Equities

6 June 2012 | 55 pages

PZU (PZU.WA)

Dividend Story Intact – Maintaining Buy

- Company Update
- Target Price Change
- Estimate Change

- **Dividend Intact** — The stock's high (c 10%) dividend yield remains the key reason why PZU remains our top pick among Polish financials. We view the regulator's restriction on dividends as a one-off and still perceive PZU as a dividend stock. For investors looking for growth, we suggest they look elsewhere as we view PZU's organic growth outlook to be modest.
- **Remains a Buy** — While we upgrade our EPS forecast +5% this year, +1% the next year and +3% in 2014, driven by increased premium assumptions, we reduce our target price to Zl 430 from Zl 436 previously (we now value the stock using a standard warranted equity valuation methodology on reported capital vs. on normalised capital previously). The stock remains Buy rated.
- **M&As Limited Risk** — Due to the lack of candidates matching the company's description of an ideal M&A target (an international platform or fully-privatised domestic leader) we doubt PZU will make a material international acquisition in the coming years. Even if it does, we believe it would mean only a short-term (one or two year) reduction in dividends as in the medium term the company will continue to generate more earnings than it needs to grow.
- **Investments: Promising Segment, Delivery is the Key** — Given the market growth potential and PZU's competitive advantage (thanks to its experience in asset management and well-known brand) we appreciate PZU's strategic decision to grow in investment products. However, given PZU's currently weak position in individual life insurance we are not convinced if the company will be able to sell investment products aggressively enough to materially increase revenues from that sub-segment.
- **Will Poland be Holland?** — We doubt PZU will achieve its target of Zl 5bn premium from health insurance in five years as it would require the introduction of competition among payers in the compulsory healthcare system, as has been done in Holland. For political reasons we view the probability of such a radical change in the Polish healthcare system as low.

Buy	**1**
Price (04 Jun 12)	ZL297.60
Target price	ZL430.00
from ZL436.00	
Expected share price return	44.5%
Expected dividend yield	10.1%
Expected total return	**54.6%**
Market Cap	ZL25,698M
	US$7,318M

Price Performance
(RIC: PZU.WA, BB: PZU PW)

PZU (PLN)

Year to 31 Dec	2010A	2011A	2012E	2013E	2014E
Profit Before Tax (ZLM)	2,509.2	2,501.5	3,304.1	3,465.1	3,511.0
Diluted EPS (ZL)	22.22	22.46	30.28	32.08	32.73
Diluted EPS (Old) (ZL)	22.22	23.02	28.91	31.64	31.63
PE (x)	13.4	13.3	9.8	9.3	9.1
DPS (ZL)	26.00	22.43	30.00	31.00	31.00
Net Div Yield (%)	8.7	7.5	10.1	10.4	10.4
Embedded Value Per Share (ZL)	294.00	297.81	307.99	312.03	315.46
Price / EVPS (x)	1.0	1.0	1.0	1.0	0.9

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See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

Fiscal year end 31-Dec	2010	2011	2012E	2013E	2014E
Valuation Ratios					
P/E adjusted (x)	13.4	13.3	9.8	9.3	9.1
P/E reported (x)	10.5	11.0	9.0	9.0	9.1
P/BV (x)	2.0	2.0	1.9	1.8	1.8
P/BV adjusted (x)	2.0	2.0	1.9	1.8	1.8
Dividend yield (%)	8.7	7.5	10.1	10.4	10.4
P/Embedded Value (x)	1.0	1.0	1.0	1.0	0.9
Per Share Data (ZL)					
EPS adjusted	22.22	22.46	30.28	32.08	32.73
EPS reported	28.25	27.16	32.95	33.24	32.73
BVPS	148.23	148.03	158.55	161.79	163.52
BVPS adjusted	148.23	148.03	158.55	161.79	163.52
DPS	26.00	22.43	30.00	31.00	31.00
Embedded Value per share	294.00	297.81	307.99	312.03	315.46
Profit & Loss (ZLM)					
Pre-tax profit	**3,029**	**2,908**	**3,534**	**3,565**	**3,511**
Tax	-590	-564	-689	-695	-685
Extraord./Min. int./Pref. div.	0	1	0	0	0
Reported net income	**2,439**	**2,345**	**2,845**	**2,870**	**2,826**
Adjusted earnings	1,919	1,939	2,615	2,770	2,826
Growth Rates (%)					
Pre-tax profit	-33.6	-4.0	21.5	0.9	-1.5
EPS adjusted	-20.8	1.1	34.8	5.9	2.0
Dividend	-83.6	-13.7	33.7	3.3	0.0
Balance Sheet (ZLM)					
Total assets	**50,534**	**52,129**	**53,437**	**55,210**	**58,215**
Investments	47,384	49,044	50,169	51,811	54,675
Goodwill/intangibles	109	166	183	201	221
Other Assets	3,041	2,919	3,085	3,199	3,320
Separate Account Assets	0	0	0	0	0
Total liabilities	**37,734**	**39,260**	**39,659**	**41,154**	**44,009**
Life policy reserves	16,867	16,895	17,624	18,489	19,483
Non-life policy reserves	14,616	15,628	16,009	16,437	16,909
Total Debt	0	0	10	10	10
Other Liabilities	6,251	6,737	6,016	6,218	7,607
Separate Account Liabilities	0	0	0	0	0
Shareholders' funds	**12,800**	**12,870**	**13,778**	**14,057**	**14,206**
Profitability/Solvency Ratios (%)					
ROE adjusted	15.9	15.2	19.8	20.0	20.1
ROA adjusted	3.7	3.8	5.0	5.1	5.0
Total debt to capital	0.0	0.0	0.1	0.1	0.1
Total debt to equity	0.0	0.0	0.1	0.1	0.1

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Dividend Story Intact

The 2011 dividend, affected by the regulator's 75% dividend payout limit, surprised on the downside, while continued newsflow on potential international acquisitions decreased investor confidence in a return to higher dividend distribution in the coming years. In our opinion, these concerns are unwarranted as the regulator's restriction on dividends seems to be a one-off action, while we believe PZU, given the high returns in its core businesses (namely group life insurance), should be able to pay close to 100% dividend payout for years, with at worse a 1-2 year pause if it decides on a large acquisition.

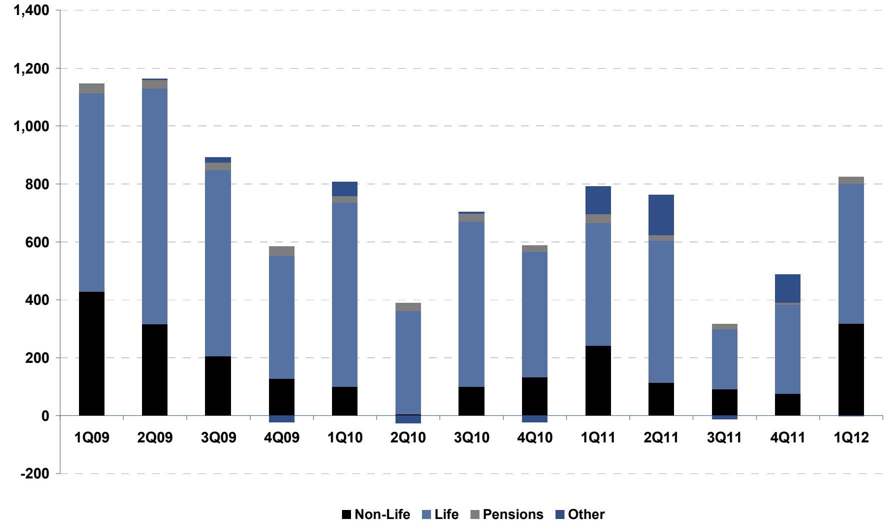
The key issue is rather whether there is any attraction in PZU other than the dividend story? In emerging markets, the importance of dividends has increased recently, but growth is still the most important reason investors invest in EM stocks. In the short and medium term, we don't see many "growth" catalysts for the stock, but we note that in the longer term the underdeveloped Polish non-motor P&C market, the practically non-existent health insurance market, and PZU's weak position in individual life insurance and investment products create room for growth.

PZU in a Nutshell

The change in the company's financial reporting of its divisional results, implemented in 1Q12, is a good excuse to highlight PZU's main business lines. According to the old method of presentation the biggest contributors to PZU's bottom line was the Life segment (accounting for 42% of gross written premiums and 59% of net profit in 1Q12, and 44% and 61%, respectively, in 2011), followed by the P&C segment (58% and 39%, respectively, in 1Q12 and 56% and 22% in 2011). The profitability of the Life division depends predominantly on the investment result while in P&C it is driven by:

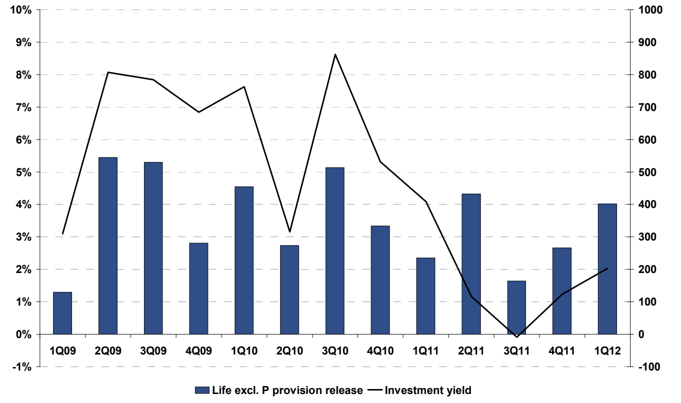
- Seasonality (due to low loss ratio and low administrative costs profitability is the highest in the 1Q);
- Weather (e.g. high snow and flood losses in 1Q10 and 2Q10) and other big one-off losses; and
- Cyclicality in the loss ratio in motor insurance.

Figure 1. PZU – Structure of Net Profit by Segment (Old Classification), 1Q09-1Q12 (Polish Zloty in million)



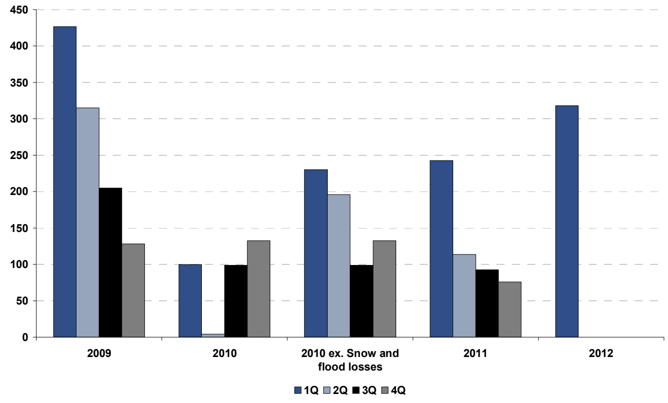
Source: Company reports

Figure 2. PZU – Life Net Profit vs. Investment Yield, 1Q09-1Q12 (Polish Zloty in million)



Source: Company reports

Figure 3. PZU – Seasonality of P&C Net Profit, 1Q09-1Q12 (Polish Zloty in million)

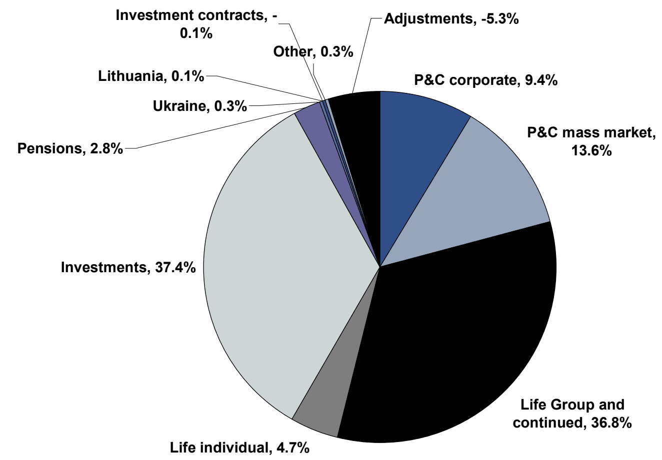


Source: Company reports

The new reporting methodology, implemented in 1Q12, is more detailed:

- The P&C insurance division distinguishes between corporate and individual (mass) segments and in Life insurance between “group&continued” and individual segments;
- The new reporting standard includes a new segment “Investments”, where the profit above reference rate on insurance provisions and the total result on the company’s own investments is reported;
- The new presentation now separately shows results in Ukraine, Lithuania and on investment contracts.

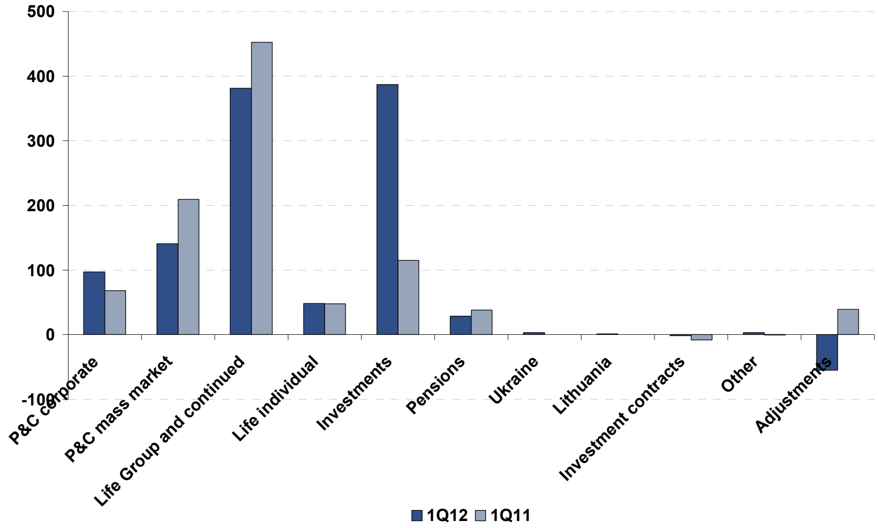
Figure 4. PZU – Structure of Net Profit by Segment (New Classification), 1Q12 (Polish Zloty in million)



Source: Company reports

According to the new segmentation, in 1Q12 the biggest contributors to the consolidated operating profit were Life Group and continued (37%) and investment (37%) segments, followed by P&C mass market (14%) and P&C corporate (9%).

Figure 5. PZU – Structure of Operating Profit by Segment (New Classification), 1Q11-1Q12 (Polish Zloty in million)



Source: Company reports

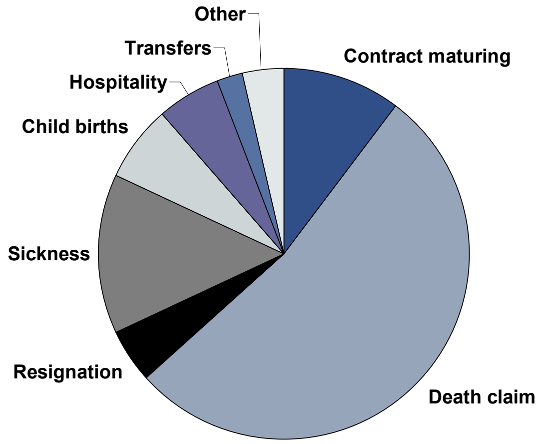
In 1Q12, in comparison with 1Q11:

- Operating profit in group and continued life insurance declined due to a lower release of provisions, driven by the conversion of multi-year contracts into annual contracts (Zl 100m vs. Zl 230m in 1Q11);

- The profit of the Investment segment grew thanks to the good performance of capital bond and equity markets;
- Operating profit in individual P&C insurance declined due to Zl 90m higher agriculture insurance, related to low temperatures in winter;
- Profitability in corporate P&C insurance increased, driven by successful restructuring in corporate motor insurance.

We remind that the group and continued life insurance business lines consist of protective products offered to employees of cooperating companies (the insurance contract is signed with employers, but the premium is paid by employees – the group insurance) or to former employees, including retired persons (continued insurance, formally being individual insurance but in fact having the characteristics of group products as only people formerly covered by group contracts are entitled to sign a contract). The insured are entitled to receive compensation (usually a small sum) in case of a number of type of accidents/events (including deaths of family members, injury, sickness, hospitality, child birth, etc).

Figure 6. PZU – Structure of Compensation Paid in Life Insurance, 2011



Source: Company reports

Figure 7. PZU – Key ratios, 2006-2015E (Percentage, except where stated)

	2006	2007	2008	2009	2010	2011E	2012E	2013E	2014E	2015E
Macro										
GDP growth	6.2%	6.8%	5.1%	1.7%	3.8%	4.3%	2.7%	2.4%	3.1%	3.4%
WIG change	42%	10%	-51%	47%	19%	-21%	10%	10%	10%	10%
5Y bonds	5.0%	6.1%	5.3%	5.9%	5.5%	5.1%	6.1%	5.8%	5.5%	
					6.1%	6.0%	5.9%			
PZU										
GWP (Polish Zloty in million)	13,664	14,077	14,563	14,363	14,541	15,279	16,013	16,646	17,336	18,069
GWP growth rate		3.0%	3.5%	-1.4%	1.2%	5.1%	4.8%	4.0%	4.1%	4.2%
Retention ratio	98.8%	99%	99%	99%	99%	98%	99%	99%	99%	99%
Claim ratio	67.0%	60.9%	59.0%	64.7%	75.9%	68.8%	70.8%	71.5%	72.1%	72.1%
Cost ratio	26.5%	26.7%	27.3%	27.2%	25.2%	24.0%	23.8%	23.9%	23.7%	23.7%
Combined ratio	93.4%	87.6%	86.3%	91.9%	101.1%	92.8%	94.6%	95.4%	95.8%	95.8%
Yield on assets	7.5%	5.5%	1.1%	6.8%	5.9%	3.5%	5.8%	5.9%	5.6%	5.3%
ROE	25%	22%	12%	24%	20.3%	18%	21%	21%	20%	20%
Adjusted ROE *	25%	17%	8%	17%	17%	16%	20%	20%	20%	20%
Normalised ROE **	44%	32%	19%	34%	24%	25%	31%	32%	31%	30%
PZU P&C division										
GWP (Polish Zloty in million)	7,863	8,196	8,435	8,024	8,033	8,529	8,938	9,260	9,657	10,083
GWP growth rate		4.2%	2.9%	-4.9%	0.1%	6.2%	4.8%	3.6%	4.3%	4.4%
Claim ratio in P&C insurance	59%	63%	61%	68%	80%	67.97%	66%	65%	65%	65%
Net claim ratio in P&C insurance (divisional presentation)		64%	63%	69%	74%	68%	67%	66%	66%	66%
Cost ratio	29%	29%	28%	29%	29%	27%	26%	26%	26%	26%
Net cost ratio in P&C (divisional presentation)		29%	28%	30%	31%	27%	26%	27%	26%	26%
P&C combined ratio	88%	92%	89%	98%	109%	95%	92%	91%	91%	91%
Net P&C combined ratio (divisional presentation))		94%	91%	99%	104%	95%	94%	93%	92%	92%
PZU Life division										
GWP (Polish Zloty in million)	5,801	5,884	6,130	6,341	6,513	6,752	7,077	7,387	7,680	7,988
GWP growth rate		1.4%	4.2%	3.4%	2.7%	3.7%	4.8%	4.4%	4.0%	4.0%
Operating margin (pre-tax profit to total reserves)		14.4%	10.0%	17.4%	12.8%	8.7%	10.5%	10.1%	9.2%	8.8%
Normalised operating margin		9.0%	4.7%	10.1%	10.1%	6.7%	9.3%	9.6%	9.2%	8.8%
Life reserves (Polish Zloty in million)	19,560	19,062	18,443	18,024	20,411	20,367	19,419	20,182	21,436	22,753

* - Excluding gains on the release of premium in life group insurance

** - Gain on normalised capital, excluding gains on the release of premium in life group insurance
Source: Company data, Citi Investment Research and Analysis

Dividend Story Still Valid

Materially Overcapitalised

PZU dividend policy

The dividend policy suggests a payout of close to 100% of earnings…

We remind that according to the company's new dividend policy announced in 2011, the dividends:

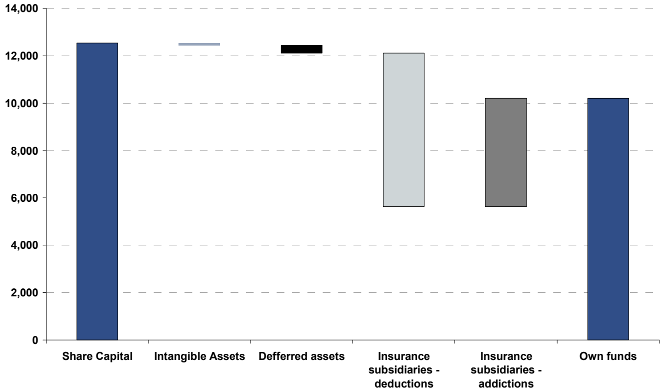
- Should be in the range of between 50% and 100% of PZU Group consolidated net profit in accordance with IFRS;
- Cannot exceed the company's non-consolidated net profit in accordance with PAS;
- Cannot result in a decrease of the company's own funds below 250% of the (consolidated) solvency margin (according to Polish law);
- Cannot weaken the financial strength of the group below the AA rating given by Standard & Poor's;

…unless PZU decides on a major acquisitions

- Should be decided upon taking into consideration the company's additional capital requirements over the 12 months from the approval of PZU group's consolidated financial statements for a given year by the management board.

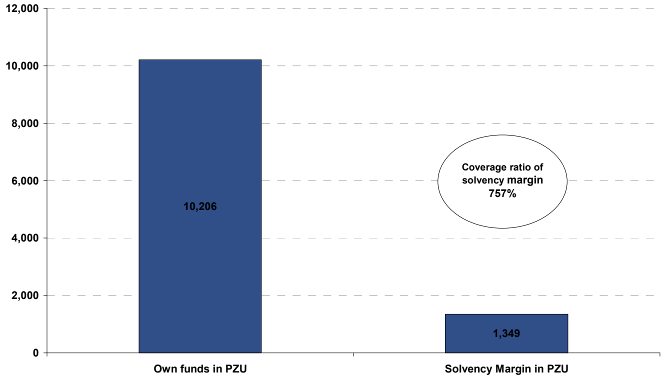
As stated by the company, given its overcapitalisation (own funds were 757% of the solvency margin at the end of 1Q12) and assuming no M&A, PZU would be able to pay nearly 100% of its profits.

Figure 8. PZU – Stand-alone Own Funds, 1Q12 (Polish Zloty in million)



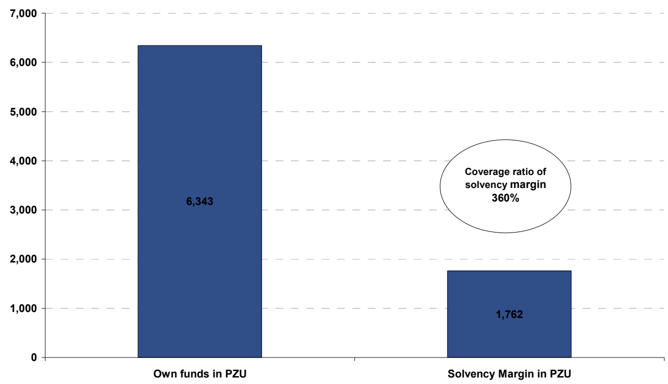
Source: Company reports

Figure 9. PZU – Stand-alone Solvency Margin, 1Q12 (Polish Zloty in million)



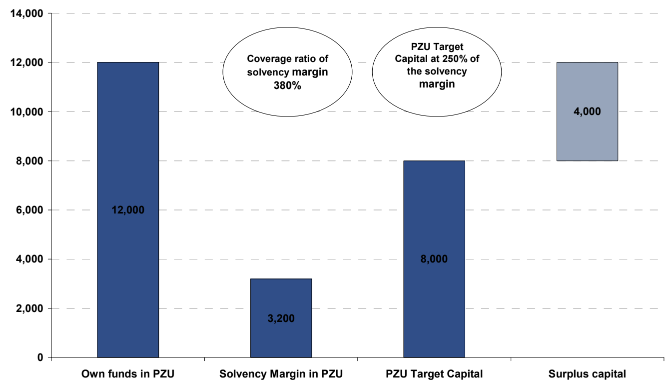
Source: Company reports

Figure 10. PZU Life – Stand-alone Solvency Margin, 1Q12 (Polish Zloty in million)



Source: Company reports

Figure 11. PZU – Group Solvency Margin, 1Q12 (Polish Zloty in million)



Source: Company reports

Solvency II

Summary of the Solvency II project

Solvency II for Insurers follows Basel 2 implemented in banks…

According to European supervisors,[1] Solvency II is a regulatory project that provides a risk-based, economic-based and principle-based framework for the supervision of insurance and reinsurance undertakings. In Solvency II capital requirements will be determined on the basis of the risk profile of undertakings as well on the way in which such risks are managed. Therefore providing tight incentives for sound risk management practices and enhanced transparency. Works on Solvency II were started more than ten years ago and it was planned to be introduced in 2013, but recently its implementation was postponed to 2014. Solvency II is similar to the Basel 2 regulations implemented for the banking industry several years ago and should help put banks and insurers on a 'level playing field'.

…based on a three pillars approach

Like Basel 2, Solvency II is based on three guiding principles (pillars) which cut across market, credit, liquidity, operational and insurance risk:

- Pillar 1 deals with quantitative requirements including technical provisions and capital requirements;
- Pillar 2 deals with the qualitative elements, defining both the principles of risk management system and governance as well as the supervisory review.
- Pillar 3 deals with the reporting and disclosure requirements, which aim to provide greater transparency to the stakeholders and information necessary for the purpose of supervision.[2]

Unexpected losses will be covered by required capital, defined at two levels (Minimum Capital Requirement and Solvency Capital Requirement)…

The design of the framework relies on technical provisions which allow insurers to meet their commitments toward policyholders arising from insurance and reinsurance activity (the expected obligations) and capital requirements which should cover unexpected losses over one-year time horizon. Solvency II outlines two levels of capital requirements:

- Minimum Capital Requirements (MCR), calibrated at 85% confidence level and

[1] EIOPA Report on the Fifth Quantitative Impact Study (QIS5) for Solvency II, https://eiopa.europa.eu

[2] Deloitte: Intro to Solvency II. Discussion requirements and implications. February 2011

- Solvency Capital Requirement (SCR), defined as the level of capital enabling an insurer to absorb significant unforeseen losses at a 99.5% confidence level.

Whereas SCR incentivises sound risk management through the explicit quantitative measurement of the risks for the insurers operations and investments, MCR should ensure a supervisory response, including withdrawal of the licence. The SCR applies at both stand-alone and group level while the MCR applies only at stand-alone level.

…and simultaneously technical provisions will be lowered as they will not include prudence margin

Solvency II removes the implicit prudence embedded in the technical provisions (being part of Solvency I regulation) and replaces them with an additional capital buffer within Solvency Capital Requirement. The insurer can calculate its SCR using a standard formula, an internal model and a partial internal model.

On average, under Solvency II own funds…

Implementation of Solvency II will lead to:

- An upward or downward change in asset valuation (due to valuing assets on a fair-value basis);
- A decrease in technical provisions (due to changed methodology);
- As a result of the two items above, an increase in own funds.

…and capital requirement will be raised

On the other hand, on average the SCR increases when compared to the current required solvency margin under Solvency I while the MCR is below or close to the Solvency I requirements.

According to the fifth quantitative impact study (QIS5), the surplus of own funds of European insurers participating in the study over MCR would amount to €676bn and over the SCR to €355bn, while surplus under Solvency I is €476bn. For Polish participants of the study, the surplus over the MCR (€10.8bn) and over the SCR (€7.4bn) are higher than under Solvency I (€4.4bn) The SCR is expected to amount to 291% of the Solvency I requirement (vs. 211% for the whole universe of insurers covered by QIS5).

According PZU, under Solvency II its surplus capital will not be lower than under Solvency I as the growth in capital requirement (SCR) will be offset by the increase in own funds (due to lower provisioning driven by a higher discount rate). Having fully implemented Solvency II, there will be no need to maintain a high surplus of own funds over SCR.

The one-off KNF intervention

KNF has set the 75% dividend payout limit…

In February, in a letter to insurance companies the KNF (Polish FSA) listed a set of requirements insurers have to meet to pay dividends and required that all insurers retain at least 25% of 2011 earnings.

According to the recommendation in order to pay a dividend an insurer needs to meet all of the following criteria:

- Solvency ratio above 160% for life insurers and above 200% for P&C insurers (as of end of 2011);
- BION assessment not worse than 2.5;
- Solvency ratio in the recent stress tests of above 110%;
- No capital shortfalls at any time in 2011.

The regulator did not indicate if the limit on the payout ratio related to standalone or consolidated net profit. PZU met all the criteria and the management board on 14 March decided to recommend a dividend payout of Zl 1.75bn (DPS Zl 20.3), which constitutes 75% of PZU's consolidated 2011 net profit. At the company's AGM which took place on 30 May, the state treasury voted for a DPS of Zl 22.43 (higher than management's recommendation and equal to 75% of stand-alone profit).

…only for distribution of 2011 earnings

According to PZU, its conversations with the regulator suggest that the recommendation relates only to 2011 profits and in coming years insurers with sufficient capital base will be allowed to distribute all profits to shareholders. However, the regulator did not clarify whether the recommendation relates only to 2011 profits or also to future earnings.

In our models we assume PZU's maintains a payout ratio close to 100%, but we see a risk that if the financial crisis in Europe significantly worsens the Polish regulator may recommend all Polish financial companies to retain all profits and not allow any capital to flow out from the country.

Limited M&A Risk

From International Expansion of PZU to "PZU International"

Assuming no further intervention of the regulator, the only other major risk to the dividend are potential acquisitions.

M&A plans still intact…

M&A was part of the PZU 2009-2011 strategy (the group intended to start acquisitions and in the longer term to increase the share of foreign subsidiaries in total revenues to 15%). Despite no success in that area, PZU continues to look for attractive M&A targets and foreign expansion remains part of the 2012-2014 strategy (presented in March 2012).

…viaPZU International, a planned joint-venture with a private equity fund and an international financial institution…

PZU plans to grow its international business under a new formula through cooperation with a financial investor and the establishment of an investment vehicle "PZU International", whose goal will be to identify acquisition targets and manage PZU's foreign operations so as to grow their value. The plan is that PZU International will be a joint-venture of:

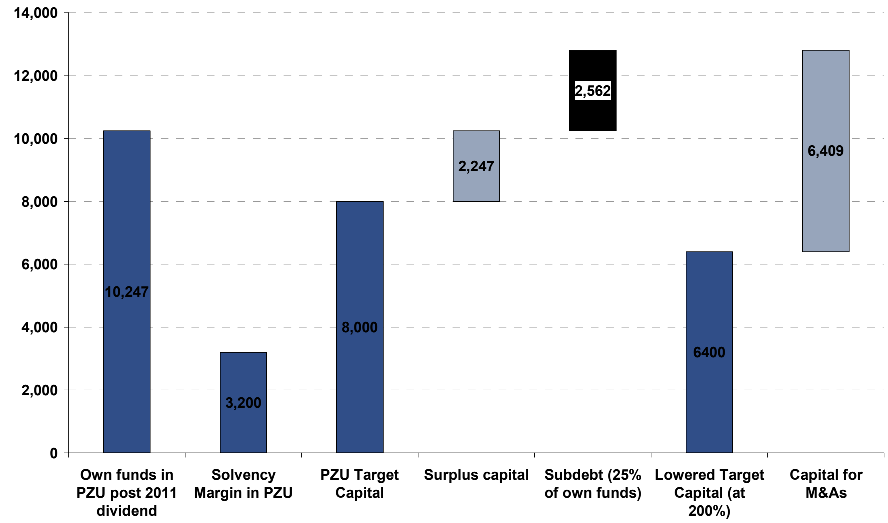
- PZU, which will remain a majority shareholder (providing the insurance expertise and status of the industry investor),
- A leading private equity fund (providing know-how in M&A, restructuring and preparing for the listing); and
- An international financial institution, e.g. EBRD (thanks to its status as a public institution, facilitating investment process in countries with material political risks).

…managed by hired external managers paid depending on the success of the company's IPO

PZU plans to not manage PZU International directly: representatives of its management board will be on the company's supervisory board but it will be managed by hired managers, whose remuneration will include a success fee, based on its increase in value, measured by PZU International's market capitalisation post its planned IPO on the Warsaw Stock Exchange.

According to PZU's 4Q11 presentation, the company is able to commit between Zl 6-7bn in capital to the joint-venture, implying that PZU International, funded broadly fifty-fifty by PZU and its partners (the private equity fund and the international financial institution), may have c Zl 13bn to spend on acquisitions.

Figure 12. PZU – Capital for M&As, 2012 (Polish Zloty in million)



Source: Company reports, Citi Investment Research and Analysis estimates

Former Monopolies – Business Risks For Buyers, Political Risks For Sellers

Croatia Osiguranje may be a potential target for PZU International…

In March 2012 there was speculation (Bloomberg) that PZU may bid to buy Croatia Osiguranje, Croatia's largest insurance company with c 40% market share of the Croatia Life and Non-life market. PZU hasn't commented regarding this company, but generally expressed an interest in the purchase of the former insurance monopolies in Eastern or Southern Europe and hasn't ruled out an acquisition in the Balkans. The only condition is that the former monopoly is fully privatised, i.e. the local government is ready to resign control of the insurer.

According to an interview to Globus daily given by the Finance Ministry, the Croatia state is apparently looking to sell a 54% stake in Croatia Osiguranje. Last year the company had earned premiums of Zl 1,547m (9% of PZU's), profits of Zl 62m (3% of PZU), assets of Zl 4,949 (9%) and equity of Zl 1,110m (9%). The insurer generated a ROE of 5.8% in 2011. Assuming a transaction price of 1-1.5x trailing book (based on market valuation of European insurers) for 54%, a sale price could be in the range of Zl 600-900m. From Croatia Osiguranje's accounts we calculate that the insurer had a loss ratio of 66% and a cost ratio of 46% (combined ratio of 113%). As such it is much less efficient than PZU which in 2011 had a comparable loss ratio of 69% but a much lower cost ratio of 22%. Due to the smaller size of the country, we see little chance that Croatia Osiguranje achieves the same cost efficiency as PZU, but the restructuring potential seems significant. The potential acquisition of another insurer in the region and centralisation of some back-office functions may lead to higher efficiency but requires the coexistence of the same political will (to fully privatise the state-controlled insurer) in a few neighboring states.

…but due to the small size of the company an acquisition would not impact PZU dividend

We note that given PZU's surplus capital of Zl 4bn, we believe any potential deal would have no impact on the company's ability to pay dividends close to 100% of earnings.

CEE Insurance Business of ING: Attractive But Most Probably Not For Sale On Their Own

ING's Insurance business in CEE looks attractive…

PZU representatives have indicated that ING's insurance business in Central and Eastern Europe could also be an interesting acquisition target, given ING's strong position in individual life insurance in Polandand a few other countries in the region. Indeed, it is nearly a perfect match given PZU's weak position in individual life.

…but may be difficult to buy on their own

The acquisition of ING's CEE insurance unit would look attractive, but in our opinion it is unlikely, mainly due to three obstacles:

- First, ING is divesting its insurance businesses globally not of its own will but at the behest of the European Commission (EC). After the sale of its Latin America insurance operation (completed in 2011) and the potential sale of its Asian insurance business (expected in 2012) it may try to avoid further asset shedding. In 2011 ING asked the European General Court to revoke some of the terms imposed by the EC which it called "disproportionate" to other European banks which received state aid. Moreover, ING has not commented on any potential separate sale of the Central and Eastern Europe insurance business.
- Secondly, PZU has stated it is not interested in the whole European insurance business and it remains questionable whether the buyers will have a chance to acquire a part of the regional division. The pending sale of the Asian unit may be a good indicator of ING's selling strategy as, according to The Wall Street Journal and Reuters, some bidders are interested only in parts of Asian insurance operation (the asset management business is sold separately).
- Lastly, due to its strong franchise ING's CEE business may attract interest from many buyers (as its recent divestments did). It should also be taken into account that one of the options explored by ING regarding disposal of the insurance business is an IPO of that business, so sale to a strategic investor isn't the only possibility.

Figure 13. ING – P&L of "Insurance Central and Rest of Europe" Segment (CRE), 2010-2011(Euro in million)

	2010	2011
Gross premium income	2,115	2,154
Commission income	147	135
Total investment and other income	348	-31
Total underlying income	**2,611**	**2,258**
Reinsurance and retrocession premiums	51	52
Net benefits Life insurance for risk company and Non-Life claims incurred	1,568	1,749
Changes in Life insurance provisions for risk company	247	132
Result sharing and rebates	26	5
Change in deferred acquisition costs	-4	-5
Other underwriting expenditure (incl. change in provision unearned premiums)	194	205
Underwriting expenditure	2,082	2,138
Operating expenses	271	317
Interest expenses	0	1
Other	4	0
Total underlying expenditure	**2,357**	**2,456**
Underlying result before tax	**254**	**-198**
Taxation	63	20
Minority interests	10	10
Underlying net result	**180**	**-229**
Net gains/losses on divestments	-5	-
Net results from divested units	1	-
Net result from discontinued operations	-	-
Special items after tax	-46	-77
Net result	**130**	**-306**
New business figures		
Single premiums	715	837
Annual premiums	280	272
New sales (APE)	352	356
Other key figures		
Employees (FTEs, end of period)	3,678	3,672

Source: Company reports

Figure 14. ING – Margin Analysis of "Insurance Central and Rest of Europe" (CRE) Segment, 2010-2011(Euro in million)

	2010	2011
Margin analysis		
Investment margin	77	76
Fees and premium based revenues	501	458
Technical margin	149	169
Income non-modelled life business	16	9
Life operating income	744	712
Administrative expenses	262	308
DAC amortisation and trail commissions	197	202
Life expenses	459	510
Life operating result	285	201
Non-life operating result	7	5
Operating result	292	206
Gains/losses and impairments	-29	-404
Revaluations	-	-1
Market & other impacts	-10	-
Underlying result before tax	254	-198
Key figures		
Gross premium income	2,115	2,154
Administrative expenses / operating income (Life & ING IM)	35.2%	43.3%
Life general account assets (end of period, in EUR billion)	8	7
Net production Client balances (in EUR billion)	1.9	-0.9
Client balances (end of period, in EUR billion)	28.6	25.0
Administrative expenses (total)	266	313

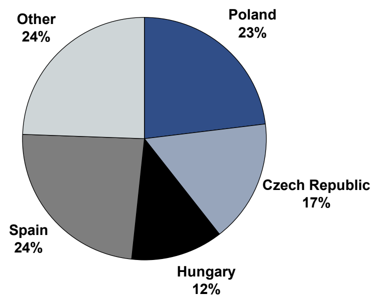
Source: Company reports

Figure 15. ING – Insurance Premium and Pre-Tax Profit by Countries, 2010-2011 (Euro in million)

	Gross written premiums by country				Underlying result before tax by country			
	2010	2011	Structure	yoy growth	2010	2011	Structure	yoy growth
Netherlands	5,871	5,911	37%	1%	773	890	79%	15%
Belgium / Luxembourg	1,306	1,077	7%	-17%	2	-151	-13%	NA
Insurance Benelux	**7,177**	**6,988**	**44%**	**-3%**	**775**	**739**	**65%**	**-5%**
Poland	499	494	3%	-1%	139	127	11%	-9%
Czech Republic	352	356	2%	1%	48	45	4%	-7%
Hungary	274	263	2%	-4%	15	1	0%	-90%
Spain	482	512	3%	6%	10	-85	-8%	NA
Other	508	527	3%	4%	41	-287	-25%	NA
Insurance CRE	**2,115**	**2,154**	**13%**	**2%**	**254**	**-198**	**-18%**	**NA**
Japan	1,702	2,125	13%	25%	171	207	18%	21%
Malaysia	739	789	5%	7%	88	98	9%	12%
South Korea	3,142	3,034	19%	-3%	271	257	23%	-5%
Rest of Asia	924	971	6%	5%	-13	26	2%	NA
Insurance Asia/Pacific	**6,506**	**6,919**	**43%**	**6%**	**516**	**589**	**52%**	**14%**
Total	**15,798**	**16,061**	**100%**	**2%**	**1,545**	**1,129**	**100%**	**-27%**

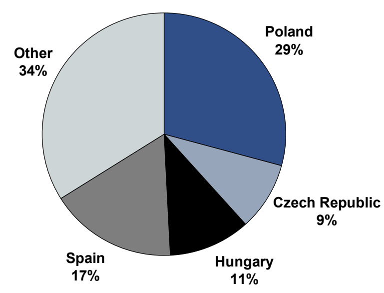
Source: Company reports

Figure 16. ING – Structure of CRE Premium by Countries, 2011 (Percentage)



Source: Company reports

Figure 17. ING – Structure of CRE New Sales by Countries, 2011 (Percentage)



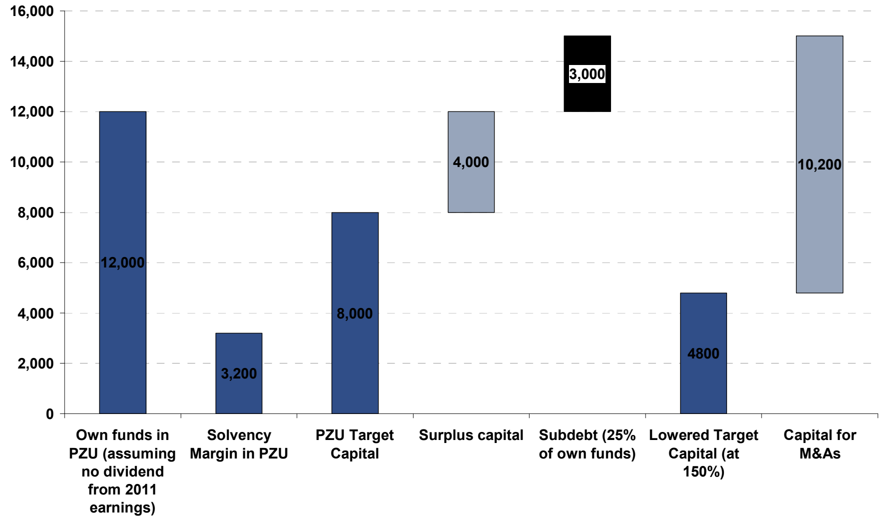
Source: Company reports

PZU may afford to buy ING's CEE insurance unit alone…

…but only if it doesn't pay dividend in one or two years

Based on the trading multiples of CEE insurers, we value the CEE part of ING's insurance business in a wide range of between Zl 6-10bn (€1.5-2.5bn), with the valuation of the Polish pension fund business being the most difficult part of the group to value. Our understanding of PZU's M&A strategy is that it would like to purchase ING's CEE insurance business by itself, without the participation of a private equity fund. We understand that PZU sees a private equity fund as a valuable partner only in case of acquisition of companies needing restructuring, like privatised ex-monopolists. The acquisition of ING's region insurance operations may require retaining one year of earnings, which would add c Zl 2bn to the currently (post 2011 dividend) available surplus capital of Zl 6.4bn. Through lowering capital coverage to 150%-200% for a short time, PZU could amass the Zl 10bn in capital that might be needed to purchase the insurance business from ING. In such a scenario, we would expect a low dividend (dividend payout materially below 50%) or no dividend in the first year after a potential acquisition (to rebuild capital to 250% of the solvency margin), but even then we would expect PZU to return to distributing a high share of profit to shareholders (dividend payout about 75%) in the following years as the ROE of the PZU group is expected to remain much higher than required to fuel growth. In other words we believe PZU's ability to pay attractive dividends is mainly based on the company's high profitability and not only on its current overcapitalisation.

Figure 18. PZU – Assessment of PZU Maximum Acquisition Ability, 2012 (Polish Zloty in million)



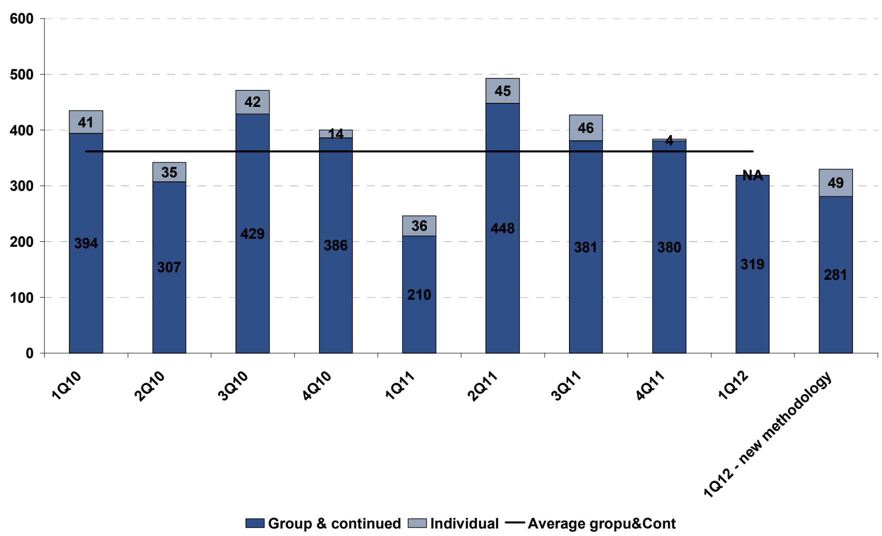
Source: Company reports, Citi Investment Research and Analysis

High Margin Maintained in Group Life

Above 20% margin in group life insurance (according to old methodology) maintained…

Group life insurance continues to be a cash cow for the company. In 1Q12 the segment's operating margin, calculated according to the old methodology, stood above 20% (20.1%) and materially improved vs. 1Q11 when it was negatively affected by a Zl 21m one-off provision on unpaid claims. The margin was lower than in 2Q11-4Q11 due to seasonality (higher loss ratio in 1Q11) and the company maintains its guidance of "above 20%" margin in the segment in coming years.

Figure 19. PZU – Operating Profit in Life Insurance, 1Q10-1Q12 (Polish Zloty in million)



Source: Company reports

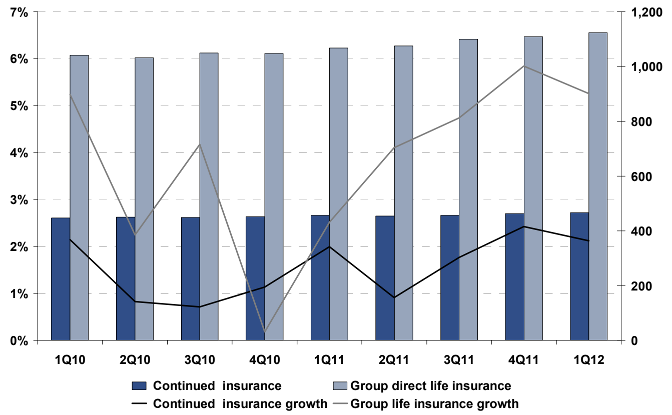
… while the margin according to new segmentation is negatively affected by reporting investment gains above benchmark in the new "investments" segment

We note that in 1Q12 PZU implemented a new segmentation of the dividsion:

- It started to report the group & continued life and individual life segments separately (vs. one general "life segment" reported previously);
- The company started also to report a new segment "Investments" and implemented a new methodology of investment gains allocation: it allocates the gains on the given segment's insurance provisions at the benchmark rate to that segment while the rest of investment result (above the benchmark rate or gain on capital above insurance provision) to the investment segment.

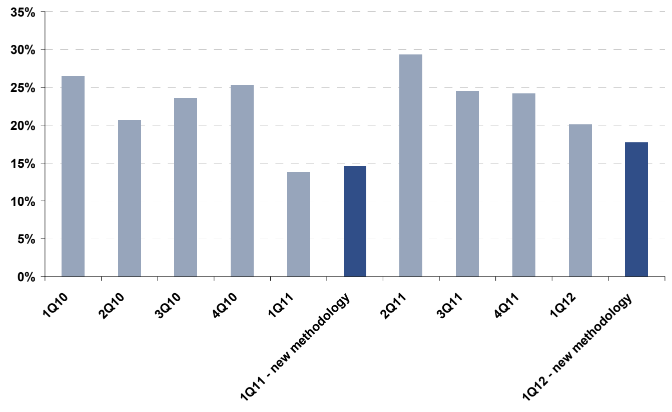
Profitability of group and continued life insurance was also supported by strong growth in gross written premium (+4.3% yoy), driven by the fourth consecutive quarter when group insurance premiums rose above the expected long-term growth rate of c4% (+5.3% in 1Q12).

Figure 20. PZU – Gross Written Premium in Group and Continued Insurance, 1Q10-1Q12 (Polish Zloty in million/Percentage)



Source: Company reports

Figure 21. PZU – Operating Margin in Life Group Insurance, 1Q10-1Q12 (Percentage)



Source: Company reports

Life premium driven by single-payment products

In 1Q12 premiums were also strong in individual life insurance. We note, however, that the growth in individual life premiums (and, to some extent, also in group products) was driven predominantly by single-payment premiums: out of a Zl 147m yoy increase in life premium, Zl 83m came from higher single premium products in the individual insurance segment and Zl 12m in the group and continued segment.

Figure 22. PZU – Life Premium, 1Q11-1Q12 ((Polish Zloty in million/Percentage)

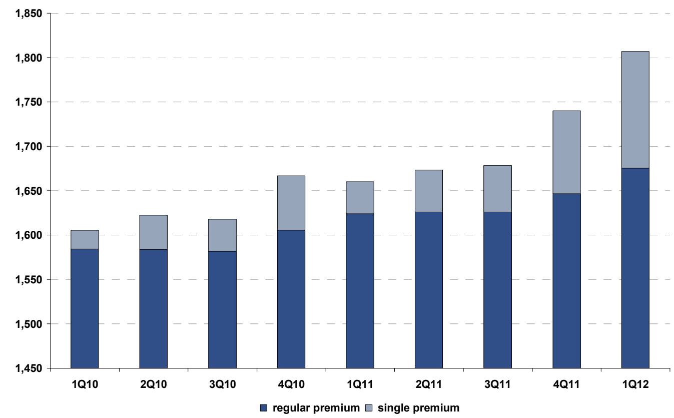
	1Q11	1Q12	yoy (Polish Zloty in million)	yoy (%)
Total life premium	**1,660**	**1,807**	**147**	**8.8%**
Group and continued	1,523	1,589	66	4.3%
regular premium	1,507	1,561	54	3.6%
single premium	16	28	12	75.6%
Individual	137	218	81	59.2%
regular premium	117	115	-2	-1.7%
single premium	20	103	83	417.3%

Source: Company reports

Figure 23. PZU – Life Individual Premium, 1Q10-1Q12 (Polish Zloty in million)

Source: Company reports

Figure 24. PZU – Breakdown of Life Premium, 1Q10-1Q12 (Polish Zloty in million)



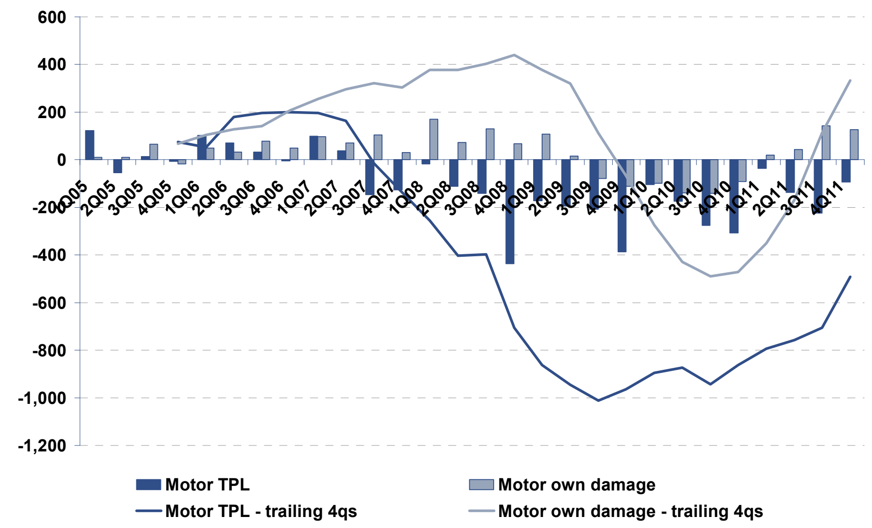
Source: Company reports

Best-in-Class Profitability in Motor Insurance

Market Trends

Lower Price Hikes

Figure 25. Polish Insurers – Technical Result in Motor Insurance, 1Q05-4Q11 (Polish Zloty in million)



Source: KNF

Cyclical re-pricing positively impacts profitability in motor insurance…

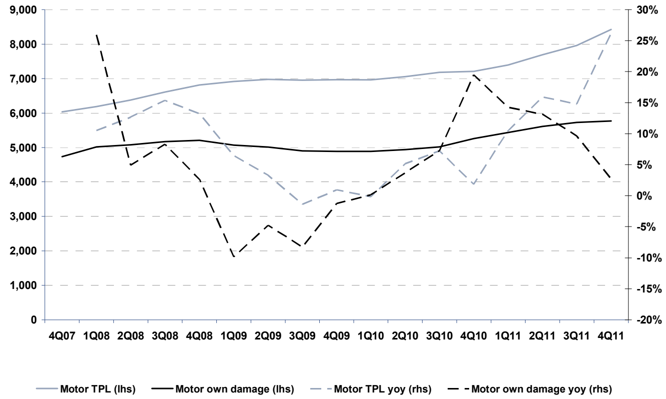
Profitability of motor insurance is driven by cyclicality. Intense competition in Poland among insurers in 2007-2010 caused flat gross written premium (GWP) in motor third party insurance (TPL) despite rising claims, while own-damage GWP even declined. In 2010 Polish insurers, heavily hit by claims related to floods, started to increase the price of motor insurance (both third-partly liability and own damage) and in 2011 the average premiums in motor TPL and own-damage insurance were 12% and 16% higher than in 2010, respectively. In TPL products the highest growth

was in policies for companies (+21% yoy in 2011 vs. +8% for private individuals), while in own-damage it was in retail products (+18% yoy vs. +6% yoy in the corporate segment).

…but the pace of price growth has decelerated

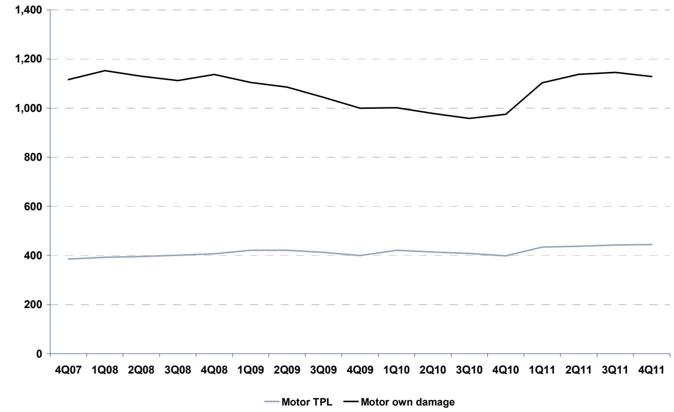
We note, however, that dynamics materially decelerated in 4Q11: the annual growth in average own-damage premiums declined to 16% from 20% in 3Q11, driven by cheaper policies for corporate clients; on a quarterly basis own-damage premiums declined 1% qoq while TPL was flat.

Figure 26. Polish Insurers – Trailing 4Qs Motor Gross Written Premium, 4Q07-4Q11 (Polish Zloty in million/Percentage)



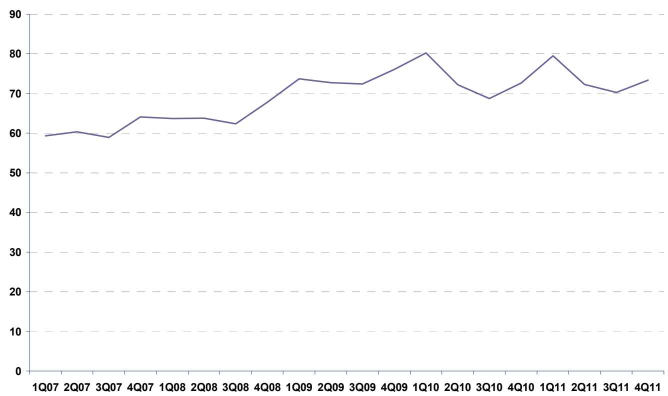
Source: KNF

Figure 27. Polish Insurers – Estimated Average Price of Motor Policy, 4Q07-4Q11 (Polish Zloty/Percentage)



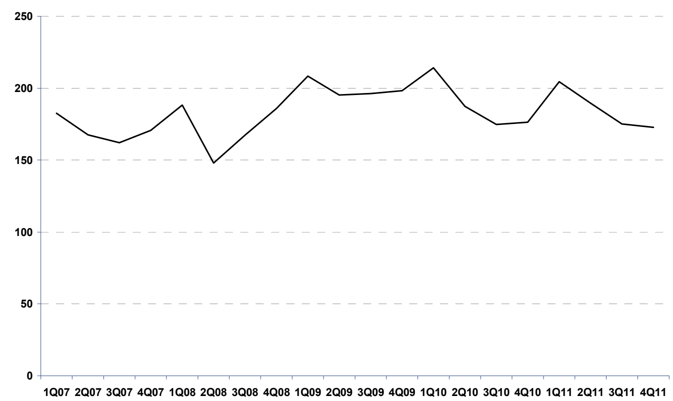
Source: KNF, Citi Investment Research and Analysis

Figure 28. Polish Insurers – Trailing 4Qs Motor TPL Claim Per Contract, 4Q07-4Q11 (Polish Zloty)



Source: KNF

Figure 29. Polish Insurers – Trailing 4Qs Motor Own Damage Claim Per Contract, 4Q07-4Q11 (Polish Zloty)



Source: KNF

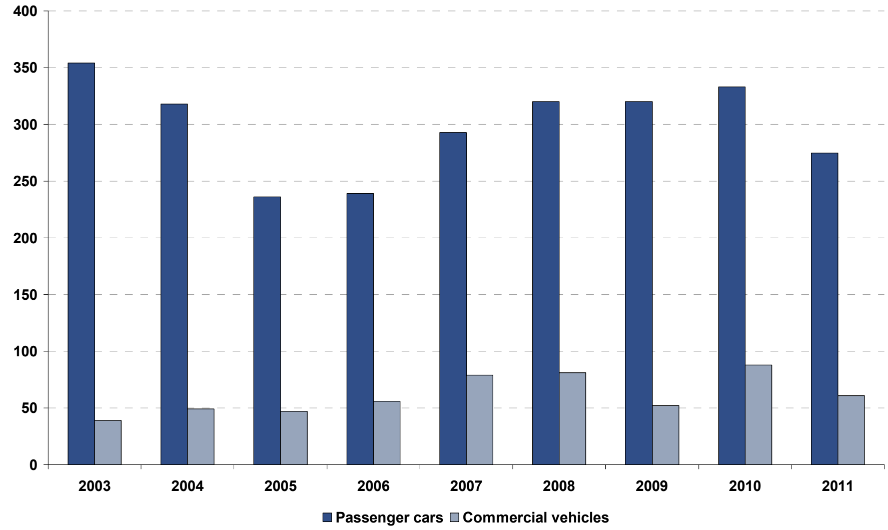
Lower Number of Policies in Motor Own Damage

Motor own-damage market shrinking…

In 2011 the motor own-damage insurance market rose in terms of the value of gross written premiums (+3% yoy), but shrank in terms of number of policies (-5% yoy). It suggests that in reaction to the increased prices, some clients decided to stop motor own-damage insurance coverage. Another factor that may have affected the number of own-damage policies was the decline in the sale of new cars in Poland (new cars are more frequently insured then old ones).

…negatively affected by lower new car sales…

Figure 30. Poland – Sale of New Cars, 2003-2011 (Thousands)



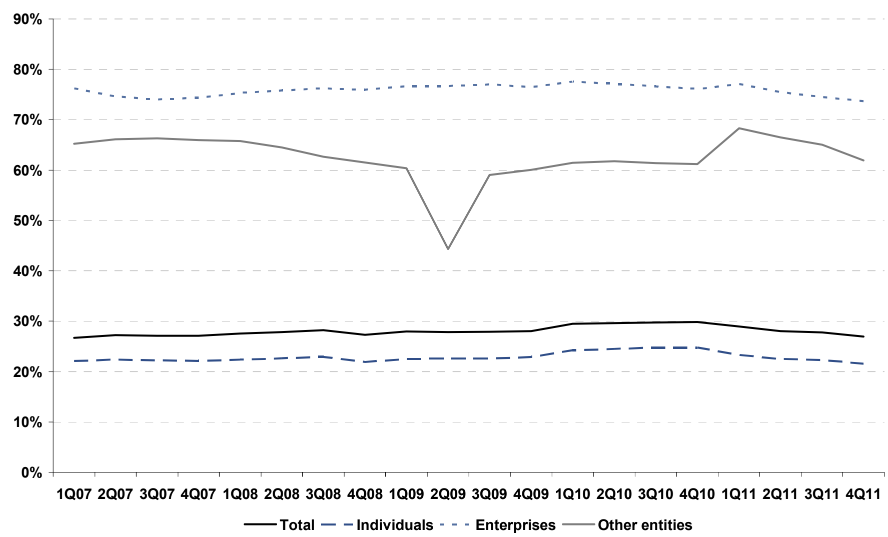
Source: Samar

…but should rebound in longer term

In the longer term there is significant growth potential in own-damage insurance as currently penetration is low: as of end-2011 only 22% of private individual car owners (more precisely: of persons possessing obligatory motor TPL insurance) have acquired motor own-damage products. We note that in 2010 the penetration ratio was 25%, so just a return to the 2010 penetration level would imply 10% upside.

…due to low currently penetration

Figure 31. Polish Insurers – Motor Own Damage Penetration (as % of Motor TPL contracts), 1Q07-4Q11 (Percentage)



Source: KNF

Higher Claims Costs

Higher average TPL claim, rising frequency in own damage

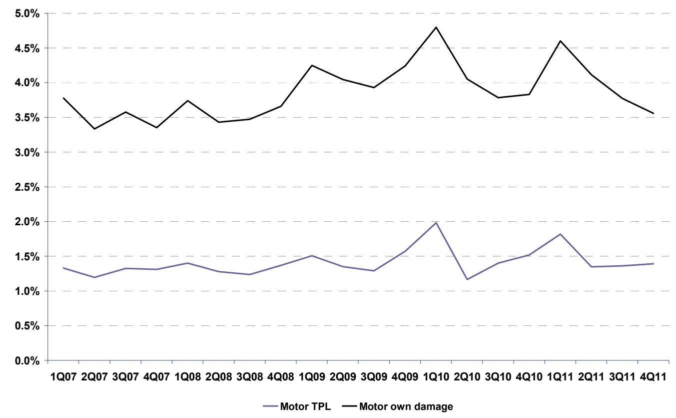
The increasing claims costs in motor TPL insurance were driven mostly by rising average claim values while claim frequency, fluctuating quarter on quarter,

remained broadly stable in the longer term. In own-damage products the main factor affecting the growth in claims was claim frequency.

Figure 32. Polish Insurers – Average Motor Claim, 1Q07-4Q11 (Polish Zloty)

Source: KNF

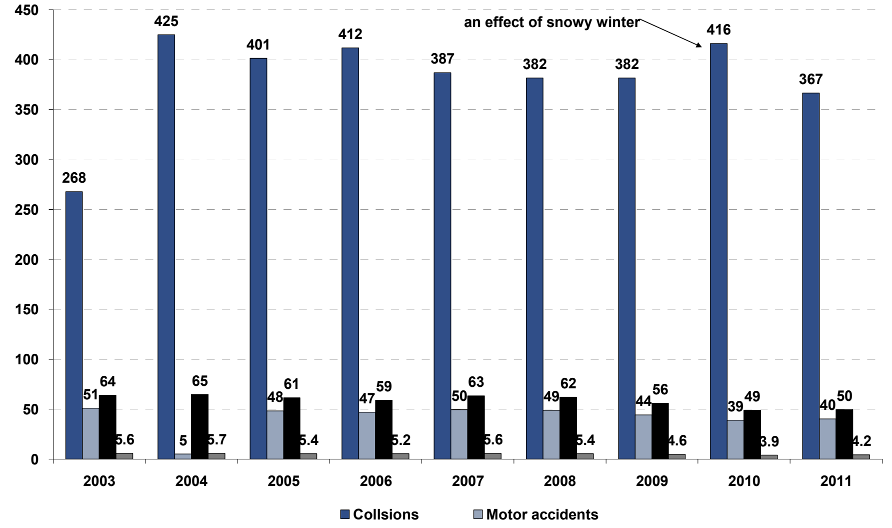
Figure 33. Polish Insurers –Motor Claim Frequency, 1Q07-4Q11 (Percentage)



Source: KNF

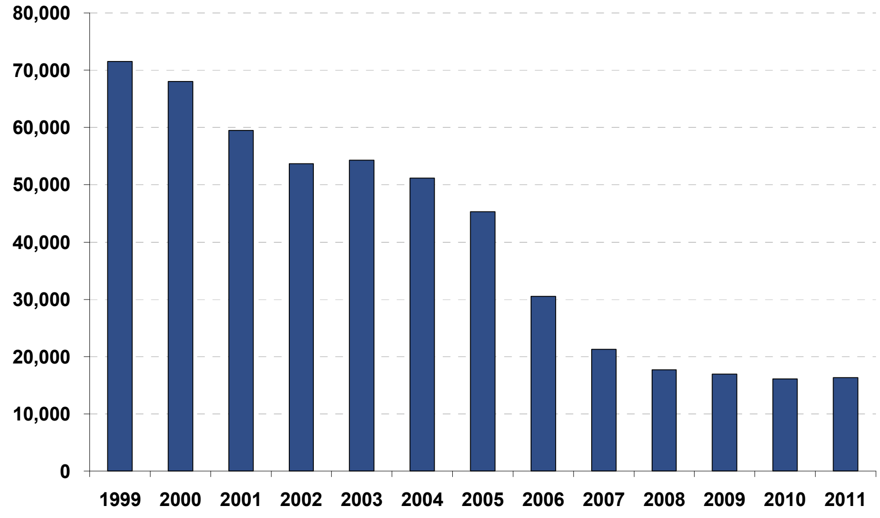
Claims in both TPL and own-damage were positively affected by a declining number of car accidents, while frequency in own-damage was also positively impacted by a significant drop in the number of vehicle thefts. Declining trends in number of car accidents' and vehicle thefts lead to lower frequency (but this may be offset by rising frequency of small cases and the ratio of reported losses to vehicle collisions rose from 2.1 in 2007 to 2.6 in 2010 in motor TPL and to 2.0 from 1.5, respectively, in own damage) and lower average claims (due to lower share of the relatively high claims paid in the case of vehicle theft or car accidents).

Figure 34. Poland – Number of Collisions, Motor Accidents, Injured and Died Persons



Source: KGP

Figure 35. Poland – Number of Car Thefts, 1999-2011



Source: KGP

Longer Term Claims Will Rise

In the medium-term we expect further growth in average claim driven by the recent ruling of the Supreme Court and the continued trend of rising compensation paid for personal injuries.

Car Rent Costs

The Supreme Court ruling on the substitute car…

In November 2011 the Supreme Court decided that the victims of car accidents are entitled to compensation for the cost of renting a car in the period when their car was repaired. The court ruled that the right to compensation doesn't depend on the victim's activity (previously insurers used to accept such demands when the victim used the car for business activity) or on the access to other means of transport (insurers used to refuse compensation when the victim could go to work by public transportation). On the other hand, according to the Supreme Court, the victim has no right to demand from the insurer an advance payment to cover the planned costs of car rental, nor to demand compensation for the impact to their quality of life for the period when public transportation was used instead of a car.

…will moderately affect insurers costs

In our opinion the negative impact on claim costs will be as large as presented by insurers because not all victims will be willing to spend in advance on car rental without the guarantee that the insurer will refund the costs (on the other hand, car rental companies may try to acquire clients offering injured persons car rental without any prepayment). According to our estimates (based on the assumption that 40% of victims of car accidents will rent a car for 7 days) we estimate the total cost for the industry at Zl 250m (including VAT), about 5% of total TPL liability claims.

Usage of New Spare Parts

The impact of the decision on usage of new spare parts may costs insurers Zl 600-1,000m

In the another ruling, the Supreme Court stated that in the calculation of compensation for owners of cars destroyed in motor accidents, the value of new parts should be used (insurers used to apply a discount to take into account wear and tear). According to estimates presented by the Insurers Ombudsman, due to not covering the full value of the new parts, insurers saved Zl 600-1,000m annually.

Long Term Growth in Personal Injury Compensation

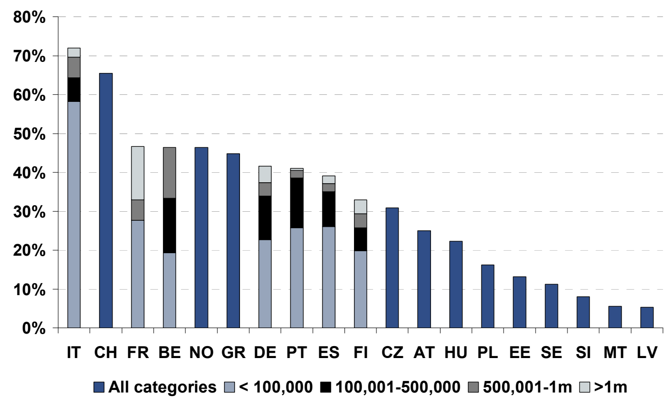
Personal injury compensation will rise due to low base…

… and rising awareness of injured…

…stimulated by rising number of legal offices specialised in compensations for injured in motor accidents

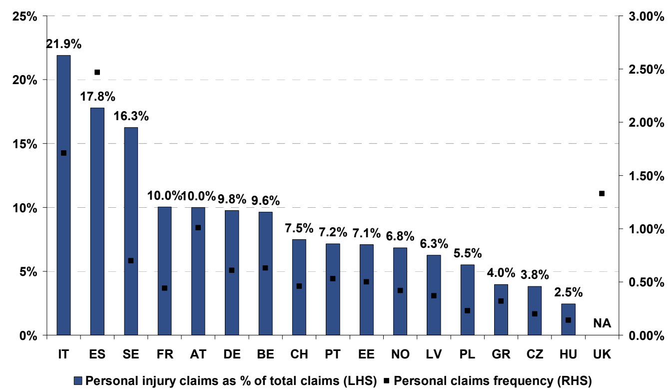
In Poland personal injury claims are still a relatively small part of total claims (16% in 2006 vs. European average 32%), mainly due to low average value of personal injury claim (€3,148 vs. €14,365 in the Czech Republic or €14,914 in Hungary) but also due to lower frequency of personal injury claims. We expect that rising awareness amongst injured parties that they are entitled to compensation covering not only the cost of medical treatment and lost income but also compensation for pain will lead to rising frequency and a rising average value of personal injury claims. The process will likely be stimulated by the growth of legal offices (e.g. listed Votum and Europejskie Centrum Odszkodowan) offering its services to people injured in the motor accidents.

Figure 36. European Insurers – Personal Injury Claims Expenditure as Percentage of Total Claims Expenditure, 2006 (Percentage)



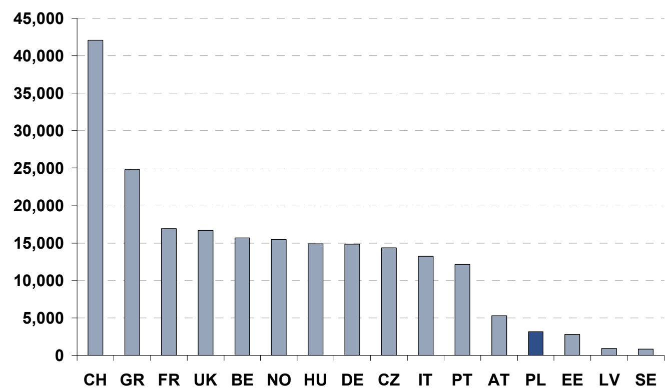
Source: CEA

Figure 37. European Insurers – Personal Injury Claims Frequency, 2006 (Percentage)



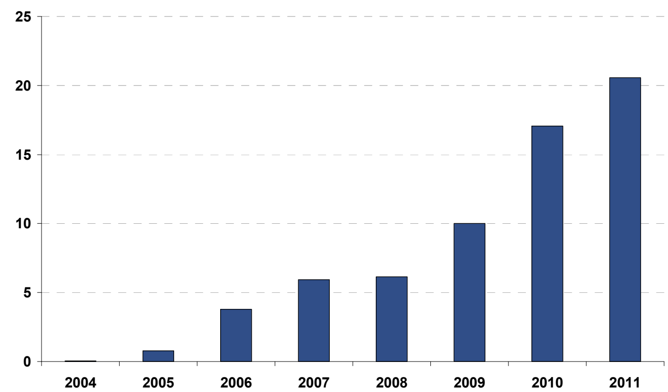
Source: CEA

Figure 38. European Insurers – Average Cost of Personal Injury Claims, 2006 (Euro)



Source: CEA

Figure 39. Votum – Registered Claims, 2004-2011 (in Thiusand)



Source: CEA

We Expect The Next Phase of Re-Pricing and Cost Savings

Insurers speak about rising prices…

In reaction to the court decisions, insurers declared that they would increase prices of motor insurance (e.g. according to Witold Jaworski, the member of PZU management responsible for individual clients, cited by Parkiet daily, the Supreme Court ruling may lead to up to a 20% increase in the price of motor TPL insurance).

In May 2012 Andrzej Jarczyk, CEO of Uniqa's Polish unit, indicated that a 20% increase in price of motor TPL could be accepted by clients as it would mean an increase of just Zl 100 annually.

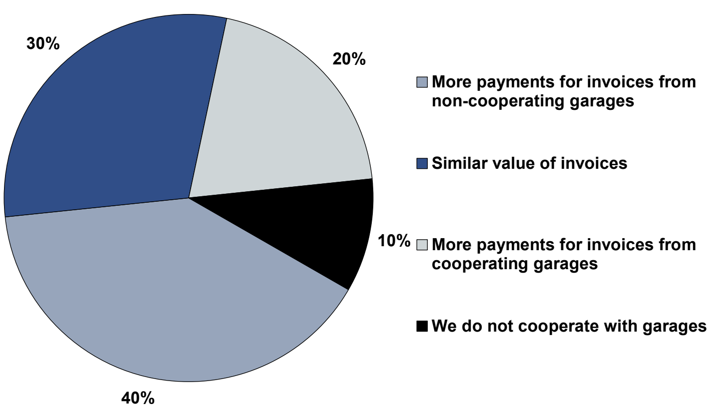
…and are looking for savings…

Simultaneously to looking for opportunities to increase prices, insurers are also seeking cost savings. According to the Deloitte survey "Trends and priorities in motor insurance claims in Poland", increasing personal claim costs will be the main challenge for insurers in the next three years. Rising claim costs put pressure on insurers to increase their effectiveness. In the own opinion of insurance companies' managers, insurers are much better at introducing new products then at cost management.

…e.g. through improving cooperation with garages

One of the potential ways to lower costs is to improve cooperation with garages. The trends that can be observed in UK, Germany and US indicate that active management of cooperation with garages can contribute to higher efficiency and improved quality of customer service. The current practice regarding cooperation between insurance companies and garages on the Polish market are varied: there are examples of a complete lack of cooperation as well as instances when every customer is referred to a cooperating garage. An optimal model of cooperation between an insurance company and a garage is beneficial to both parties: a garage receives more referrals for repairs from the insurer, and in return the insurer achieves more competitive hourly rates for labour and discounts on spare parts. Another interesting aspect of partnering with garages is cooperation on the trade in spare parts, potentially leading to negotiating higher discounts on spare parts by insurers (being de facto the biggest buyers of spare parts).

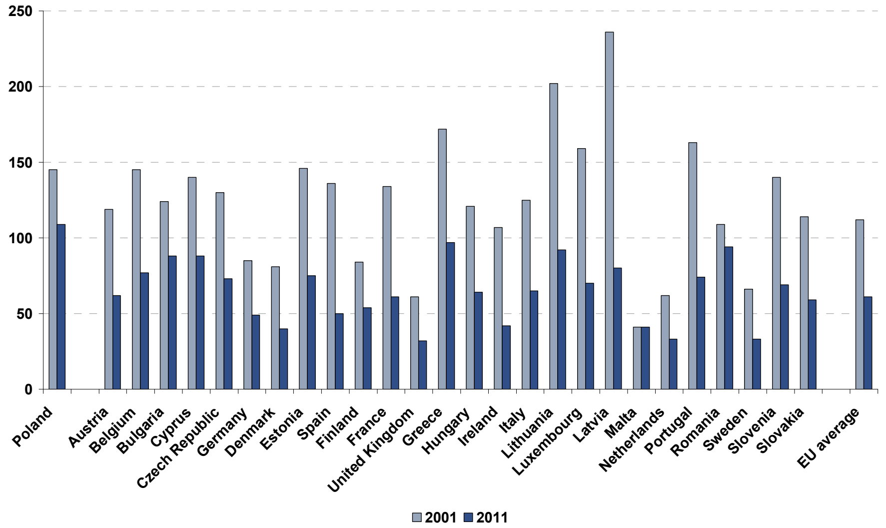
Figure 40. Polish Insurers – Survey on Expected Trends in Cooperation with Garages, 2012



Source: Deloitte

In the longer term insurers should also benefit from a further reduction in the number of motor accidents and declining number of deaths as, despite the material decline in mortality, Poland still has one of the highest number of deaths in motor accidents per 1 million inhabitants in Europe (in fact, in 2011 Poland had the highest mortality ratio in EU).

Figure 41. EU – Died in Motor Accidents Per 1 million Inhabitants, 2001 and 2011



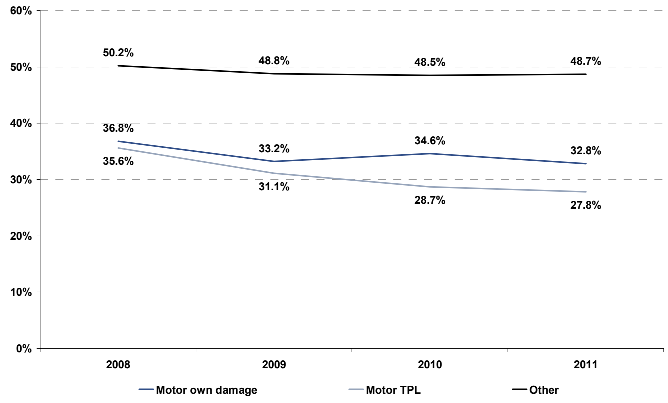
Source: EC

PZU Leads in Term of Market Share and Profitability

PZU leads the market…

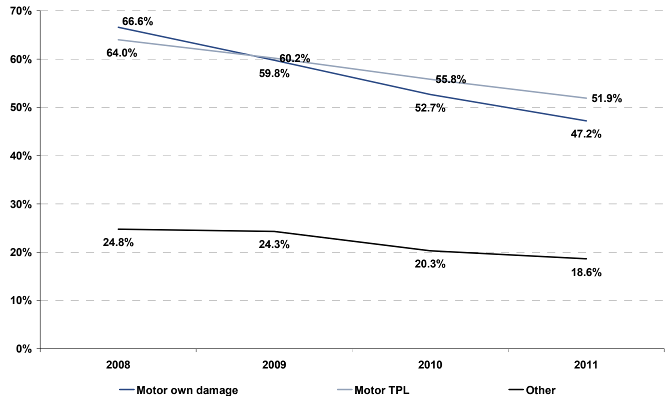
PZU is the biggest player in the motor insurance market (both in TPL and own-damage segments, and in corporate and retail parts). High scale leads to superior position in terms of profitability, as shown by a comparison of PZU's operating profit on motor insurance with that of the market (in many quarters PZU's result was better than the aggregate result of the whole industry).

Figure 42. PZU – Market Share in Retail Insurance, 2008-2011 (Percentage)



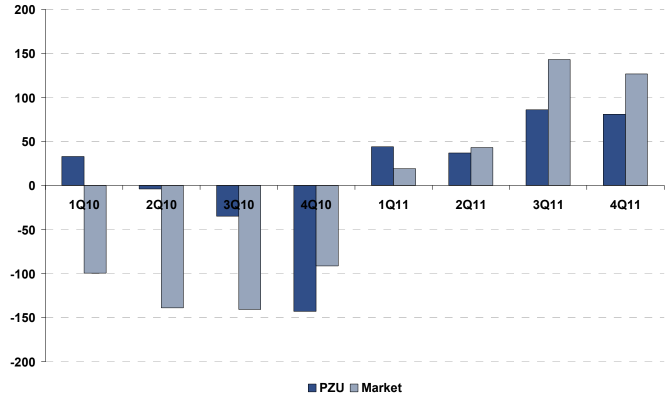
Source: Company reports

Figure 43. PZU – Market Share in Corporate Insurance, 2008-2011 (Percentage)



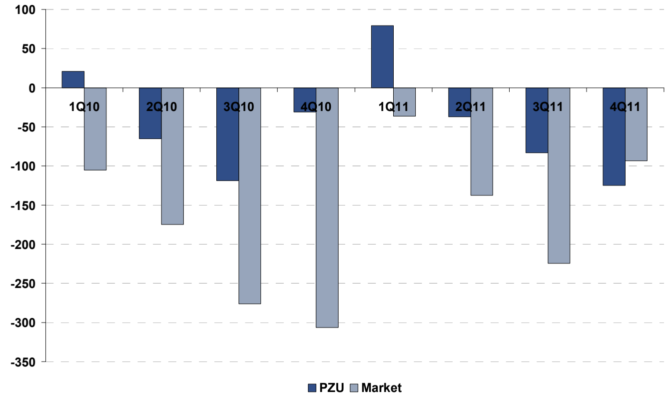
Source: Company reports

Figure 44. PZU – Operating Result in Motor Own Damage Insurance vs. Market, 1Q10-4Q11 (Polish Zloty in million)



Source: KNF, Company reports

Figure 45. PZU – Operating Result in Motor TPL Insurance vs. Market, 1Q10-4Q11 (Polish Zloty in million)

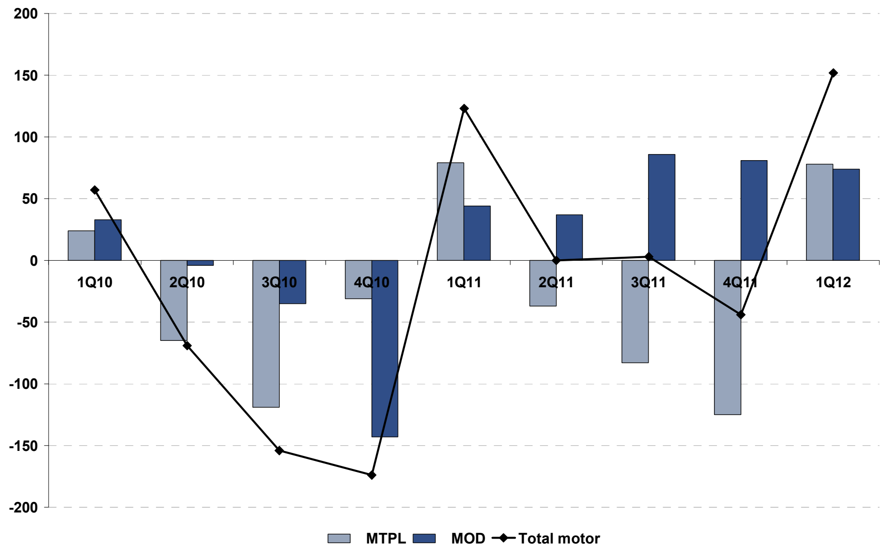


Source: KNF, Company reports

…and continuously improves profitability

Assessing the profitability of PZU's motor insurance is difficult due to seasonality (highest profitability is in 1Q then declining in subsequent quarters), but comparing 1Q12 vs. 1Q11 we find that operating profit in motor third-party liability insurance was broadly flat (-2% yoy), but profit in motor own-damage insurance improved materially (+67% yoy). In percentage terms the highest growth was in motor corporate insurance (operating profit up by 67% yoy vs. 16% yoy in mass market motor insurance), but in nominal terms mass market was much more (Zl +21m vs. +8m).

Figure 46. PZU – Operating Profit in Motor Insurance, 1Q10-1Q12 (Polish Zloty in million)



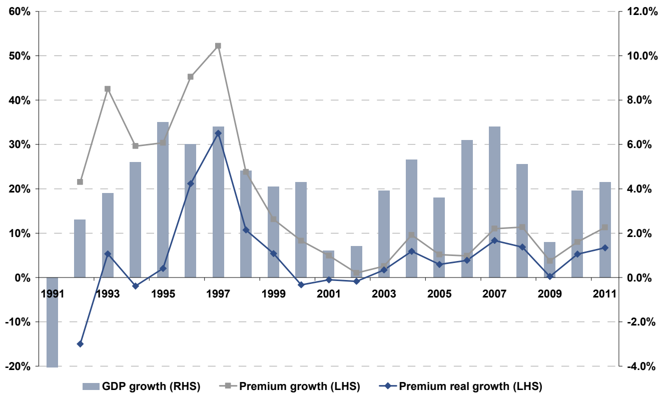
Source: PZU

Lack of Other Drivers

Economy Doesn't Help

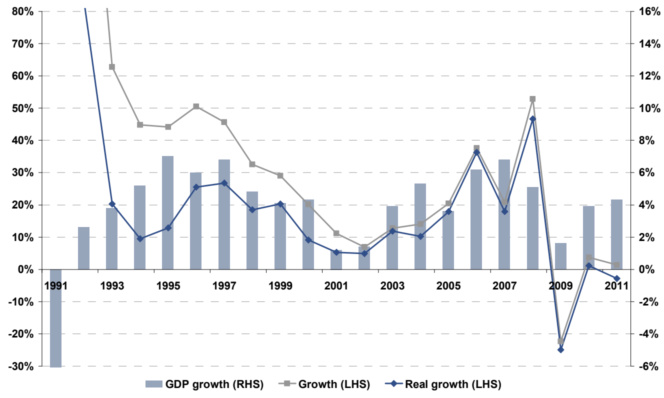
Unsurprisingly, the growth in gross written premiums is correlated with GDP dynamics. Given that observation, the slowdown in the economy (Citi economists forecast 2.7% and 2.4% GDP growth in 2012 and 2013, respectively vs. 4.3% in 2011 and 3.9% in 2010) doesn't bode well for market growth in the coming years. We expect lower growth in gross written premium, especially in life insurance, and rising claim ratio (as in a tougher macro environment more clients report losses).

Figure 47. Polish Insurers – P&C Gross Written Premium vs. GDP Growth, 1991-2011 (Percentage)



Source: KNF, GUS

Figure 48. Polish Insurers – Life Gross Written Premium vs. GDP Growth, 1991-2011 (Percentage)



Source: KNF, GUS

Long-term Potential in Non-Motor P&C Insurance

Market Overview

Six product lines score well on size, growth and profitability

We have looked at the market statistics of gross written premium and operating profit and have found that, excluding products with insignificant premium (defined as products with lower than 1% share in total gross written premium), there were four products that combined profitability (positive operating profit in 2011) and high (i.e. higher than total sector) growth. They were:

- Fire and other natural forces insurance;
- Accident insurance;
- Insurance of various financial risks; and
- Credit insurance.

We also view property and general liability insurance as attractive (they are not on our list as they were not profitable in 2011, but we note that these product lines were profitable in 2010).

Figure 49. Polish P&C Insurers – Summary of Growth and Profitability in Products, 2005-2011 (Polish Zloty in million/Percentage)

	GWP							Structure	CAGR (2005-2010)	Profitability
	2005	2006	2007	2008	2009	2010	2011			
Total	**15,337**	**16,058**	**17,543**	**19,854**	**20,616**	**22,237**	**24,812**	**100%**	**8%**	**2%**
Motor TPL	5,519	5,773	6,153	7,010	7,135	7,535	8,599	34%	8%	-6%
Motor own damage	4,364	4,224	4,704	5,207	4,888	5,250	5,768	24%	5%	6%
Fire and natural forces insurance	**1,685**	**1,744**	**1,732**	**1,887**	**2,174**	**2,397**	**2,826**	**11%**	**9%**	**5%**
Other damage or loss property	1,081	1,147	1,234	1,437	1,544	1,761	1,990	8%	11%	0%
General liability	707	821	864	973	1,113	1,250	1,440	6%	13%	-4%
Accident insurance	**740**	**815**	**949**	**1,232**	**1,212**	**1,267**	**1,245**	**6%**	**9%**	**26%**
Insurance of various financial risks	**243**	**295**	**440**	**544**	**867**	**788**	**771**	**4%**	**21%**	**6%**
Credit insurance	**315**	**445**	**567**	**492**	**460**	**465**	**545**	**2%**	**10%**	**12%**
Sickness insurance	149	168	197	294	276	344	436	2%	20%	-5%
Assistance	95	157	183	210	287	346	406	2%	27%	-12%
Suretyship	136	150	183	215	277	318	303	1%	14%	25%
Insurance of legal protection	12	17	35	74	97	240	170	1%	56%	8%
Goods-in-transit insurance	123	120	112	112	92	96	107	0%	-2%	6%
Insurance of vessels	103	117	127	101	106	89	96	0%	-1%	-3%
Casco insurance of railway rolling stock	6	7	10	12	17	16	34	0%	32%	25%
Casco insurance of aircraft	14	15	13	17	20	32	30	0%	13%	28%
Aircraft liability	29	24	21	21	24	24	26	0%	-2%	-9%
Marine liability	17	17	18	15	26	19	20	0%	2%	-1%

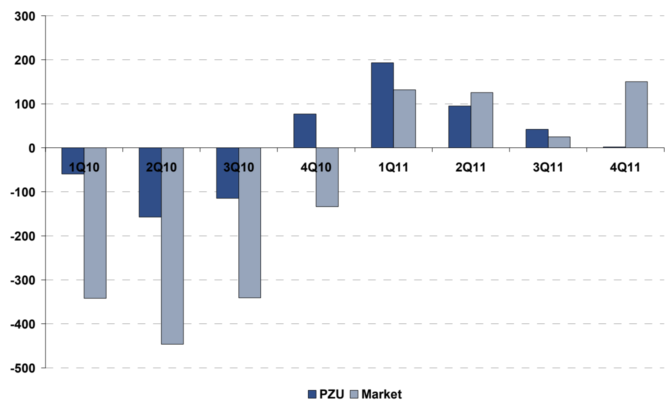
Source: KNF, Citi Investment Research and Analysis

Company Position

PZU is strong in non-motor P&C products but not so dominant as in motor insurance

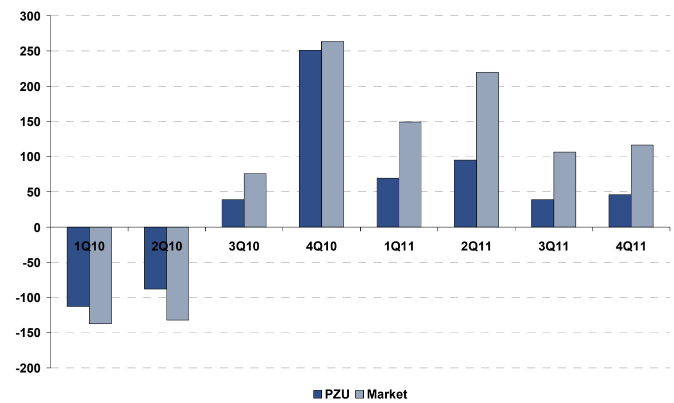
Generally, PZU's leading position in non-motor P&C insurance is not as dominant as in motor insurance. Its market share in premium is high in retail products (about 50% - see Figure 42 but low in corporate insurance (below 20% - see Fig . 43). In terms of profitability, in non-motor insurance PZU doesn't' stand out so much as in motor-insurance, where its operating profit exceeded the total industry profit in many quarters).

Figure 50. PZU – Operating Result in P&L Insurance vs. Market, 1Q10-4Q11 (Polish Zloty in million)



Source: KNF, Company reports

Figure 51. PZU – Operating Result in P&L Non-motor Insurance vs. Market, 1Q10-4Q11 (Polish Zloty in million)



Source: KNF, Company reports

PZU is strong in all prospective products except financial insurance…

Out of the six most attractive product lines, PZU has a high (above 30%) market share in four (fire, property, general liability and accident), so in all except financial insurance. While on the one hand it is reassuring that PZU is well-positioned in growth products, on the other hand limited room for a further increase in market

share suggests PZU has a low chance to grow above market – in fact in 2012 PZU lost market share in fire, property and general liability insurance.

Financial insurance (credit insurance and insurance of various financial risks) products are usually cross-sold with retail loans (both mortgage and consumer). Given the slowdown in retail lending in 2012, we expect that in coming years the growth in these products will be lower than in the previous six years, making efforts to increase market share even more difficult.

Figure 52. PZU – Market Share in P&C Premium, 2010-2011 (Polish Zloty in million/Percentage)

	PZU			Structure		Market			PZU market share	
	2010	2011	%	2010	2011	2010	2011	%	2010	2011
Accident insurance	**453**	**451**	**-1%**	**5.8%**	**5.5%**	**1,267**	**1,245**	**-2%**	**36%**	**36%**
Sickness insurance	16	13	-20%	0.2%	0.2%	344	436	27%	5%	3%
Motor own damage	2,248	2,284	2%	28.9%	27.7%	5,250	5,768	10%	43%	40%
Own damage insurance of railway rolling stock	4	9	99%	0.1%	0.1%	16	34	106%	27%	26%
Own damage insurance of aircraft	16	15	-10%	0.2%	0.2%	32	30	-5%	51%	49%
Insurance of vessels in sea and inland navigation	14	12	-11%	0.2%	0.1%	89	96	7%	16%	13%
Goods-in-transit insurance	11	9	-20%	0.1%	0.1%	96	107	12%	12%	8%
Fire and natural forces insurance	**978**	**1,042**	**7%**	**12.6%**	**12.6%**	**2,397**	**2,826**	**18%**	**41%**	**37%**
Damage or loss property	**615**	**652**	**6%**	**7.9%**	**7.9%**	**1,761**	**1,990**	**13%**	**35%**	**33%**
Motor TPL	2,596	2,890	11%	33.4%	35.0%	7,535	8,599	14%	34%	34%
Aircraft liability	7	6	-11%	0.1%	0.1%	24	26	8%	27%	22%
Marine liability	1	1	-7%	0.0%	0.0%	19	20	2%	3%	3%
General liability	**483**	**507**	**5%**	**6.2%**	**6.2%**	**1,250**	**1,440**	**15%**	**39%**	**35%**
Credit insurance	**14**	**13**	**-11%**	**0.2%**	**0.2%**	**465**	**545**	**17%**	**3%**	**2%**
Suretyship	47	43	-9%	0.6%	0.5%	318	303	-5%	15%	14%
Insurance of various financial risks	**62**	**70**	**13%**	**0.8%**	**0.9%**	**788**	**771**	**-2%**	**8%**	**9%**
Insurance of legal protection	1	1	6%	0.0%	0.0%	240	170	-29%	0%	0%
Assistance	176	191	8%	2.3%	2.3%	346	406	17%	51%	47%
Total direct	**7,741**	**8,208**	**6%**	**99.5%**	**99.5%**	**22,237**	**24,812**	**12%**	**35%**	**33%**

Source: KNF, Company reports

… and more profitable than peers in all lines except property insurance

In terms of profitability PZU outperforms the market in all prospective product lines except property. We note that technical profit on accident and fire insurance amounted for 96% of the company's total technical result (vs. 75% for motor own damage and -50% for motor TPL).

Figure 53. PZU – Technical Profit vs. Market, 2010-2011 (Polish Zloty in million/Percentage)

	PZU			Structure	Market			2011 Margin	
	2010	2011	%	2011	2010	2011	%	PZU	Market
Accident insurance	**112**	**127**	**13%**	**38.1%**	**295**	**325**	**10%**	**28%**	**26%**
Sickness insurance	5	1	-80%	0.3%	-7	-23	230%	7%	-5%
Motor own damage	11	248	2247%	74.7%	-315	332	-205%	11%	6%
Own damage insurance of railway rolling stock	-2	3	-263%	1.0%	-1	8	-953%	36%	25%
Own damage insurance of aircraft	-8	8	-204%	2.5%	-8	9	-201%	57%	28%
Insurance of vessels in sea and inland navigation	-4	-1	-78%	-0.3%	-32	-3	-90%	-8%	-3%
Goods-in-transit insurance	4	-3	-183%	-0.9%	16	6	-63%	-35%	6%
Fire and natural forces insurance	**-199**	**193**	**-197%**	**58.0%**	**-554**	**151**	**-127%**	**18%**	**5%**
Damage or loss property	**-6**	**-52**	**759%**	**-15.7%**	**78**	**9**	**-88%**	**-8%**	**0%**
Motor TPL	-230	-167	-27%	-50.2%	-908	-492	-46%	-6%	-6%
Aircraft liability	2	-2	-199%	-0.7%	13	-2	-117%	-40%	-9%
Marine liability	0	0	270%	-0.1%	7	0	-102%	-32%	-1%
General liability	**99**	**-11**	**-111%**	**-3.4%**	**52**	**-54**	**-204%**	**-2%**	**-4%**
Credit insurance	**5**	**6**	**15%**	**1.8%**	**81**	**66**	**-18%**	**46%**	**12%**
Suretyship	6	12	100%	3.7%	80	75	-6%	29%	25%
Insurance of various financial risks	**-21**	**11**	**-152%**	**3.3%**	**-35**	**43**	**-222%**	**16%**	**6%**
Insurance of legal protection	-1	-1	-2%	-0.2%	12	14	20%	-92%	8%
Assistance	-34	-37	10%	-11.2%	-47	-48	1%	-20%	-12%
Total direct	**-261**	**334**	**-228%**	**100.6%**	**-1,275**	**415**	**-133%**	**4%**	**2%**

Source: KNF, Company reports

How to Grab Bigger Share in Individual Life?

PZU Remains Weak in Individual Life

PZU remains weak in individual life insurance

Despite its extensive distribution network, PZU remains weak in individual life insurance. If we deduct continued life insurance, which are de facto group products (only people previously covered by the group insurance are entitled to sign up the individual contract), PZU's market share in gross written premium (according to PAS and including premium from investment contracts) is about 10%.

It may slightly increase its market position…

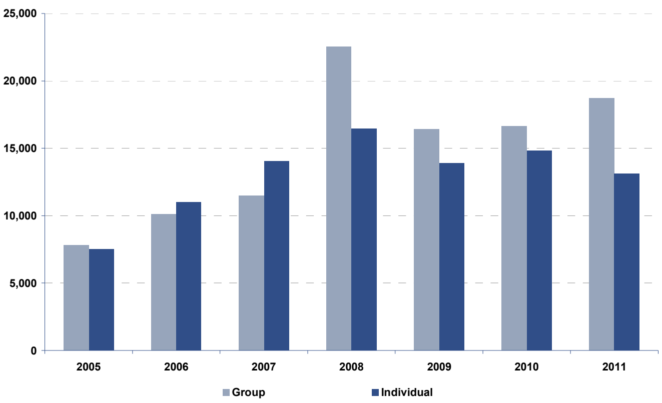
We think PZU could improve its market position in life insurance through new initiatives, including:

- Rebranding, implemented in May 2012;
- Introduction of a new remuneration system in the company with increased variable parts depending on individual performance (2012);
- Increasing its position in investment products (discussed in more detail below).

…but needs acquisitions to make material progress

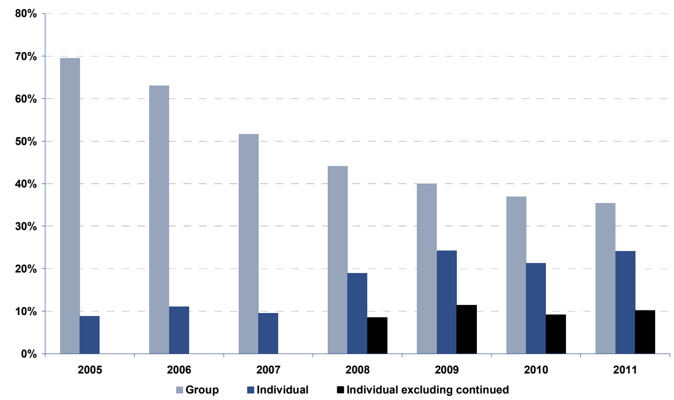
However, we don't expect these actions will be enough to materially increase life individual premiums. In our opinion only an acquisition of the Polish insurance business of ING (alone or as a part of purchase of CEE operations) may materially boost PZU's market position in that segment (ING's market share is about 9%).

Figure 54. Polish Insurers – Premium* in Group and Individual Life Insurance, 2005-2011 (Polish Zloty in million)



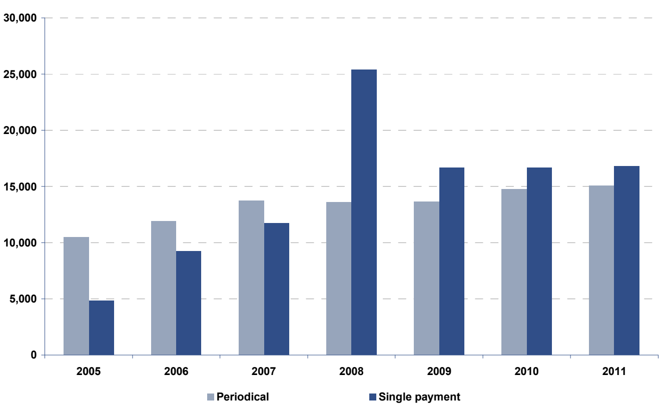
Note: Premium according to PAS (includes premium from investment contracts)
Source: KNF

Figure 55. PZU – Market Share in Premium* in Group and Individual Life Insurance, 2005-2011 (Percentage)



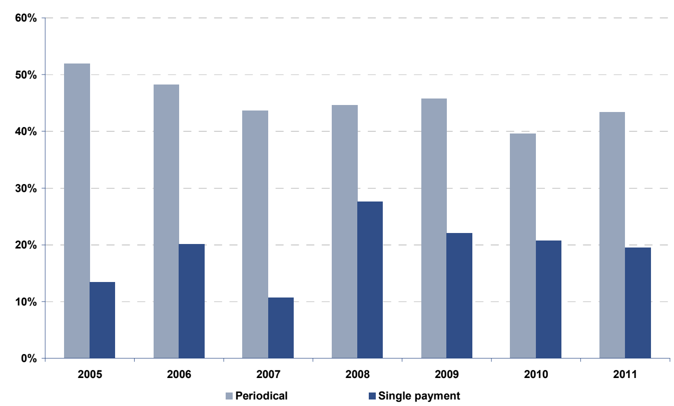
Note: Premium according to PAS (includes premium from investment contracts)
Source: KNF, company reports

Figure 56. Polish Insurers – Premium* in Periodical and Single-Payment Life Insurance, 2005-2011 (Polish Zloty in million)



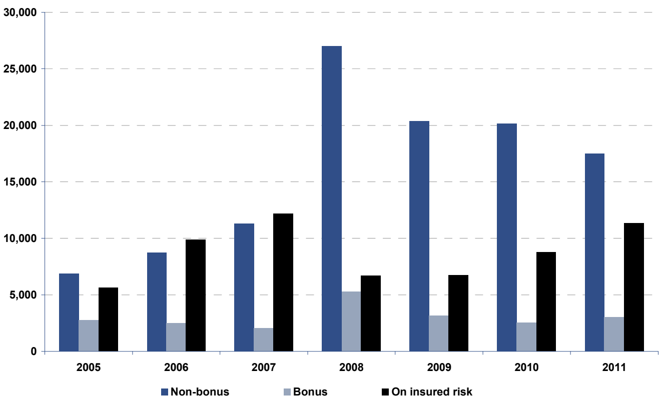
Note: Premium according to PAS (includes premium from investment contracts)
Source: KNF

Figure 57. PZU – Market Share in Premium* in Periodical and Single-Payment Life Insurance, 2005-2011 (Percentage)



Note: Premium according to PAS (includes premium from investment contracts)
Source: KNF

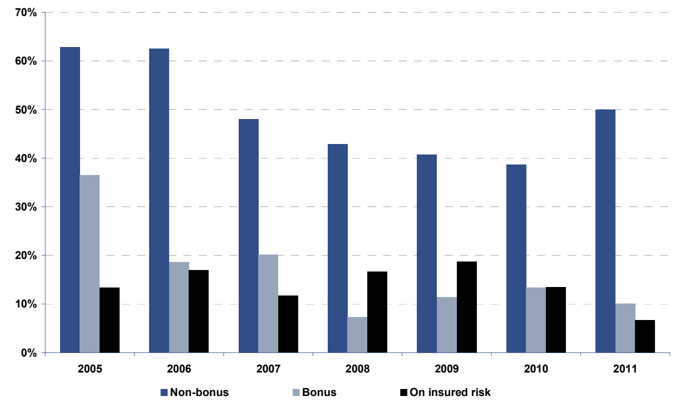
Figure 58. Polish Insurers – Life Insurance Premium* Depending on the Investment Risk, 2005-2011 (Polish Zloty in million)



Note: Premium according to PAS (includes premium from investment contracts)

Source: KNF

Figure 59. PZU – Market Share in Life Insurance Premium* Depending on the Investment Risk, 2005-2011 (Percentage)



Note: Premium according to PAS (includes premium from investment contracts)

Source: KNF

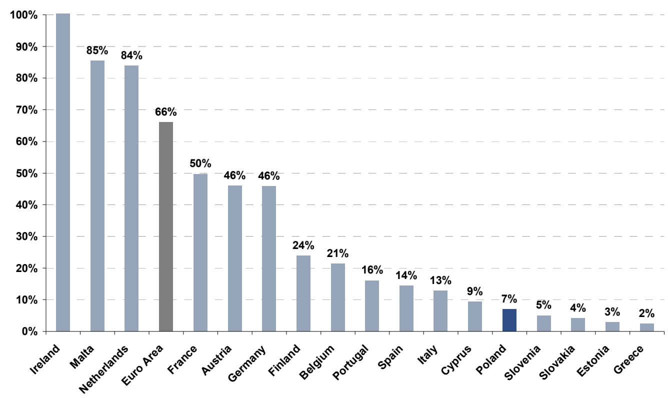
Investments Look Promising

Underdeveloped market

In Germany investment fund penetration is seven times higher than in Poland while mortgage penetration is only two times higher

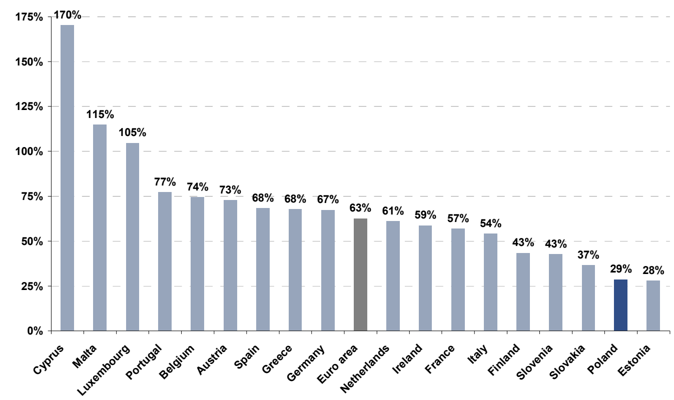
In terms of investment products (investment funds or structured products) the Polish market is underdeveloped (in contrast to consumer loans), and more so than in mortgage lending. Investment funds' assets under management are just 7% of GDP in Poland vs. 46% in Germany or 50% in France, while consumer loans are 13% (vs. 18% and 12%, respectively) and mortgage loans 19% (vs. 38% and 41%, respectively). We expect the market of investment products to rise more than GDP growth in long term, driven by a closing of this gap.

Figure 60. Europe – AUM of Investment Funds to GDP, 2011 (Percentage)



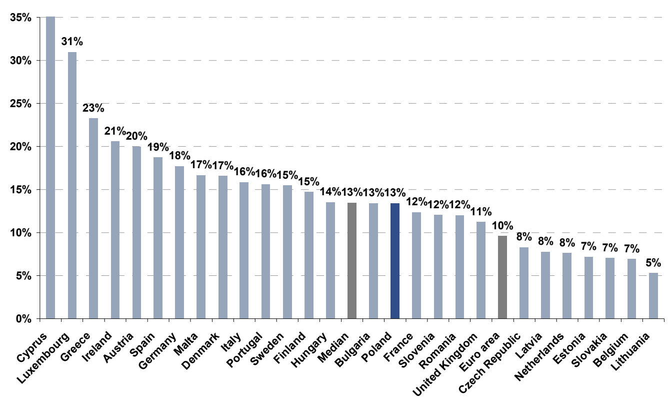
Source: ECB, IZFiA

Figure 61. Europe – Retail Deposits to GDP, 2011 (Percentage)



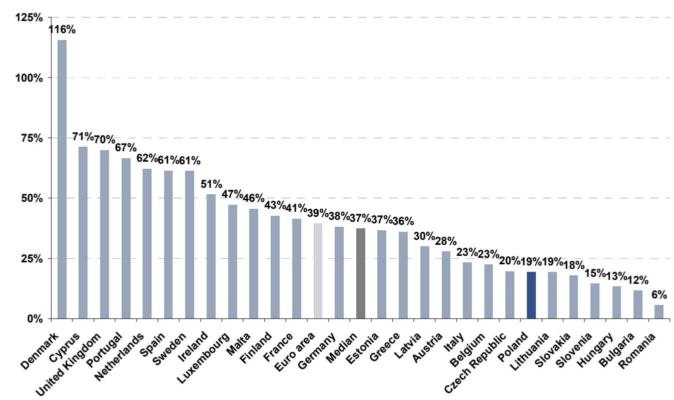
Source: ECB, NBP

Figure 62. Europe – Consumer Loans to GDP, 2011 (Percentage)



Source: ECB

Figure 63. Europe – Mortgage Loans to GDP, 2011 (Percentage)

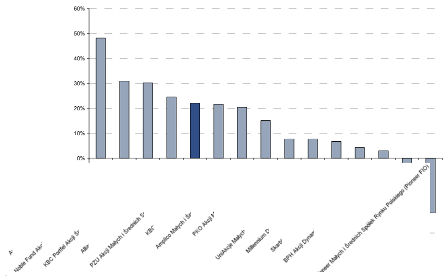


Source: ECB

Solid Asset Management Expertise

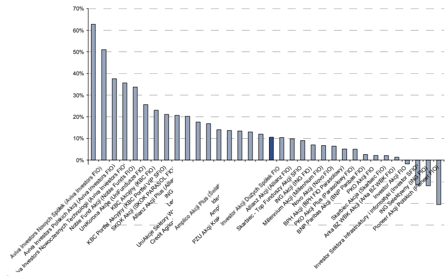
PZU is one of the biggest asset managers in Poland. Its investment performance, measured by the 36m performance of investment funds managed by PZU, is average, but taking into account difficulties in managing such a large portfolio, we view its investment results as decent.

Figure 64. Polish Investment Funds – 36M Performance of Small Cap Funds, April 2012 (Percentage)



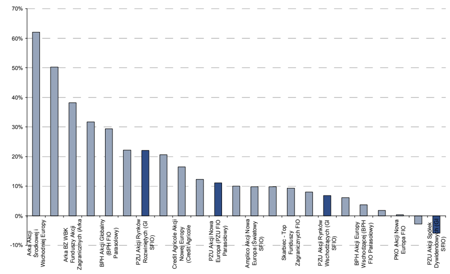
Source: analizy.pl

Figure 65. Polish Investment Funds – 36M Performance of Domestic Equity Funds, April 2012 (Percentage)



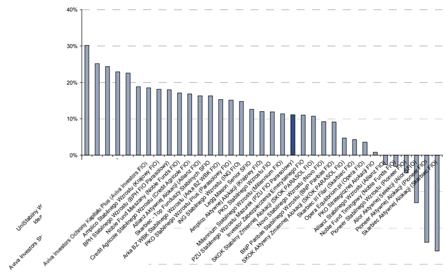
Source: analizy.pl

Figure 66. Polish Investment Funds – 36M Performance of Foreign Equity Funds, April 2012 (Percentage)



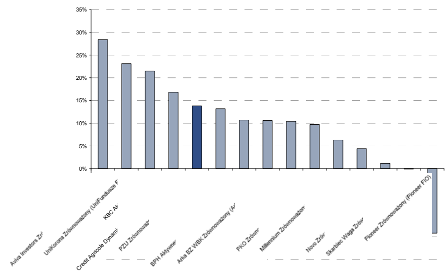
Source: analizy.pl

Figure 67. Polish Investment Funds – 36M Performance of "Stable Growth" Funds, April 2012 (Percentage)



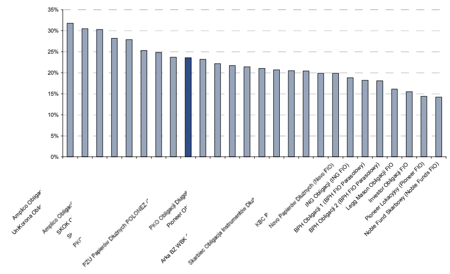
Source: analizy.pl

Figure 68. Polish Investment Funds – 36M Performance of "Balanced" Funds, April 2012 (Percentage)



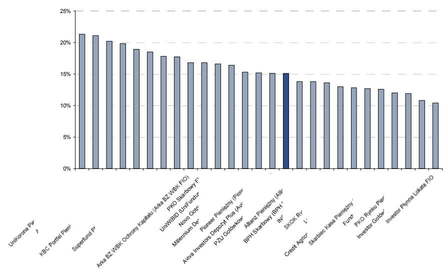
Source: analizy.pl

Figure 69. Polish Investment Funds – 36M Performance of Bond Funds, April 2012 (Percentage)



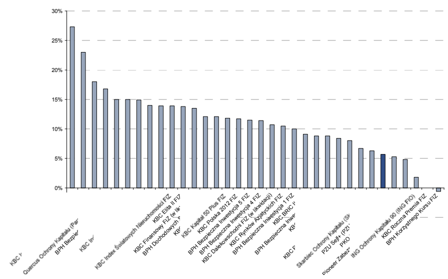
Source: analizy.pl

Figure 70. Polish Investment Funds – 36M Performance of Money Market Funds, April 2012 (Percentage)



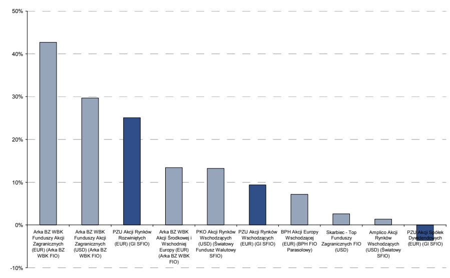
Source: analizy.pl

Figure 71. Polish Investment Funds – 36M Performance of Foreign Defensive Funds, April 2012 (Percentage)



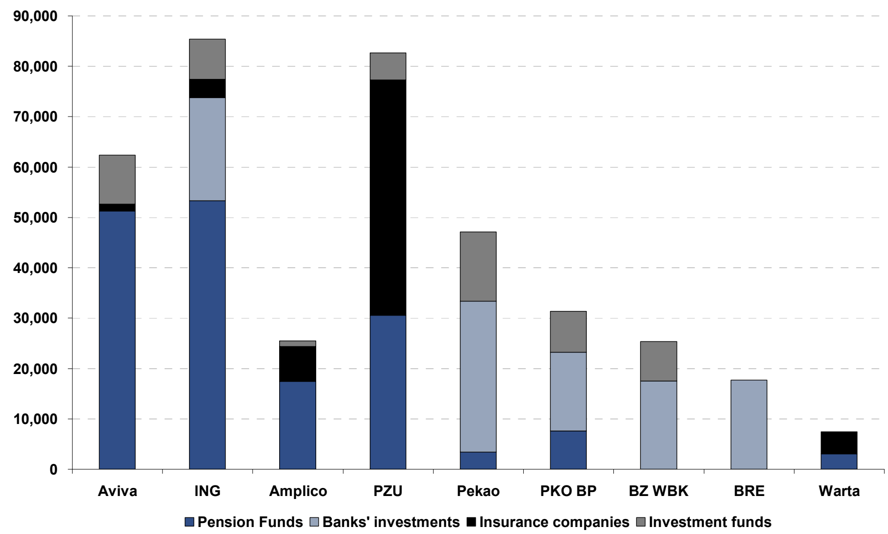
Source: analizy.pl

Figure 72. Polish Investment Funds – 36M Performance of Foreign Equity Funds Denominated in FX, April 2012 (Percentage)



Source: analizy.pl

Figure 73. Poland – Biggest Institutional Investors, 2011 (Polish Zloty in million)



Source: Company reports, Citi Investment Research and Analysis (estimate of intra-group deductions)

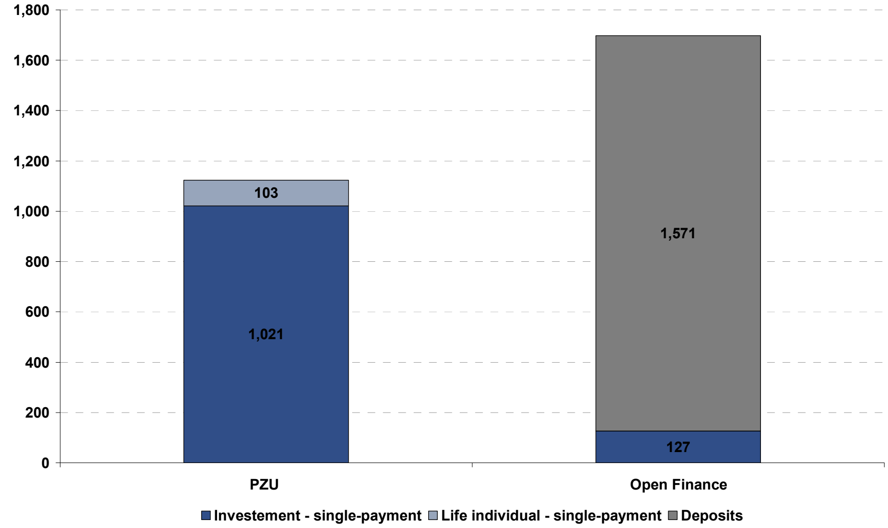
Given PZU's expertise in asset management, relatively good track record in terms of its fund performance, recognisable brand and high distribution network, we like the company's decision to focus more on investment products. On the other hand, PZU's weak position in individual life products (being mostly investment products) indicates that as yet PZU hasn't acquired the know-how in selling retail investment products, so the success will likely depend on the improvement in general sale skills of the organisation rather than just a stronger focus on investment products.

David vs the Goliath - Benchmarking to Open Finance

An example of a company very efficient in selling investment products is Open Finance. We don't have the comparable data to compare the selling performance of Open Finance with PZU in regular products but we note that in 1Q12:

- PZU's annual premium equivalent (APE) amounted to Zl 25m but only Zl 16m came from sales through own channels and Zl 9m from bancassurance; this number doesn't include APE in investment contracts which we estimate at Zl 102m (a big part of which came from sales through bancassurance);
- We estimate Open Finance APE at Zl 62m;
- The sale of single-payment products at Open Finance (including bank deposits) amounted to Zl 1.7bn, while it was Zl 1.1bn at PZU (including bank deposits wrapped as insurance contracts).

Figure 74. PZU and Open Finance – Sale of Single-Payment Investment Products, 1Q12 (Polish Zloty in million)



Source: Company reports

Healthcare Insurance

Market Overview

Healthcare insurance in Poland is at an initial stage of development. According to the Ministry of Health, out of c Zl 85bn spending on healthcare in 2011, the subsector of healthcare insurance amounted to just Zl 200m. Larger, but still not material, was the sub-segment of health subscriptions (pre-paid plans), amounting to Zl c2bn. The main reason of the market's underdevelopment is the lack of legal regulation of the market:

- Healthcare insurance is regulated by the general provisions of the insurance law (there is no specific regulation of this kind of insurance);
- The scope of medical procedures and services provided within the state healthcare system is not strictly defined, making it difficult to offer insurance products covering the cost of additional services or procedures;
- There are tax advantages for the insured.

Several insurers offer healthcare insurance, both as separate products or as part of packages. The active players on the market are niche insurers like Signal Iduna, Medica Polska, as well as universal insurers like PZU, Allianz, Axa, Aviva

Company Position

PZU is one of the insurers providing healthcare insurance. It offers:

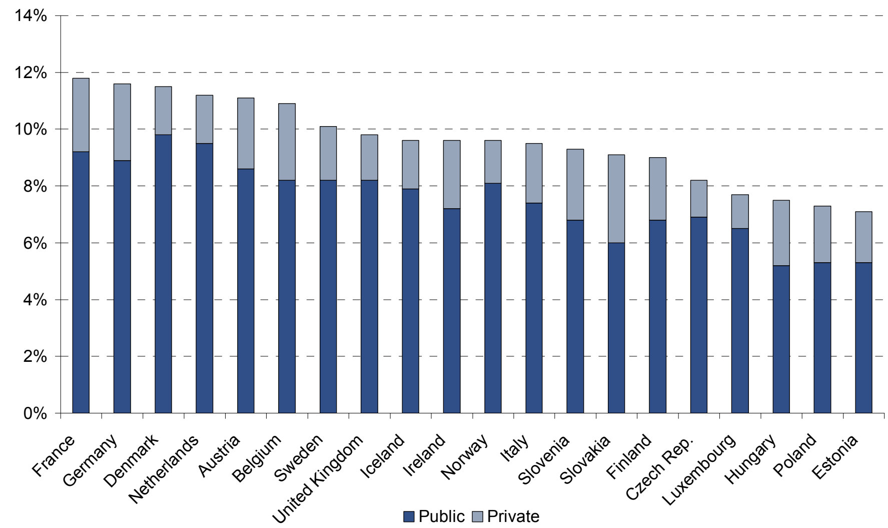
- A product covering costs of clinic services,
- Insurance covering hospital services;

- Recently launched insurance for medicine purchases (available only as group insurance to avoid negative selection).

Growth Potential

The Polish healthcare system is generally perceived as needing changes (Poland ranks 27th in the Euro Health Consumer Index). Several drafts bills to reform the healthcare system, including bills regulating health insurance, have been prepared in recent years. However, it is difficult to say in what direction the Polish healthcare system will evolve and what role insurers will have in a new system.

Figure 75. Public and Private Expenditure for Health as % of GDP, 2009



Source: OECD

According to an Ernst&Young report, there are three, not mutually exclusive, potential directions of change:

- Introduction of co-payment by clients (co-payment potentially may also be covered by insurers);
- Introduction of supplementary healthcare insurance;
- Introduction of competition in the base (compulsory) system through the introduction of competition among payers (e.g. as in the Netherlands).

The Ernst&Young report recommended a combination of the three propositions but in its opinion:

- In the initial stage, the insurance covering co-payment should be prohibited (as it might reduce the positive effect of co-payments on the reduction of unneeded use of medical services);
- About 19% of Polish households declared an interest in supplementary insurance but the analysis of penetration of healthcare insurance in other European countries suggests that the potential target group is about 5-9% of adults (1.4-2.3m) and the potential value of the market about Zl 1-2.3bn. Given that the value of the health subscriptions market is close to that level, penetration of surplus products seems to be close to the maximum potential size and the

promotion of insurance may only lead to replacement of pre-paid plans by regular healthcare insurance. Ernst&Young also suggests not implementing any tax benefits for the insured as there are no evidence that such incentives have really stimulated market growth;

- Introduction of competition in the base system through allowing insurers to be payers should be preceded by implementation of several changes in the healthcare system (including the implementation of a service valuation and creation of a system to provide better information to the patient about medical service-providers) and thus this major reform shouldn't be done immediately.

Given the declining popularity of the ruling party (based on polls) and the problems faced during the implementation of changes in the medicine funding system in January 2012, we don't see a likelihood of rapid changes in the healthcare funding system and thus we don't include any impact of potential reform in our forecasts.

Changes in Estimates

Taking into account FY2011 and 1Q12 financial results, market trends and company guidance, we make the following changes to our 2012-2014 estimates:

- Given high growth in premium in 1Q12 (albeit driven mostly by one-off increase in P&C premium from hospitals due to changes in legislation and the jump in single-payment life premiums) and the expected growth in claim costs (caused by the Supreme Court decisions) prompting insurers to raise prices, we increase our premium forecasts by 2% in 2012, 2% in 2013 and 3% in 2014;

- Given lower profitability in the life group segment, we increase our loss ratio assumptions. Coupled with higher premium forecasts, this leads us to raise claim estimates by 1% this year, 3% the next year and 4% in 2013.

- Seeing lower than anticipated growth in acquisition costs and higher growth in administrative costs, we lowered our acquisition cost forecasts by 3% this year, next year and in 2014 and increased estimate of administrative costs by 2% in 2012, 1% in 2013 and decreased by 2% in 2014.

- Summing up, we increase our diluted EPS estimates by 5% this year, 1% in 2013 and 3% in 2014.

Figure 76. PZU – Changes in Income Statement Estimates, 2012-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
	OLD	**NEW**	**Chg (%)**	**OLD**	**NEW**	**Chg (%)**	**OLD**	**NEW**	**Chg (%)**
Gross written premium	**15,753**	**16,013**	**1.7%**	**16,248**	**16,646**	**2.4%**	**16,875**	**17,336**	**2.7%**
Reinsurers' share in written premium	-221	-224	1.7%	-227	-233	2.4%	-236	-243	2.7%
Net written premium	15,532	15,789	1.7%	16,021	16,413	2.4%	16,638	17,093	2.7%
Net change in unearned premium reserve	-64	-64	0.0%	-64	-64	0.0%	-64	-64	0.0%
Net earned premium	15,468	15,725	1.7%	15,957	16,349	2.5%	16,574	17,029	2.7%
Fee income	216	243	12.8%	235	235	0%	257	257	0%
Net investment income	1,985	2,040	2.8%	2,066	2,111	2.2%	2,019	2,062	2.1%
Net result from investments and writedown	53	73	36.7%	28	44	61.0%	49	66	35.6%
Change in fair value	727	650	-10.7%	812	723	-11.0%	805	726	-9.8%
Aggregate investment gains	**2,765**	**2,762**	**-0.1%**	**2,906**	**2,878**	**-0.9%**	**2,873**	**2,854**	**-0.6%**
Other operating income	352	352	0.0%	370	370	0.0%	388	388	0.0%
Total revenues	**18,801**	**19,082**	**1.5%**	**19,468**	**19,832**	**1.9%**	**20,092**	**20,529**	**2.2%**
Gross claims, benefits and change in claim provisions	-11,122	-11,286	1.5%	-11,481	-11,859	3.3%	-12,021	-12,455	3.6%
Reinsurers' share in claims	58	59	1.1%	59	60	1.0%	62	62	0.8%
Net claims, benefits and change in claim provisions	-11,064	-11,228	1.5%	-11,422	-11,800	3.3%	-11,959	-12,393	3.6%
including release of group life provisions	200	230	15.0%	100	100	0.0%	0	0	NA
Other benefits and costs of investment contracts	-282	-163	-42.0%	-234	-132	-43.5%	-262	-146	-44.1%
Acquisition costs	-2,145	-2,078	-3.2%	-2,260	-2,191	-3.0%	-2,355	-2,284	-3.0%
Administrative costs	-1,369	-1,391	1.6%	-1,399	-1,418	1.3%	-1,439	-1,415	-1.7%
Other operating costs	-612	-678	10.7%	-657	-726	10.6%	-705	-780	10.5%
Total costs	**-15,472**	**-15,538**	**0.4%**	**-15,971**	**-16,267**	**1.9%**	**-16,720**	**-17,018**	**1.8%**
Operating income	**3,329**	**3,544**	**6.5%**	**3,497**	**3,565**	**2.0%**	**3,372**	**3,511**	**4.1%**
Financial costs	0	-10	NA	0	0	NA	0	0	NA
Subsidiaries profits	0	0	NA	0	0	NA	0	0	NA
Pre-tax profit	**3,329**	**3,534**	**6.2%**	**3,497**	**3,565**	**2.0%**	**3,372**	**3,511**	**4.1%**
Tax	-633	-689	9.0%	-664	-695	4.6%	-641	-685	6.9%
Minorities	0.0	0.0	NA	0.0	0.0	NA	0.0	0.0	NA
Net Profit	**2,697**	**2,845**	**5.5%**	**2,832**	**2,870**	**1.3%**	**2,731**	**2,826**	**3.5%**
Reported EPS	31.23	32.95	5.5%	32.80	33.24	1.3%	31.63	32.73	3.5%
Diluted EPS	28.91	30.28	4.7%	31.64	32.08	1.4%	31.63	32.73	3.5%
DPS	**30**	**30**	**0.0%**	**32**	**31**	**-3.1%**	**32**	**31**	**-3.1%**

Source: Citi Investment Research and Analysis

Figure 77. PZU – Changes in Balance Sheet Estimates, 2012-2014E (Polish Zloty in million)

	2012E			2013E			2014E		
Balance Sheet	**OLD**	**NEW**	**Chg (%)**	**OLD**	**NEW**	**Chg (%)**	**OLD**	**NEW**	**Chg (%)**
Intangible	132	183	38.4%	145	201	38.4%	160	221	38.4%
Fixed assets	913	1,024	12.2%	931	1,044	12.2%	950	1,065	12.2%
Investment real estate	534	588	10.1%	587	646	10.1%	646	711	10.1%
Financial assets	47,980	47,980	0.0%	49,500	49,500	0.0%	52,230	52,230	0.0%
Receivables	1,575	1,601	1.7%	1,625	1,665	2.4%	1,687	1,734	2.7%
Reinsurers share in insurance reserves	753	841	11.7%	751	873	16.2%	755	910	20.4%
Deferred acquisition costs	554	598	7.9%	582	628	7.9%	611	660	7.9%
Prepayments	256	132	-48.4%	269	139	-48.4%	282	146	-48.4%
Cash	467	250	-46.6%	490	262	-46.6%	515	275	-46.6%
Other assets	132	241	82.6%	138	252	82.8%	144	264	83.1%
Total assets	**53,295**	**53,437**	**0.3%**	**55,018**	**55,210**	**0.3%**	**57,981**	**58,215**	**0.4%**
Total equity	**13,465**	**13,778**	**2.3%**	**13,707**	**14,057**	**2.6%**	**13,761**	**14,206**	**3.2%**
Provisions for unearned premiums and for unexpiered risk	4,166	4,586	10.1%	4,231	4,651	9.9%	4,296	4,716	9.8%
Life insurance provision	13,081	14,929	14.1%	12,521	15,365	22.7%	12,035	15,894	32.1%
Provisions for outstanding claims	4,275	5,503	28.7%	4,269	5,621	31.7%	4,362	5,785	32.6%
Provisions for capitalized value of annuity claims	4,838	5,332	10.2%	4,826	5,576	15.5%	4,814	5,819	20.9%
Other technical provisions	621	588	-5.2%	621	588	-5.2%	621	588	-5.2%
Life provisions for products where the risk is taken by clients	3,120	2,695	-13.6%	3,585	3,124	-12.9%	4,090	3,590	-12.2%
Total insurance reserves	30,100	33,633	11.7%	30,053	34,926	16.2%	30,218	36,392	20.4%
Investment contracts	2,799	1,795	-35.9%	2,624	1,693	-35.5%	3,043	1,952	-35.8%
Provisions for employee benefits	284	268	-5.6%	299	282	-5.6%	313	296	-5.6%
Provisions for deferred income tax	446	115	-74.2%	469	121	-74.2%	492	127	-74.2%
Accruals and deferred income	755	721	-4.5%	793	757	-4.5%	833	795	-4.5%
Other liabilities	5,445	3,126	-42.6%	7,074	3,375	-52.3%	9,320	4,446	-52.3%
Total liabilities	**39,830**	**39,659**	**-0.4%**	**41,312**	**41,154**	**-0.4%**	**44,220**	**44,009**	**-0.5%**
Total equity and liabilities	**53,295**	**53,437**	**0.3%**	**55,018**	**55,210**	**0.3%**	**57,981**	**58,215**	**0.4%**

Source: Citi Investment Research and Analysis

Valuation

Summary of Valuation

We set our target price at Zl 430, derived using a Standard Warranted Equity Valuation based on reported equity

For valuation purposes we use a Standard Warranted Equity Valuation (WEV) based on normalised capital as well as WEV based on reported equity. Given confirmation by the company the M&A appetite on one hand and seeing limited targets matching PZU target for acquisitions, we see a risk that PZU for longer term may remain overcapitalized, continuously looking for new potential M&As targets but not finding any of them attractive enough to make acquisition. Thus conservatively we set our target price at Zl 430 which is equal to the lower value from these two valuation methods. We prefer these methodologies due to their simplicity (the valuation is based on return on consolidated equity and thus we avoid problems with allocation of capital between business lines) and comparability (the same method we use in our banks valuation and, due to the limited number of listed insurers in the CEEMEA region, the regional investors treat banks and insurers as the one subgroup).

Additionally, for illustrative purposes only, we compare the current market capitalisation of PZU with actual and estimated embedded value; we also show a peers' comparative valuation table.

Figure 78. PZU – Target Price Per Share (Polish Zloty)

Standard Warranted Equity Valuation	430
Warranted Equity Valuation based on Normalized Equity	466
Average	448
Price Target	**430**
Current share price	297.5
Upside / (Downside)	**44.5%**
DPS (2011)	22.43
Dividend yield (%)	7.54%
Total Expected Return (ETR)	**52.1%**

Source: Citi Investment Research and Analysis

Standard Warranted Equity Valuation

Our Standard Warranted Equity Valuation of Zl 430 per share

Our Standard Warranted Equity Valuation of Zl 430 per share is based upon the formula: Price / Book value = (Sustainable ROE - growth) / (Cost of equity - growth). We assume a sustainable return on equity of 20% (decreased from 21% previously due to higher expected loss ratio) and use a cost of equity of 10.5% and a sustainable growth rate of 4.5%.

Figure 79. PZU – Warranted Equity Valuation (Polish Zloty, except where stated)

Sustainable ROE	**20.0%**
2013E COE	**10.5%**
Growth	**4.50%**
Target P/BV multiple	**2.58**
2013E BVPS	162.8
2013E Target Value Per Share	420.5
Months to Discount to Jun 2013	6
Discounted	400.1
2012E DPS	30.0
Months to Discount to Jun 2013	3
Discounted	29.6
Value per share	430
Upside / (Downside)	44.5%

Source: Citi Investment Research and Analysis

Warranted Equity Valuation Based on Normalised Equity

Standard Warranted Equity Valuation based on normalised capital implies value of Zl 466 per share

In our Warranted Equity Valuation based on normalized equity, in line with the company's target to keep capital at 250% of the solvency margin longer term, we assume normalised capital at 250% of the consolidated solvency margin, and calculate an adjusted return on capital (deducting the investment gain on estimated surplus capital from the reporting earnings) and separately value the insurance business (assuming a 30% ROE vs. our estimate of 32% ROE in 2013) and surplus capital (at P/BV=1). This method arrives at a valuation of Zl 466 per share.

Figure 80. PZU – Warranted Equity Valuation Based on Normalised Capital (Polish Zloty, except where stated)

Sustainable ROE	**30.0%**
2013E COE	**10.5%**
Growth	**4.50%**
Target P/BV multiple	**4.25**
2013E BVPS	94.0
2013E Target Value Per Share	**399.6**
Months to Discount to May 2012	6
Discounted	380.1
Surplus 2013E capital per share	58.7
Discounted	55.8
2012E DPS	30.0
Months to Discount to May 2012	3
Discounted	29.6
Value per share	**466**
Upside / (Downside)	56.5%

Source: Citi Investment Research and Analysis

Comparative Multiple

Premium to European insurers justified by much higher profitability and higher growth perspective…

PZU trades at a premium to European insurers (2011E PE 27% above European median and P/BV 121% above). We believe this premium is justified by PZU's higher profitability (2011E ROE at 19% vs. European average of 12%).

Figure 81. European insurers – Valuation Table (Prices as of June 4)

Non-Life	Rating	Current Price	PE 2011	P/BV 2011	ROE 2006	2007	2008	2009	2010	2011	Av 2006-2011
ACE Limited	1	70.00	10.04	0.96	17%	16%	18%	16%	13%	10%	15%
XLCapital LTD	1	19.60	70.00	na	17%	17%	13%	12%	8%	3%	12%
TrygVesta A/S	NA	311.70	16.94	2.09	34%	23%	9%	21%	NA	NA	22%
Admiral Group	2	10.45	12.79	7.18	52%	56%	56%	52%	60%	59%	56%
Euler Hermes SA	NA	51.76	6.86	1.03	18%	20%	4%	1%	NA	14%	12%
Amlin Plc	1	3.13	na	1.09	31%	35%	7%	29%	13%	-10%	18%
Hiscox Ltd	2	3.90	73.58	1.21	NA	24%	8%	25%	15%	2%	15%
Average			**31.70**	**2.26**	**28%**	**27%**	**17%**	**22%**	**22%**	**13%**	**21%**
Median			**14.87**	**1.15**	**25%**	**23%**	**9%**	**21%**	**13%**	**7%**	**15%**
Life											
Aegon NV	2H	3.27	4.91	0.33	11%	11%	-8%	1%	7%	5%	4%
CNP Assurance SA	NA	8.61	4.95	0.43	9%	10%	6%	9%	11%	9%	9%
Legal and General Group PLC	2	1.06	8.65	1.20	29%	13%	8%	14%	18%	15%	16%
Old Mutual PLC	NA	1.39	7.73	0.80	10%	10%	7%	7%	10%	10%	9%
Standard Life PLC	2	2.04	20.08	1.21	na	14%	18%	19%	10%	15%	15%
Swiss Life Holding	NA	75.85	4.34	0.27	12%	15%	-16%	4%	8%	7%	5%
Resolution	2H	1.92	3.82	0.47	na	NA	NA	1%	6%	12%	6%
Irish Life & Permanet PLC	2	0.03	NA	na	na	na	na	NA	NA	NA	na
Storebrand ASA	NA	17.33	7.24	na	17%	12%	-13%	5%	10%	6%	6%
Mediolanum SpA	NA	2.35	8.94	2.26	26%	24%	15%	NA	NA	21%	22%
Cattolica Assicurazioni SpA	NA	9.98	na	na	10%	2%	2%	5%	5%	NA	5%
St.James's Plc	NA	3.08	14.50	2.24	27%	41%	14%	49%	63%	17%	35%
Prudential Plc	1	6.60	11.24	1.84	16%	31%	39%	35%	20%	17%	26%
Average			**8.76**	**1.10**	**17%**	**16%**	**7%**	**14%**	**15%**	**12%**	**13%**
Median			**7.73**	**1.00**	**14%**	**13%**	**7%**	**7%**	**10%**	**12%**	**9%**
Multi-Line											
Allianz	1	70.31	12.83	0.71	14%	15%	10%	11%	12%	6%	11%
Axa	2H	8.91	6.23	0.43	11%	11%	8%	8%	9%	10%	10%
Assicurazioni Generali SpA	3	8.81	15.72	0.88	13%	16%	5%	8%	10%	5%	9%
Zurich Financial Services AG	1	194.20	8.55	0.96	18%	20%	11%	11%	11%	12%	14%
Aviva PLC	2H	2.55	5.14	0.58	18%	11%	16%	25%	11%	11%	15%
Sampo Oyj	2	18.06	9.76	na	20%	55%	11%	8%	13%	12%	20%
Mapfre SA	3	1.56	4.89	na	8%	15%	16%	15%	15%	14%	14%
Vienna Insurance Group	NA	28.90	10.07	0.80	12%	13%	12%	8%	8%	9%	10%
RSA Insurance Group	2	0.98	5.96	0.90	15%	15%	16%	12%	10%	15%	14%
Baloise Holding	NA	59.05	45.78	0.72	15%	16%	8%	10%	10%	2%	10%
Grupo Catalana Occidente SA	NA	9.48	5.30	0.90	16%	16%	7%	10%	16%	18%	14%
Helvetia Hldg	NA	261.75	8.04	0.67	16%	14%	8%	10%	11%	9%	11%
Topdanmark A/S	NA	941.50	12.65	2.75	45%	35%	-6%	35%	27%	21%	26%
Clal Insurance EnterprisesHoldings Ltd	NA	46.90	NA	NA	20%	18%	NA	NA	19%	NA	20%
Schweizerische National Versicherungs	NA	31.95	4.35	0.77	11%	14%	12%	11%	13%	20%	13%
Nuernberger Beteiligungs-AG	NA	58.80	NA	NA	NA	NA	NA	NA	NA	NA	NA
FBD Holdings PLC	NA	8.05	6.07	1.28	33%	31%	21%	15%	9%	22%	22%
Average			**10.76**	**0.91**	**18%**	**20%**	**10%**	**13%**	**13%**	**12%**	**15%**
Median			**8.04**	**0.80**	**16%**	**15%**	**11%**	**11%**	**11%**	**12%**	**14%**
Average			**14.00**	**1.25**	**19%**	**20%**	**10%**	**15%**	**15%**	**12%**	**15%**
Median			**8.60**	**0.90**	**17%**	**16%**	**9%**	**11%**	**11%**	**11%**	**14%**
PZU	**1**	**297.60**	**10.95**	**2.0**	**NA**	**22%**	**12%**	**24%**	**20%**	**19%**	**20%**
Premium/Discount			**27%**	**121%**	**NA**	**38%**	**33%**	**125%**	**85%**	**65%**	**43%**

Source: dataCentral, IBES

Figure 82. PZU – 2011 ROE and P/BV Compared to Global Averages (Prices as of June 4)

	Non-Life		Life		Multi-line	
	P/BV	ROE	P/BV	ROE	P/BV	ROE
North American	1.16	6%	0.82	9%	0.72	5%
European	1.21	3%	0.80	12%	0.77	11%
Asian	1.31	14%	2.46	10%	2.09	23%
Cemea	NA	NA	2.01	19%	2.0	20%
Latam	NA	NA	NA	17%	2.70	17%
Japan	0.58	2%	2.52	9%	NA	NA
PZU	NA	NA	NA	NA	2	19%

Source: IBES, Citi Investment Research and Analysis

…similar to regional banks trading at a premium to Western Europe peers

We note that CEE stocks, notably Polish stocks, trade at a premium to their Western European peers given strong growth dynamics (for example, on a 2012-2013E P/E basis, CEE banks trade at a 29% and 92% premium, respectively, to Western European banks).

Figure 83. CEE Banks – Valuation Table, 2011-2013E (Prices as of June 4)

	Share Price	Rating/Risk	Mkt Cap		P/E (x)			P/BV (x)			Div Yield			RoAE	
Company			USD (M)	2011	2012	2013	2011	2012	2013	2011	2012	2013	2011	2012	2013
Bank Pekao	PLN 136.00	1	10,162	12.31	12.65	12.90	1.68	1.57	1.54	3.96%	6.62%	7.35%	13.99%	12.81%	12.04%
BGZ	PLN 71.00	1	872	23.91	21.11	22.81	1.16	1.09	1.04	0.00%	0.00%	0.00%	4.99%	5.33%	4.67%
Bank Millennium	PLN 3.42	3	1,182	8.89	10.66	14.14	0.90	0.86	0.84	0.00%	4.69%	3.54%	10.75%	8.27%	6.03%
Komercni Banka	CZK 3,111.00	2	5,746	12.48	9.15	8.92	1.49	1.37	1.29	5.14%	6.43%	7.07%	12.31%	15.64%	14.92%
Kredyt Bank	PLN 12.98	1H	1,004	10.78	27.51	85.44	1.15	1.09	1.08	0.00%	0.00%	0.47%	11.10%	4.07%	1.27%
BRE	PLN 261.50	3	3,135	9.41	10.42	12.27	1.37	1.20	1.15	0.00%	4.80%	6.52%	15.64%	12.26%	9.57%
Bank Zachodni	PLN 227.90	1	4,743	14.14	13.94	14.68	2.26	2.03	1.99	3.51%	5.71%	5.48%	16.95%	15.44%	13.76%
GETIN HOLDING	PLN 1.55	1H	323	1.12	1.76	5.05	0.20	0.49	0.45	0.00%	0.00%	0.00%	19.91%	16.20%	9.31%
Getin Noble Bank	PLN 3.55	2H	964	3.56	7.12	5.99	0.83	0.75	0.67	0.00%	0.00%	0.00%	25.84%	11.08%	11.80%
Nova Kreditna Bk	EUR 2.39	1	117	13.18	4.36	2.68	0.19	0.18	0.17	2.09%	4.18%	6.28%	1.27%	4.16%	6.47%
OTP Bank	HUF 3,322.0	2H	3,879	8.81	6.55	4.67	0.64	0.54	0.51	3.01%	7.53%	10.54%	7.48%	8.59%	11.22%
PKO BP	PLN 31.66	1	11,270	10.39	10.07	10.88	1.73	1.59	1.46	4.01%	3.97%	5.51%	17.23%	16.45%	13.99%
ING Bank Slaski	PLN 74.95	1	2,777	11.08	12.31	14.87	1.52	1.34	1.31	0.00%	4.87%	4.03%	14.59%	11.58%	8.91%
Central Europe Banks Agg			**46,174**	**10.78**	**10.42**	**12.27**	**1.16**	**1.09**	**1.08**	**3.80%**	**5.72%**	**7.01%**	**15.35%**	**14.67%**	**14.51%**
Austria Banks Agg			**12,628**	**NM**	**9.96**	**5.36**	**0.56**	**0.53**	**0.49**	**2.03%**	**2.03%**	**4.57%**	**0.19%**	**5.64%**	**9.55%**
CIS Banks Agg			**73,745**	**5.54**	**4.97**	**4.67**	**1.13**	**0.94**	**0.81**	**2.27%**	**3.41%**	**4.26%**	**24.29%**	**21.93%**	**19.14%**
Israel Banks Agg			**9,281**	**5.28**	**5.00**	**5.10**	**0.59**	**0.55**	**0.52**	**6.78%**	**7.85%**	**8.18%**	**12.46%**	**12.10%**	**10.96%**
Turkey Banks Agg			**43,399**	**7.03**	**6.93**	**6.27**	**1.20**	**1.04**	**0.90**	**2.10%**	**1.85%**	**2.01%**	**18.09%**	**16.10%**	**15.44%**
South Africa Banks Agg			**69,489**	**12.41**	**10.30**	**8.59**	**1.74**	**1.60**	**1.44**	**4.33%**	**4.74%**	**5.65%**	**15.33%**	**17.09%**	**18.50%**
Aggregates															
Central Europe & Austria Banks			66,120	13.36	10.07	8.20	1.08	1.01	0.94	3.47%	5.05%	6.58%	12.33%	12.88%	13.48%
CEEMEA Banks			285,673	8.53	6.97	6.35	1.23	1.12	1.00	3.60%	4.22%	5.10%	18.06%	17.75%	17.25%
Western Europe Banks			657,246	9.83	8.07	6.40	0.49	0.50	0.48	4.49%	5.07%	6.32%	5.24%	7.40%	8.73%
Latin America Banks			221,107	8.87	8.48	7.46	1.55	1.40	1.26	4.47%	4.21%	4.78%	19.67%	17.92%	18.27%
Asia Banks			1,471,437	7.62	7.07	6.22	1.24	1.11	0.98	4.43%	4.64%	5.02%	18.46%	17.62%	17.52%
Global Emerging Banks			1,613,226	7.46	6.89	6.06	1.32	1.16	1.02	4.20%	4.42%	4.89%	19.84%	18.80%	18.62%
United States Banks			368,154	11.75	9.27	8.60	1.10	1.01	0.95	2.89%	3.65%	4.24%	10.63%	11.67%	12.10%

Source: dataCentral

Summary Financials

Figure 84. PZU – Income Statement, 2008-2014E (Polish Zloty in million)

	2008	2009	yoy	2010	yoy	2011	yoy	2012E	yoy	2013E	yoy	2014E	yoy
Gross written premium	**14,563**	**14,363**	**-1.4%**	**14,541**	**1.2%**	**15,279**	**5.1%**	**16,013**	**4.8%**	**16,646**	**4.0%**	**17,336**	**4.1%**
Reinsurers' share in written premium	-130	-163	24.8%	-201	23.4%	-285	42.1%	-224	-21.4%	-233	4.0%	-243	4.1%
Net written premium	14,433	14,200	-1.6%	14,340	1.0%	14,994	4.6%	15,789	5.3%	16,413	4.0%	17,093	4.1%
Net change in unearned premium reserve	-147	285	-293.9%	-127	-144.6%	-103	-18.7%	-64	-38.1%	-64	0.0%	-64	0.0%
Net earned premium	**14,286**	**14,485**	**1.4%**	**14,213**	**-1.9%**	**14,891**	**4.8%**	**15,725**	**5.6%**	**16,349**	**4.0%**	**17,029**	**4.2%**
Fee income	338	341	0.8%	288	-15.5%	281	-2.3%	243	-13.6%	235	-3.3%	257	9.3%
Net investment income	2,412	2,363	-2.0%	1,825	-22.8%	1,970	8.0%	2,040	3.5%	2,111	3.5%	2,062	-2.3%
Net result from investments and writedown	-856	261	-130.5%	199	-23.7%	-187	-193.9%	73	-138.7%	44	-38.9%	66	48.7%
Change in fair value	-976	844	-186.5%	754	-10.7%	-189	-125.1%	650	-443.4%	723	11.3%	726	0.4%
Aggregate investment gains	580	3,469	498.2%	2,778	-19.9%	1,594	-42.6%	2,762	73.3%	2,878	4.2%	2,854	-0.8%
Other operating income	192	260	35.3%	89	-65.7%	485	443.7%	352	-27.5%	370	5.0%	388	5.0%
Total revenues	**15,396**	**18,555**	**20.5%**	**17,368**	**-6.4%**	**17,251**	**-0.7%**	**19,082**	**10.6%**	**19,832**	**3.9%**	**20,529**	**3.5%**
Gross claims, benefits and change in claim provisions	-8,503	-9,470	11.4%	-10,939	15.5%	-10,374	-5.2%	-11,286	8.8%	-11,859	5.1%	-12,455	5.0%
Reinsurers' share in claims	-89	34	-138.2%	555	1538.0%	152	-72.5%	59	-61.6%	60	2.1%	62	4.3%
Net claims, benefits and change in claim provisions	**-8,592**	**-9,436**	**9.8%**	**-10,384**	**10.0%**	**-10,221**	**-1.6%**	**-11,228**	**9.8%**	**-11,800**	**5.1%**	**-12,393**	**5.0%**
including life group provisions	997	1,340	34.4%	520	-61.2%	406	-21.9%	230	-43.4%	100	-56.5%	0	NA
Other benefits and costs of investment contracts	246	-275	-212.0%	-178	-35.5%	33	-118.3%	-163	-602.7%	-132	-19.1%	-146	10.6%
Acquisition costs	**-1,668**	**-1,840**	**10.3%**	**-1,911**	**3.9%**	**-1,962**	**2.7%**	**-2,078**	**5.9%**	**-2,191**	**5.4%**	**-2,284**	**4.3%**
Administrative costs	**-1,775**	**-1,809**	**1.9%**	**-1,506**	**-16.8%**	**-1,384**	**-8.1%**	**-1,391**	**0.5%**	**-1,418**	**1.9%**	**-1,415**	**-0.2%**
Other operating costs	-675	-594	-12.1%	-301	-49.2%	-760	152.2%	-678	-10.8%	-726	7.2%	-780	7.3%
Total costs	-12,465	-13,953	11.9%	-14,280	2.3%	-14,294	0.1%	-15,538	8.7%	-16,267	4.7%	-17,018	4.6%
Operating income	**2,931**	**4,602**	**57.0%**	**3,088**	**-32.9%**	**2,957**	**-4.3%**	**3,544**	**19.9%**	**3,565**	**0.6%**	**3,511**	**-1.5%**
Financial costs	0	-36	NA	-59	63.2%	-49	-16.2%	-10	-79.7%	0	NA	0	NA
Subsidiaries profits	0	0	NA	0	NA	0	NA	0	NA	0	NA	0	NA
Pre-tax profit	2,931	4,566	55.8%	3,029	-33.6%	2,908	-4.0%	3,534	21.5%	3,565	0.9%	3,511	-1.5%
Tax	-601	-803	33.5%	-590	-26.5%	-564	-4.5%	-689	22.3%	-695	0.9%	-685	-1.5%
Minorities	0.0	0.0	47.8%	0.0	-94.1%	1.5	73750%	0.0	NA	0.0	NA	0.0	NA
Net Profit	**2,330**	**3,763**	**61.5%**	**2,439**	**-35.2%**	**2,345**	**-3.8%**	**2,845**	**21.3%**	**2,870**	**0.9%**	**2,826**	**-1.5%**
Reported EPS	26.98	43.58	61.5%	28.25	-35.2%	27.16	-3.8%	32.95	21.3%	33.24	0.9%	32.73	-1.5%
Diluted EPS	15.44	28.06	81.8%	22.22	-20.8%	22.46	1.1%	30.28	34.8%	32.08	5.9%	32.73	2.0%
DPS	0.00	158.56	NA	26.00	-83.6%	22.43	-13.7%	30.00	33.7%	31.00	3.3%	31.00	0.0%

Source: Compay reports, Citi Investment Research and Analysis

Figure 85. PZU – Balance Sheet, 2008-2014E (Polish Zloty in million)

	2008	2009	yoy	2010	yoy	2011	yoy	2012E	yoy	2013E	yoy	2014E	yoy
Intangible	70	85	22.3%	109	28.2%	166	52.2%	183	10.0%	201	10.0%	221	10.0%
Fixed assets	1,086	1,044	-3.8%	990	-5.1%	1,055	6.6%	1,024	-3.0%	1,044	2.0%	1,065	2.0%
Investment real estate	283	347	22.6%	441	27.3%	534	21.1%	588	10.0%	646	10.0%	711	10.0%
Financial assets	54,221	48,238	-11.0%	45,345	-6.0%	46,775	3.2%	47,980	2.6%	49,500	3.2%	52,230	5.5%
Receivables	1,412	1,384	-2.0%	1,598	15.4%	1,735	8.6%	1,601	-7.7%	1,665	4.0%	1,734	4.1%
Reinsurers share in insurance reserves	885	748	-15.4%	772	3.1%	701	-9.2%	841	20.0%	873	3.8%	910	4.2%
Deffered acquisition costs	454	481	5.9%	503	4.5%	570	13.3%	598	5.0%	628	5.0%	660	5.0%
Prepayments	291	253	-13.2%	232	-8.2%	126	-45.8%	132	5.0%	139	5.0%	146	5.0%
Other assets	12	16	34.6%	7	-52.8%	120	1515.8%	126	5.0%	133	5.0%	139	5.0%
Cash	533	367	-31.3%	424	15.6%	238	-43.9%	250	5.0%	262	5.0%	275	5.0%
Total assets	**59,359**	**53,176**	**-10.4%**	**50,534**	**-5.0%**	**52,129**	**3.2%**	**53,437**	**2.5%**	**55,210**	**3.3%**	**58,215**	**5.4%**
Total equity	**20,052**	**11,267**	**-43.8%**	**12,800**	**13.6%**	**12,870**	**0.5%**	**13,778**	**7.1%**	**14,057**	**2.0%**	**14,206**	**1.1%**
Provisions for unearned premiums and for unexpiered risk	4,127	3,847	-6.8%	3,976	3.4%	4,521	13.7%	4,586	1.4%	4,651	1.4%	4,716	1.4%
Life insurance provision	15,289	14,583	-4.6%	14,571	-0.1%	14,595	0.2%	14,929	2.3%	15,365	2.9%	15,894	3.4%
Provisions for outstanding claims	4,322	4,456	3.1%	5,157	15.7%	5,429	5.3%	5,503	1.3%	5,621	2.2%	5,785	2.9%
Provisions for capitalized value of annuity claims	4,529	4,875	7.6%	4,863	-0.2%	5,089	4.6%	5,332	4.8%	5,576	4.6%	5,819	4.4%
Other technical provisions	734	699	-4.8%	615	-12.1%	581	-5.5%	581	0.0%	581	0.0%	581	0.0%
Life provisions for products where the risk is taken by clients	1,765	2,018	14.3%	2,296	13.8%	2,300	0.2%	2,695	17.2%	3,124	15.9%	3,590	14.9%
Total insurance reserves	30,767	30,482	-0.9%	31,483	3.3%	32,523	3.3%	33,633	3.4%	34,926	3.8%	36,392	4.2%
Investment contracts	5,991	3,727	-37.8%	3,545	-4.9%	3,472	-2.1%	1,795	-48.3%	1,693	-5.7%	1,952	15.3%
Provisions for employee benefits	262	261	-0.4%	258	-1.2%	256	-0.9%	268	5.0%	282	5.0%	296	5.0%
Provisions for deferred income tax	205	444	116.3%	405	-8.8%	110	-72.9%	115	5.0%	121	5.0%	127	5.0%
Accruals and deferred income	653	701	7.4%	685	-2.2%	687	0.3%	721	5.0%	757	5.0%	795	5.0%
Liabilities related to discontinued operations	0	0	NA	0	NA	0	NA	0	NA	0	NA	0	NA
Other liabilities	1,428	6,295	340.7%	1,358	-78.4%	2,213	62.9%	3,126	41.2%	3,375	8.0%	4,446	31.7%
Total liabilities	**39,307**	**41,909**	**6.6%**	**37,734**	**-10.0%**	**39,260**	**4.0%**	**39,659**	**1.0%**	**41,154**	**3.8%**	**44,009**	**6.9%**
Total equity and liabilities	**59,359**	**53,176**	**-10.4%**	**50,534**	**-5.0%**	**52,129**	**3.2%**	**53,437**	**2.5%**	**55,210**	**3.3%**	**58,215**	**5.4%**

Source: Company reports, Citi Investment Research and Analysis

PZU

Company description

PZU is Poland's biggest insurance group by gross written premiums and one of the biggest insurers in the CEE region. In 2011, 56% of premiums (according to IFRS, i.e. excluding revenues from investment contracts without insurance protection) came from P&C insurance and 44% from life. In non-life insurance the main product is motor insurance (62% of non-life premium and 35% of total premium in 2011), while in life insurance the main product is employee protection group insurance (group life insurance, predominantly employee protection products plus insurance individually continued by former employees of insured enterprises, constituted 92% of life premium and 40% of total premium in 2011).

Investment strategy

In the long term, we expect PZU to benefit from rising Polish insurance premium income and its leading position in the domestic insurance market. In the medium term, the company's profitability should be driven by re-pricing in motor insurance, more than offsetting the negative impact of lower release of reserves in life group insurance. Short-term results may be negatively impacted by weak investment gains due to the declining equity markets, but the company should still be able to pay attractive dividends. We rate the company Buy.

Valuation

For valuation purposes we use Standard Warranted Equity Valuation (WEV) based on normalised capital as well as WEV based on reported equity. Conservatively we set our target price at Zl 430, at the lower value from these two valuation methods.

Our Standard Warranted Equity Valuation of Zl 430 per share is based upon the formula: Price / Book value = (Sustainable ROE - growth) / (Cost of equity - growth). We assume a sustainable return on equity of 20% and use a cost of equity of 10.5% and a sustainable growth rate of 4.5%.

In a Warranted Equity Valuation based on normalised equity we assume normalised capital at 250% of the consolidated solvency margin, and calculate an adjusted return on capital (deducting the investment gain on estimated surplus capital from the reporting earnings) and separately value the insurance business (assuming a 30% ROE vs. our estimate of 32% ROE in 2013) and surplus capital (at P/BV=1). This method arrives at a valuation of Zl 466 per share.

Risks

PZU is exposed to industry- and company-specific risk factors. The main downside risks that could prevent the shares from reaching our target price relate to (1) weather and catastrophe losses, (2) return to price competition in motor insurance, (3) reserving in life insurance and (4) investment yield achieved on investments held on own risk, mainly Polish T-bonds and listed equities.

Notes

Notes

Appendix A-1

Analyst Certification

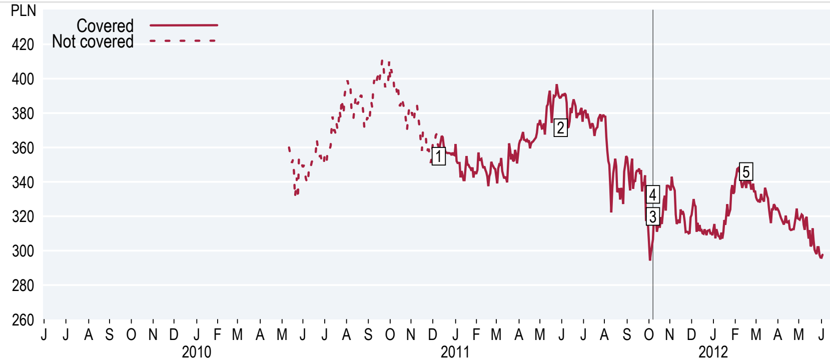
The research analyst(s) primarily responsible for the preparation and content of this research report are named in bold text in the author block at the front of the product except for those sections where an analyst's name appears in bold alongside content which is attributable to that analyst. Each of these analyst(s) certify, with respect to the section(s) of the report for which they are responsible, that the views expressed therein accurately reflect their personal views about each issuer and security referenced and were prepared in an independent manner, including with respect to Citigroup Global Markets Inc and its affiliates. No part of the research analyst's compensation was, is, or will be, directly or indirectly, related to the specific recommendation(s) or view(s) expressed by that research analyst in this report.

IMPORTANT DISCLOSURES

PZU (PZU.WA)

Ratings and Target Price History
Fundamental Research

Analyst: Andrzej Powierza
Covered since December 9 2010



	Date	Rating	Target Price	Closing Price
1	9-Dec-10	*1L	*431.00	360.00
2	31-May-11	1L	*449.00	389.00

	Date	Rating	Target Price	Closing Price
3	7-Oct-11	Stock rating system changed		
4	7-Oct-11	*1	449.00	306.50

	Date	Rating	Target Price	Closing Price
5	16-Feb-12	1	*436.00	336.40

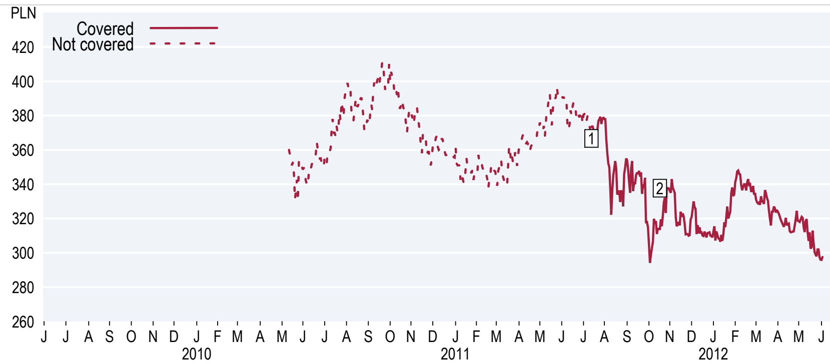
* Indicates change

Rating/target price changes above reflect Eastern Standard Time

PZU (PZU.WA)

Ratings and Target Price History
Best Ideas Research
Relative Call (3 Month)

Analyst: Andrzej Powierza
Covered since December 9 2010



	Date	Rating	Target Price	Closing Price
1	13-Jul-11	*ADD MP	-	373.30

	Date	Rating	Target Price	Closing Price
2	18-Oct-11	*REM MP	-	313.90

* Indicates change

Rating/target price changes above reflect Eastern Standard Time

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