for the Company and the PZU Group, without the contribution from acquired companies, as you can see, they have fallen 8.1%, from 370 to 340 year-on-year. So those are quite significant cost savings. What costs are affected? Well we are talking mainly about operating and administrative expenses. I do know that it is the 1st quarter; we are starting a year and those operating and administrative expenses are not generally generated at such a level. I would like to assure you that the Management Board, both me and the President, we will continue this trend. Judging by my own experience in the company where I worked previously, there is a significant capacity for keeping this trend and achieving that 20% within the next 3 years, which was communicated to you by President Krupiński. The slide at the bottom – the administrative expense ratio on the insurance activity is what I told you about, which is we have a division into companies in Poland and companies abroad. As you can see, we've seen a decline in those costs, which is naturally a very positive signal for the Company and for the Management Board. And here we have the main factors that I've told you about earlier. We can go through them quickly. Property insurance – as I have said, a decline in profitability, much higher claims in the agricultural insurance portfolio. Well, as I have said, the consequences of wintering. Life insurance – profitability maintained, significant growth year-on-year. And here we have declining profitability in protection insurance, that is the effect of the lower frequency of death-related events, as confirmed by the statistics from the Central Statistical Office. I know that this issue has been returning every quarter in discussions with you. This is something that I will analyze in-depth with my financial division and with the Management Board as well, because we would like have a better understanding of the whole issue of the loss ratio, the decreases and the fluctuations. In terms of the international issues – maintain profitability in LD Balta companies, this is where we will take notice the Baltics compared with 2015 show quite a positive upward trend and we want to maintain this trend. There will naturally be questions about what we want to do. This is the question of our strategy. President Krupiński has already mentioned that we have quite a large appetite for continuing this trend on Eastern European markets, but in the near future or farther future, I hope that by 2020, assuming good growth of the entire Group and personal ambitions, I believe that this Company can also look at the markets beyond our western borders; why not? The banking segment: well I have already experienced myself – on 31 March – the acquisition of that good bank, BPH, by Alior. Alior is also a part, it is consolidated in PZU Group's results. And investments: here, as I have said, there is quite a large decline on the investment portfolio, on individual indices that I hope the 2nd quarter and the 3rd quarter will offset somewhat. And the last thing, FX differences on valuation reports, which are carried at the FX rate of the semi-annual valuation date. Well, we don't have much influence on that, as well. Next slide: non-life insurance, mass segment You have already seen this slide because it is the same, quarter after quarter. We have a breakdown into the mass segment, which signifies individual insurance, the small and medium enterprise segment and the corporate segment. Gross written premium naturally grows by 10.1 percentage points in the mass segment, but the combined ratio, where we can see the agricultural insurance effect again, increased from 87.2% to 99.6%, which naturally is relected below in the operating profit, where a 73.8% decline is posted. In the corporate insurance segment: gross written premium is up again, but the combined ratio here is a consequence of the reversal of TPL insurance provisions in 2015, which constitutes the low base. Consequently, the operating profit in the corporate segment also went down, by 22.9%. In life insurance, the group and individually continued insurance segment recorded a gross written premium growth of 1.7%. There is a positive trend: the margin has increased. And the operating profit: we can see the effect, up by 24.7%. In the individual insurance segment, there is a downward trend in gross written premium; in this case the margin goes up from 12.8% to 22% and the annualized premium, which is really the average between what the investment margin and the insurance margin are generating, is 5.9%. Here, I would like to focus more on the core business, the insurance margin: when we look at the trend between 208 and 119 where the premium, the reduction in premium will be much lower than recorded at 5.9.

Foreign operations. As I have already mentioned, in the Baltics and in the Ukraine we have growth everywhere. The combined ratio has an upward trend as well. Movement down from 102.7% to 99.2%. I'd like to maintain this trend in combined ratio as much as possible in the Baltic companies. Operating result: well we can see small profits here already, but as I've mentioned I can still see a potential in this market, where in 2-3 years after the strategy is finalized, this market may generate much more. We have such a slide for Alior Bank, but please remember one thing – and this has already been said by President Krupiński: we are treating Alior Bank as an investment. One slide showing the loan portfolio by segments, portfolio structure and the banking segment. I wouldn't want to get too deep into the analysis of Alior Bank; I do know that Alior Bank also had its analysis for the 1st quarter today. I am sure we will get back to this subject as far as Alior Bank is concerned, but this is the first quarter in which we are consolidating Alior Bank's result in PZU Group's result. And the first slide that I personally like because it shows what is most interesting to us, which is the summary, the comparison between Q1 2015 and Q1 2016. As you already know, gross written premium is up. Net result on investing activity: what we see here is mainly the Alior effect, to be blunt; in the same context, the interest expenses, which increased significantly from quarter to quarter from 35 million to 274 million, well those are also Alior's expenses. Net profit is something that I've talked about already. It is very important and I would like to emphasize this, because you do know the consensus about the Group's results. Here we are obviously showing 536 million. The 536 million result includes Alior, but the result generated by the PZU Group with the portion of its share in Alior, that is 29%, is 486 million. 486 million compared to the consensus expected at 521 million, well we are beneath the consensus, but this is not a dramatic drop. I do hope that the 2nd quarter will change this result to a more positive trend. The operating segments result includes those two things and immediately we are looking at the operating result at the bottom. I am looking at two things here, that is the down from 146 million to 112 million year on year, with the main effect of a decline in TPL, other insurance, and the 258 million to 68 million drop, which is again agricultural insurance, that is wintering. That has a significant impact on the Group's operating result.

Profitability by sector. This is also quite an interesting slide. You must have seen it already and for me it is even more interesting, because it shows the structure by individual insurance segments and also the entire company divided into non-life and life; we can see the result for the non-life company at 2,622 million and the life company at 1,935 million; in the year-on-year comparison, the premium, gross written premium increases for non-life and is almost flat for life insurance. The change concerns motor TPL insurance in mass insurance, at 22.6%, and for motor MOD it is 16.2%. Corporate insurance: we have an upward trend as well and, as you can see, motor TPL insurance is at 26%, motor MOD at 37.9%. Significant effect on other mass insurance products; this is naturally a large leap year-on-year, from 68.6% to 95.6%; it is the unfortunate effect of agricultural insurance and wintering.

Normalized operating profit: This is where we see the conversion effect of the agricultural insurance, again. The exact amount that I talked about was 213.8 year-on-year. Huge impact on the financial result. Profitability of the mass insurance segment. You can see the increase in the combined ratio, which is a negative effect, change of the loss ratio in agricultural insurance and mainly a higher level of claims in motor TPL insurance. This is the effect of the higher average loss and the administrative expense ratio and the acquisition expense ratio in the Company. Profitability of the corporate segments, if you could take a look, also underwent a certain deterioration – we are moving from 64.4% to 73.4%. The change in the administrative expense ratio related to lower costs in project activity and current activity concerning among others training and marketing expenses. This is what I've mentioned: it is the first quarter and I hope that this trend will be maintained. This is the beginning of the year, so I don't think we will experience a significant increase in operating and administrative expenses in the second quarter. I would like to keep them at a similar level, or at a very slight increase. Additionally in the 1st quarter of the year, the corporate insurance segment includes TUW PZU; the company is at its initial stage of business; its gross written premium in Q1 2016 was PLN 2.3 million.

Group and continued insurance segment – life insurance. We can see gross operating profit of 315 million, so it is really up. You have seen this trend in an earlier slide. In life, the margins will be maintained by the end of the year in this business. We will also do our best to receive higher gross written premium. And obviously one thing, which is new for me: decline in investment income principally ensuing from lower income in unit-linked products, that is something that we as the Company are observing very carefully and considering its impact on the group's profitability. Another important issue, which I have marked here, is the movement in net other technical provisions at a similar level as in the comparable period of last year. This is also an accounting and financial effect that we recorded in 2015, at the end of 2015; this is obviously also visible in the first quarter.

Profitability of international companies: the trend is obviously positive here and is a continuation of what I have already discussed. I would like to go on to slide number 30, that is Investments. We are talking here about worse results on unit-linked products. This is something that I mentioned a while ago. Net result on investing activity – growth is very low, at 0.7% year-on-year. If we look on the right-hand side here, what is important about the net result on investing activity, out of this 1,026 million amount, 314 million is Alior's part and 712 million is PZU Group's part. Net result on investment activity earned on investment products, as you can see, recorded a large drop year-on-year. We are returning here to the issue of investment portfolios, which earned such results.

Solvency ratio. I would like to talk to you about this slide. In 2015, shareholder funds, we are obviously talking about Solvency II here, as compared to Solvency, shareholder funds increased quite significantly. Therefore, we as the Company must analyze the potential solvency according to Solvency II. The main reason for this leap is a new analysis of provisions and assets covering the Company's capital according to the Solvency II regulations. This slide here will be definitely a starting point for developing a new dividend policy, where as the Management Board or more broadly as the entire Group, we must consider potential investments where capital will be needed. Solvency, shareholder funds – I would go on to this slide, Group's capital requirement by risk category. We have 4 key risks:

actuarial, market, counterparty insolvency and operational risks. If you could look at those other risks, it is very important, I would like to turn your attention: the 0.6 billion that you see here is obviously Alior and the 0.9 billion is TFI. As a result of the diversification effect, the basic capital for solvency requirements is 6.9 billion. The risks are not fully correlated, which reduces the PZU Group's capital requirement is roughly 30%. The tax adjustment is calculated under the assumption that if a risk materializes in full whose metric is SCR, then the company could avail itself of the tax shield. Its impact reduces solvency requirements to about 19%. This is also a very important information, which we will certainly take into account in developing our new strategy, where solvency requirements according to Solvency II are quite important in light of the risks.

Ladies and gentlemen, so this is our short summary of results. Looking at the 1st quarter after one and a half months I believe that this is not a bad performance. Considering to the impact of the acquisition, considering the external factors that had quite a significant influence on our net performance, the agricultural effects, the consolidation of Alior and also some additional costs, despite the additional administrative expenses related to Alior and also a certain part of BPH's expenses, the result is good. The 2nd quarter will certainly be a challenge for the company, even though I don't believe that we are unable to achieve an upward growth trend. As of now, we can already see some preliminary figures for the 2nd quarter and they really look quite optimistic. Naturally, I will share the final results with you at the end of the second quarter. As far as other issues are concerned, such as the strategy, we are working on it together with the Management Board. As President Krupiński informed you on 15 March, the strategy will entail quite a broad aspect. There will be no revolution and let me be honest, after I came to this Company and analyzed strategy 3.0, I do not believe that we should change much. There are certain aspects where we can define something where all of us, Management Board Members coming to this Company, we can implement something new that could bring about a positive effect for the Company over the next 4 years. The strategy is currently being improved and we expect it to be finalized in late June/early July and then we will present it to you.

So that is all from me about the results. I know that you are familiar with them. I am sure that from quarter to quarter I will try to be more precise in terms of the analysis of the results compared to the past trend and also showing some of the opportunities that we as the PZU Group can see for the future of the organization. As I've already said, the Company is huge. It is quite a challenge for me. As you already know, I'm not from the sector, but sometimes someone new who comes to the organization may implement new ideas, bring in the new wind, who can implement new, fine ideas. This is how I see it together with President Krupiński and with the new Management Board Members.

Thank you very much for the meeting.