Presentation of PZU's financial results for Q3 2018 – 15 November 2018

Paweł Surówka, President of the Management Board, CEO of the PZU Group:

Ladies and gentlemen, if you allow me, I would suggest we begin. Welcome to the review of the PZU Group's third quarter financial results. Today, I have with me, as usual, Mr. Roman Pałac, President of PZU Życie and Mr. Tomasz Kulik, the PZU SA Management Board Member responsible for finance. I just wanted to mention this technical matter at the beginning. I will be attending the first part of the presentation only, because I will have to leave in just a moment. Today I must also be at a congress in Rzeszów. That's why I will have to go to the airport soon. I will be here for the presentation, while Roman and Tomek will answer all the questions. So if you allow me, I would like to start right away. I think that we all know the agenda of the presentation. At the outset, we should state that we are very happy with this quarter. This is not only the highest quarterly net result in 5 years, but also one that has not been affected by any material non-recurring events. We believe that it is a very healthy result based on healthy foundations of our core insurance business and we consider it to be repeatable. In this respect, we believe that it is a quarter that on the one hand brings us great joy but also shows the effects of all our work on implementing the strategy of improvements for the whole Group over the last quarters and, as I've said, it bodes well for the future. On a cumulative basis, we had the record gross written premium in the PZU Group; we have never had such a high premiums at this time of the year. Overall, the third quarter of the year is also better than in 2017, just by 1%, but still this gross written premium is being built. There is also stable flow and we are growing by 3% in the mass segment. We have partially given away some of the written premium in the life segment in the single premium product group. My colleague, Mr. Pałac, will address this in a moment. But to some extent we did consciously control gross written premiums in this respect; as I have said, it is a record-breaking season: the performance is naturally lower than in the second quarter but still above the last year's figures and still bodes well for the future. Premium levels are also very stable in life insurance, that is in group and individual continuation products. We will talk a bit more about individual continuation. Stable market share in motor insurance, despite the difficult pricing situation, about which we will tell you more later. And still very large high and we maintain strong growth in the number of contracts in PZU Zdrowie. The financial result – I don't have to explain this to you – we have a really good combined ratio at 84.3%, improving in comparison to the second quarter and also much below the level that we set for ourselves in the strategy. Profitability in life insurance, that is in group insurance and individual continuation, is also very good. Among others, both are caused by excellent loss ratios. They are also related to the fact that there were no greater one-off events that would influence the loss ratio. So then it all translates into net profit allocated to parent company's shareholders: one billion seven million zloty, 47% above last year's results (comparable period), or 59% if we exclude banks. Capital allocation, as we have said and communicated, we are proud that our A- rating with a stable outlook was affirmed by the S&P rating agency. On this occasion, we should emphasize that the group's capital strength was rated AAA. This A- rating is naturally caused by the fact that we cannot exceed the sovereign rating significantly. The return generated on capital in the third quarter is indeed exceptional, because it is 29.3 on a cumulative basis, 22.9% this year. By this token we could say that the goal has been achieved when it comes to strategy. However we do realize that this is a really exceptionally good result and we will not always be able to repeat it at this level. Nevertheless, we are hoping that this 22% by 2020 is now becoming very likely. As you well know, the capital ratio is very high, at 227%. We could say that we have some buffer here and we will be considering different options on how to use it. You are also aware of the dividend that was announced at 2.50 PLN, with a dividend yield of over 6%. This seems like a very attractive return on a company that delivers its results in such a stable manner and has such stability of capital. Going forward, the review of the non-life market, as I've said, our share as the PZU Group at 35.4% signifies a 0.6 percentage points growth from the last quarter. Overall, our position on the property market, including reinsurance, Link4 and TUW, is 37.4%, so we can say we have a strong position on the market and also a strong 57.2% share in the technical result of the whole market. Still, we do not just dominate the market, but we are easily the most profitable company on that market. We do see the price pressure in non-life insurance products. We can see that some of the market players that had some profitability buffers, that were built up by the price hikes last years, used these buffers first of all to fight for clients, also with us. But I believe that we showed this quarter that we can fight for those clients and we can defend our market position. As a result, our market share in the motor division, which is stable, with a satisfactory or even very good combined ratio, at the level of 92% in that quarter. In the other property insurance segment, we are still within the combined ratio corridor that is satisfactory, at about 69%. Here we must say primarily that there were no major events that affected this loss ratio; it allowed us to keep this profitability. In this respect, it was another boring but very profitable quarter for this portion of the non-life segment. So that was the market review and now I will ask CEO Pałac to guide us through the life part and then Mr. Kulik the financial and cost part and after that we will get back o you with the strategy and the questions.

Roman Pałac, President of the PZU Życie Management Board

Moving on to the life part, we only have the market data for the first half of the year, so I will just comment on what happened on the market and then I will move on to the quarterly results. As you are well aware, since you have been watching this market with us for a long time, the regular premium part of the market is virtually flat, we are doing quite well, because we are growing slightly in this market, but it is still growth. In the first half of the year, we improved our market share in the part of the market that we are most interested in, in the regular premium and for the whole quarter, for the whole first half of the year, we closed it at 46%. We have also improved our share in market profits – it is now at 50%. So what was happening in the group and individually continued insurance segments? We acted as we have been communicating for a long time, meaning: our strategy for this part of the market is strong discipline when it comes to working with the portfolio. Our focus is not on strong growth, dynamics, but rather the quality of growth and quality of the portfolio. We have introduced new products and worked very hard with the portfolio to make sure it behaves predictably with respect to its profitability. The quarterly result was very good, profitability measured by a margin on this portfolio was over 26%. If you look back at how this part of our business has been performing since 2015, you will see that, on a standardized basis, it was the best quarter in terms of profitability. On the one hand, this resulted from simply a lower loss ratio, but on the other hand – very significant efforts working on the portfolio, on product changes, and also the cost discipline that Tomek Kulik will address.

In the individual part of our life business, we had two separate trends. On the one hand, when we look at this market segment, which is really based on single premium investment products, the whole market was in decline. In this market segment, we are working mainly with our banks and we performed as the market did – well, maybe the scale of this decline was not as big as it was for other market players. But what we are particularly pleased about is the fact that regular premium protection products showed strong growth, driven by a more pronounced involvement of our banks, including Alior, in the distribution of these products. On the other hand, we introduced a number of changes in our product offering. These products are distributed through our agency network, which we have been expanding significantly this year, so we are starting to see the effects. What is particularly pleasing is the quality of this business – profitability above 19%. You probably must admit that it is a very good profitability for this kind of business with this mix. Two words about our health business. It is a business that we have been developing strongly for several years now. We have invested heavily in two elements: one is the product range and distribution, and the other is the service facilities. As of today, we are cooperating with more than two thousand medical centers. We own 63 facilities and we are now opening new locations in Warsaw, Krakow, Poznań, Gdańsk, etc. I would like to encourage you to benefit as well, because the quality of these facilities is the highest on the market – I can be very confident about that. We are working with 1300 doctors, 50% of pharmacies in the country, and we are investing heavily in the availability of these services. This service availability is at the top of the market: according to our standards, it is less than 5 days for specialists, below 3 for general practitioners. This is something that the public health service or our commercial competitors cannot achieve. So now how this business segment performed in the last period. We have grown 30% year on year, year to date, while the scale of our business and customer relationships, is growing faster. This is because, on the one hand, we continue the model that was based on our relationships from the life business. It was one of the main products we offered to our corporate clients. On the other hand, we launched a whole range of health products for customers from non-life businesses, Link4 launched the distribution of our life products, and that greatly improved the acquisition of new risks. We are very pleased with these results. We believe we are on the right track to meet the strategic goal of one billion zloty in 2020. I will not give the floor to Tomek Kulik to guide us through the next part.

Tomasz Kulik, Management Board Member, CFO of the PZU Group:

Thank you very much. Now a few words about our clients' assets that we are managing. The factors driving the capital market and affecting our assets under management and the level of our clients' assets, included on the one hand, depreciation and on the other – significant volatility. This affected the value of the portfolio but I'd like to emphasize this – it affected the value but not the number of records or outflows. There are several reasons why we are not under the same pressure as our competitors: The first reason is that a large part our asset management for external clients are portfolios that are highly regular, repeatable. Those are pension products, where we have regular monthly contributions, so the product is regular, the cash flow is regular. On the other hand, we are trying to address these concerns related to the market situation. On the one hand, there is Sejf+, which we started distributing in the previous quarter. It sells quite well and it addresses the concerns related to uncertainty and outflow of clients to safer forms of investing. This product offers a classic investment in fund units, but benefits from a 100% guarantee of capital from PZU SA. Also, there are sales and there is a new platform: passive funds. There are two sales paths, six funds, six portfolios and quite a significant growth in customers. We can see more or less 35 to 50 new customers every day. Therefore, the sales targets related to an increase in new customers, which we assumed and set for this platform, were relatively quickly achieved and exceeded, which is very pleasing. As far as our cooperation with the banks is concerned, there are three dimensions of such cooperation. The first one involves very strong further sales of the products that were on offer in the beginning of the year, including assets in the Multikapitał product that was historically sold by Alior. Introduction of new savings and investment products in cooperation with Bank Pekao SA, also the launch of Sejf+ which is sold by DCM, but also of our existing investment products that are already available on the mojePZU platform. Today, the mojePZU platform is available to clients of PZU and Pekao SA. The roll-out in the fourth quarter, about which the CEO will talk about. Obviously, the third area is cost optimization. The savings that we have achieved in this area are driven obviously by the optimized use of real properties and office space, better contracts renegotiated with our suppliers with much greater bargaining power in the negotiations, and as a result we generate savings within the entire Group. Turning to the results and starting with the premiums, I would like to start by making sure that we are aware of a certain cyclicality in sales and the distribution of sales over the year. The fact that our sales, quarter to quarter, meaning the third quarter to the second quarter, are slightly lower, does not result from anything other than seasonality over the course of a year and when you look historically, year after year, this is nothing out of ordinary. What does please us is certainly the year on year growth, at which we should look in two ways. First of all, there is non life insurance, where we grew by nearly 3% on the mass market side, and by over 3% on the corporate side. What pleases us is, first of all, is the increased saturation of MOD (auto-casco) insurance in addition to TPL motor insurance. MOD, which is more difficult to sell, is a product that is more difficult to offer and convince the client, but in the long term it generates higher profitability and these relationships are more stable, and the stability of relationship is what we care about the most. On the other hand, we posted good sales of non-motor insurance and quite a nice year-on-year growth. On the life side, as CEO Pałac has already mentioned, what is very pleasing is the stability in the segment of regular premium products. I realize that the perception of our topline performance is strongly affected by gross written premiums and by performance of our investment products, but once again, this is nothing out of ordinary. Last year we had above-average sales of investment products in the bancassurance channel. This year it is sales above forecasts, above the plan, but for obvious reasons, in a market like this that does not help and does not support investment behavior, we should not expect above-average allocation of our clients' savings and investments in such solutions. As far as the third quarter results are concerned, we have already said a lot and you have written a lot about them. It was a very good quarter. There is one more thing we can say: it is a quarter that shows our full strength, that is, it is not affected by any one-offs, it simply shows what the underwriting strength is and how we quote and approach the pricing of risk at PZU. So, once again, we are growing in terms of sales measured by premiums. Investment products are the only element with a negative impact; we have already talked about that. As far as claims are concerned, we are below last quarter as well as year on year. This was influenced by the very good claims history and claims situation in both non-life and life insurance and much lower transfers of new cash to investment products. Accordingly, the increase in provisions on this side is much lower. As far as the investment result is concerned, apart from one reclassification, again I'm referring here to our exposure to Azoty Tarnów, we can say that we are at the level of the good third quarter of 2017, significantly above the second quarter. Therefore, not only insurance activity in this quarter, but also investment activity contributed very well to the consolidated result. In terms of costs, they were flat year on year, which is very pleasing given the growing portfolio, which grew not only in terms of premiums, but also in terms our exposure to the number of risks, which later must be serviced at both the sales and after-sales side and claims that must be handled in claims handling processes. Naturally, there will be more claims on a larger portfolio, loss frequency does not fall and therefore they require additional costs. Despite this, we are nominally flat, year on year. Compared to the second quarter, we have seen a positive trend. A slight increase in acquisition expenses, distribution-related expenses. On the one hand they were driven by higher sales, on the other hand by a slight change in the business mix, that is a higher share in sales of higher-commission products. These are mainly non-motor products, and in the case of motor products with a lower level of automatic renewals, we pay commissions to our agents for higher renewal levels in order to keep our portfolio constantly growing. These factors have allowed us to close this quarter, for PZU without banks, at under 850 million. These is very solid year on year and quarter on quarter growth. Taking into account our share in the banks, we have exceeded one billion, which is the best result in the last 5 years, posting very high return on equity, but also with solid measures of quality of the insurance business, both on the life and non-life side. Two words about the costs measured by the cost to premium ratio. On the one hand, there is great discipline, savings on the IT side and in the processes that we are automating, becoming more and more a technology company, where our resources are maintained at the same level, while we are growing in the area of technology. So, on the one hand, there are savings, but on the other hand, they must be well re-allocated towards the developments in the area of technology. Quarter on quarter, third to second, the costs remained disciplined; there was no one-off effect related to the recognition of the new model of remunerating employees for the whole first half of the year. It will now be accruing month to month at a fixed amount; lower support costs related to the sales being distributed over the year and lower training costs. As far as the investment result is concerned, we have already talked about that:the quarter on quarter comparability, meaning the third quarter to the third quarter last year, was affected by the position and reallocation of the exposure to Azoty Tarnów. Please remember that this year they do not pass through profit and loss; they pass through equity. Then there are other strategies, asset classes; mainly an increase in debt, both in zloty and in other currencies. There is a year on year decline in equity strategies and in the element, the held-to-maturity, HTM portfolio, which used to be a large portfolio with very high yields – it has simply shrunk as a tranche of 900 million matured last year, so this affects comparability and ability to generate such returns. But we must admit that the third quarter was very solid. As far as the Group's solvency is concerned, we remain at a very stable level 227, an increase driven by the result on the core business, the contribution of banks, however it is unfortunately offset by the negative impact of the flattening of the yield curve, which affects the valuation of our liabilities, the best estimation of our insurance liabilities. Therefore, it automatically translates into lower own funds. When it comes to the requirement, it was just slightly higher year on year due to the counterparty insolvency risk associated with increasing settlement balances.

Paweł Surówka:

Thank you very much, Tomek. To cut a long story short, I will just show you the quarter's results compared to the measures that we set for ourselves in the strategy. In the first line, of course, we should emphasize that we exceeded the ceiling that we set for ourselves in the nowePZU strategy, that is to have ROE above 22% by 2020. This was achieved both in the third quarter and on a cumulative basis, year-to-date. After three quarters, the ratio is 22.9%. Of course, as I said in the beginning, we wouldn't want you to get used to and believe that all our quarters will now look like this. Even though, as I said, these results were achieved in a repetitive, normalized manner, based on the Group's foundations and its core business, we were helped by the fact that there were no larger non-recurring loss events. For this reason, this result will probably not always remain at this level. Nevertheless, we believe that it shows that the strategy that we adopted at the beginning of this year, which was considered by many to be very ambitious, in terms of this measure, is quite probable and plausible. Moving shortly through the various areas – non-life insurance: here we still have a deviation in the market share that we expected in 2020 at 38%, today it is at 35.4%. Of course, this is something that we will be fighting for, because we want to have the right scale and the right portfolio and certain action for the whole market. However we will always favor profitability and technical result, so we will not sacrifice profitability just to deliver on this measure. However we will still want to get closer. It is much more important for us that overall the combined ratio is very satisfactory at 85.7%. Here we can really say that we maintained great discipline in terms of underwriting control of the prices. And also great discipline in terms of the cost ratio, as we have said, 6 and a half percent. Life insurance, well: I think everything has been said here, we are assuming that as a result of all these activities, especially cross-sell, and by winning new clients, such as in individual insurance, we will be able to rebuild this portfolio to the level of 11 million clients without sacrificing the margin assumed at more than 20% – it has been achieved fully today. As we have said, the solvency ratio is above the level we have set ourselves, which creates opportunities. If we have an eye on any growth opportunities, not only organic, then we can say today that we still have the resources to carry out projects like that. But there is nothing we would like to communicate to you in this respect today. In terms of investments, this is an area where I think we should have better communication with the market and emphasize that PZU Group, through its stability and transparency, is an attractive and, above all, a stable player in this market. What I mean is mainly the products such as Sejf+ with a guarantee of capital. It seems to me that in these times of a volatile stock market this is something that should be an attractive alternative for customers who mainly migrate to bank deposits today. We will continue to fight for these clients. Another element that I hope will also grow this result is the inPZU platform. However, there is still some work ahead of us and we are fully aware of it. The same is true for the surplus of rates above the risk-free rate. Here we achieved 1.2%, but we still a little bit to get the profitability we assumed, that is 2% above the risk free rate. Tomasz Kulik's entire team and the new managing director for investments, that is Robert Kubin, who joined us from Metlife, who had previously been the CEO of Metlife for our entire region – I think that his input will also be very valuable in bringing us closer to these repeatable levels that are attractive for us. As President Pałac said, we are on track in health insurance and in terms of volumes and margins, we do believe that this result is achievable even though it requires enormous work, associated with building a network up from its foundations and increasing number of friendly establishments. The banking segment contributed well to our performance this quarter. Nevertheless, we still hope that both banks will implement the strategies they have announced for the following quarters, which should allow them to reach this level, mainly the financial result, which will contribute to our results from 2020 on. Naturally, we are aware of the fact that it is also subject to the market context, mainly interest rates, but still we believe that the banks, by focusing on organic growth at this point in time, will be able to achieve these results. Well, at this stage I would like to thank you and apologize for my absence in the second part. Now I'd like to ask you for your questions, which will be answered by my colleagues from the management board.

Marta Wasilewska: Good morning, Marta Wasilewska here, Wood Company. I would like to ask you a little about the loss ratios in both segments, but maybe let's start from the beginning: the 84% combined ratio in the non-life segment is clearly below what your strategy assumes. It is also clearly below what European insurers would consider a good achievement, even 92% would be desirable. So my question is whether it is a matter of rising prices, while the levels of reported claims stay flat, or perhaps there is growth in... and I would like to submit my feedback: in the past you stated the number of contracts signed, so that we know whether the business is growing in value or quantity in the non-life segment, that also helped us to get the whole picture. So, how much of the effect is a simple matter of an extremely low number of car accidents, and how much it is a matter of rising prices, with you being the beneficiary.

Tomasz Kulik: As far as strategy is concerned – No, we do not change anything and we continue to declare that 92% will be the standardized target level, taking the cycle into account, since we all know it exists. So, to answer your question, no, we are not raising the target for ROE; nothing is changing here. This quarter is very good, but we cannot assume that we have an infinite advantage resulting from luck. In non-motor insurance, nothing really happened, none of the mass events typical for the third quarter. Lest me remind you of 2017, the previous year, weather conditions are changing, the weather in Poland is changing as well. There are sudden changes in temperature in the summer and spring, accompanied by violent storms, gusty winds; we know what happened near Bydgoszcz, Bory Tucholskie, we know what happened in the north of Poland, so the belief that these things will suddenly stop happening is not justified and we cannot focus our underwriting on whether or not we will have events of this type. We should rather include these events in our prices and we should rather think about that and use it to inform our relationships with reinsurers. It's the same with motor insurance. Yes, we are the beneficiary of historical increases. Let me remind you that we tackled the cycle of increases, which is already behind us, in a completely different fashion than our competitors. We started a little earlier, but we stayed in it in the first and second quarters of 2016 much below the market. This allowed us to get the appropriate weight and then, when we reached the averages market levels with our rates, taking into account those advantages that we have as the PZU Group, we were able to become the beneficiary and we still are one. Please remember that in terms of the motor market, there is price pressure here, we feel it and we have already informed you about it. Therefore, maintaining the profitability at 94%, 95% for the entire portfolio (motor and non-motor) is not justified. We should approach 90% levels, otherwise we will simply lose the advantages that we gained as we built our portfolio historically.

Marta Wasilewska: Would it be possible, in the future, if possible, also have access to information whether your contracts are growing, in terms of the number of clients, signed insurance contracts? I remember that, for a quarter or two (...).

Tomasz Kulik: And we did present that for more than a year, but at some point... well, ok, we can reinstate it.

Marta Wasilewska: And now I have a similar question regarding the life insurance segment, because there the ratio of claims paid to premiums is also far below those long-term averages.

Roman Pałac: You are aware of the long-term averages, because we report them. Our expectation is for the group business to perform at around 20% annually and there will be two additional superimposed elements. On the one hand, how our portfolio behaves: you know very well that mortality, the mortality rate, is the main factor determining the loss ratio in this portfolio. This quarter was indeed very special in this respect. Perhaps optimistically, simply fewer people died, but on the other hand we are working very hard with the portfolio to ensure adequate profitability, repricing, where necessary, in relations with our corporate clients and we introduce additional products, all the while increasing the margin and scale of that portfolio. Accordingly, I would rather expect that 20% in the long term. There will probably be very good quarters such as this one. The first quarter of this year was definitely below, I don't know if you remember it was rather around 16%, so i believe that 20% in the long term is something that we should plan.

Asker: I would like to ask you about the reversals of the provision for used holidays in this quarter.

Tomasz Kulik: Of course, the "holiday provision", so called, fell because we have just finished the third quarter, which is characterized by the fact that people are using their accumulated holiday days. Some time ago we decided in the PZU Group to implement a mechanism, as part of the measures and incentives that exist in the Group, that would promote the use of holidays. We wanted that provision, which was in our balance sheet and was historically very high, to drop, so we were going down from very high levels, measured by the average days of leave per employee per year, by 4-5 days per year. Right now, we are in the third quarter, and this is a completely regular situation; there were no non-standard events and I think that in 2018 – again on average, because you surely cannot manage it in such a way that everyone goes on holiday at the same time, because it is simply impossible operationally – this provision will not grow in any way. Let me remind you that it has been falling year over year because there are certain incentives promoting the use of the days of leave, instead of building them up, accumulating them in this provision in the balance sheet.

Ok, so in the meantime let me get to the questions from the Internet.

Where does your conviction come from concerning the repeatable nature of your results, considering the low loss ratio in the quarter due to favorable weather conditions?

We have no conviction of repeatability. Instead, we are convinced that it was a very good quarter and I believe that we have already given an answer to this question.

Are you interested in acquiring the 13% stake in Pekao SA from PFR; would such a transaction be possible, in the context of maintaining Solvency II at minimum 200% and a dividend payout ratio at around 70%, 80%?

If PFR wanted to exit this investment, and please remember that PFR communicated to us that it was not a strategic position but rather a simple equity investment, then today both the agreement that we have signed with PFR and our approach to this investment (and we treat it as a strategic investment) our goal would be to maintain this total exposure at the PFR PZU level at the 33% that we have today. In other words, if PFR wants to sell then we will want to take over these shares. Would such a transaction make it impossible to keep Solvency II at 200%? It all depends on the pace, if PFR said today they wanted to exit the whole thing then perhaps yes, and perhaps we would have to think about issuing an equity instrument to maintain this level. However, let me remind you that the 200% is something that is our long-term goal and that we accept that there may be short-term fluctuations around this long-term goal. Therefore, this is not something that is like a cosmic anchor for us. We can imagine a scenario in which, in a specific quarter or for 6 months, we drop below let's say 195%, as long as we know why and we have a plan how to go back to these levels. This is not a value that we will want to defend in any special way by making decisions that are irrational or very expensive for the organization.

There is also a question about "Zdzisław's Plan". What role do you see for the PZU Group and for its controlled banks in connection with the "Zdzisław's Plan" reported recently in the media and the amendment to the Banking Law, which gives the Polish Financial Supervision Authority the power to take over a bank in peril by identifying an acquiring bank.

I will answer by saying that as of today, we are not working on any transactions that would increase the composition of the PZU Group as it is today. And that's how I will leave this.

Asker: Perhaps, if I may add to my previous question about the possible changes in Pekao SA's shareholder structure, you mentioned that an equity issue could be necessary. You meant equity instruments or debt instruments?

Tomasz Kulik: Debt instruments classified as own funds.

Roman Pałac: I understand that today this is more of a theoretical question – this is not a capital market. I understand that we have exhausted the questions. Very well then, thank you very much.