Q2 Results 2015

Remarks by Martin Senn (slides 3 to 8), Chief Executive Officer, and George Quinn (slides 10 to 22), Chief Financial Officer of Zurich Insurance Group.

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Slide 3: Key financials

Welcome to Zurich Insurance Group’s results presentation for the first half of the 2015 financial year.

Business operating profit for the six months ended June 30 was 2.2 billion US dollars, down 15 percent from the prior year period on a reported basis, and down 10 percent at constant currency. Net income attributable to shareholders was down 3 percent at 2.1 billion dollars.

While our Life and Farmers businesses are continuing their positive trend and showing good results, the profitability of our General Insurance business has been negatively impacted by higher than expected large losses, particularly in the UK and within Global Corporate’s US operations, and a higher expense ratio. This led to a business operating profit return on equity for the first half of 2015 of 11.6 percent, below our target range of 12 to 14 percent.

We are addressing the expense ratio issue and expect to see the benefits coming through early next year. Additionally, we have taken steps to improve profitability, particularly in Global Corporate in North America.

While BOPAT ROE remains the challenge, we continue to deliver on our other key targets. First, our Zurich Economic Capital Model ratio stood at 120 percent at the end of the first quarter, at the top of our target range. And second, cash remittances are expected to exceed 3.5 billion dollars for the full year and 10 billion dollars for the period 2014-2016, well ahead of our target of 9 billion dollars.

Slide 4: Report card – Group

We provided an update on our progress at our Investor Day in May, highlighting the investments we are making in distinctive positions, the actions we have taken in the businesses we are managing for value and our various initiatives to grow our operating earnings.

In relation to the first cornerstone of our strategy, we gave a clear sense of the actions underway in Farmers and NAC last December, and in relation to our life business and Global Corporate two months ago. To give you a sense of some of the tangible actions taken in the first half, we have continued the roll out of our predictive analytics initiative, which is now up and running in 21 countries. In our Corporate business, as of June 30, we had achieved over 100 new common customers across our
Corporate Life & Pensions and Global Corporate businesses out of a target for this year of 150 and we are seeing further improvements in product density.

In the businesses that we are managing for value, we have continued to implement measures to turn around under-performing smaller General Insurance Businesses and are taking action to improve profitability in our Brazil operations. In our life business we have agreed the sale of part of a block of UK annuities to Rothesay Life and plan to sell our stake in UK-based Seven Investment Management to Caledonia Investments. Both transactions are subject to regulatory or court approval.

In terms of growing operating earnings, we have begun to execute on our plan to deliver 300 million dollars of efficiencies by the end of next year. And, as I mentioned earlier, we have also taken steps to address the weaker environment in some of our GI portfolios.

**Slide 5: Report card – General Insurance**

Gross premiums are up 3 percent on a local currency basis, with continued progress in our priority markets. The overall rate environment continues to be broadly stable, although we see challenges in some markets, such as US property.

Business operating profits in our General Insurance Business for the first half were 27 percent lower than in the prior year period, at constant currency. This is due to two factors: an increase in large losses, particularly in the UK and within Global Corporate’s US operations, and a higher expense ratio.

We recognize that there will always be some volatility in large losses in our GI business on a quarterly basis, with losses in both Q1 and Q2 higher than in any quarter in 2014.

Of the 1.5 point increase in the expense ratio, around 0.5 points is due to one-off positives in the prior year and a further 0.5 points is due to mix effects on commission and the upfront cost of the extended warranty business in Brazil.

We also have a number of important initiatives underway to deliver a 2 to 3 percentage points improvement in the combined ratio from 2014 levels. We see positive signs, for example, in some of our turnaround businesses, and would expect the benefit of these actions to become visible in our results towards the end of this year.

Nonetheless, we had clearly expected to see more progress in improving profitability at this half way stage in the current three year strategic period. We have launched additional actions in the US Global Corporate property portfolio and we will look to adjust pricing in other parts of the US business. We are prepared to shed volume to ensure we achieve these goals.
Let me be clear. I am not satisfied with our current performance in General Insurance, and delivering on the commitments we made at the investor day is my number one priority.

**Slide 6: Report card – Global Life**

We have seen further good growth in new business, with APE up 19 percent in local currency, and with strong performance from bank distribution, developed markets growth businesses, and from some of our manage for value units.

We have also seen a very good improvement in business operating profits, up 21 percent in local currency, again, with bank distribution, developed markets growth and manage for value all contributing. While partly due to one-off charges in the prior year, BOP was still 14 percent higher in local currency excluding these items, driven by strong growth in revenues and the technical margin.

New business value has not matched this strong performance, down 5 percent in local currency, though this is largely a function of low bond yields.

While actions are underway to address some challenges within the Emerging Markets growth businesses, overall we can see that our strategic actions are starting to flow through to financial metrics. As I mentioned before, we are also in the process of exiting two non-core parts of our life portfolio in the UK, and expect to see further actions to release risk capital in the next 18 months.

**Slide 7: Report card – Farmers**

We continue to see encouraging trends at the Farmers Exchanges, which we do not own.

Gross written premiums at the Farmers Exchanges rose by about 4 percent in the core business, and 2 percent overall.

This was driven by a further improvement in retention. There has also been encouraging progress in the net promoter score, which is an important leading indicator for the future.

We have seen further growth in the number of agents. Although growth in new business has slowed, this is due to some actions in the Bristol West auto book and it doesn’t change our confident view of the outlook.

In summary, we are executing what we said we would do and seeing tangible progress in key metrics.
**Slide 8: Key messages**

Our half year results are below our expectations but General Insurance is working on a large number of projects to improve profitability and reduce costs, and we expect to see the benefits in our results in the coming quarters.

We are making good progress in many areas, notably in our life business and Farmers.

New business volumes and business operating profit in our life operations were both up around 20 percent compared to the prior-year period.

The top-line of the Farmers Exchanges continues to improve, underpinned by execution of the strategy and further evidenced in our key metrics.

And we remain very well capitalized and now expect to achieve cash remittances over this strategic cycle of more than 10 billion dollars, well ahead of our target.

Finally, you will no doubt be aware that we are evaluating making an offer to acquire RSA Insurance Group. At this stage, there is very little that we can say on this topic.

We believe that a transaction could bring significant benefits to us and to our investors, in terms of the complementary fit of RSA’s business with our own operations, and in terms of financial benefits from, for example, expense and other synergies.

But let me make one point absolutely clear. This or any other investment must meet the hurdles that we set last year – 10 percent, unlevered. As we’ve said repeatedly in the past, if we are unable to achieve this for organic or inorganic opportunities, we’d rather return capital to our investors.

Let me also reassure you that this does not, and will not, distract us from our core focus of delivering on the commitments to investors that we made at our May investor day.

Thank you for your attention and your continued trust and support.

**Slide 10: Group – Business Operating Profit**

Good morning or good afternoon. My name is George Quinn and I am the Chief Financial Officer of Zurich Insurance Group. I will take you through our results in more detail.

Q2 Business Operating Profit of 943 million dollars is 24 percent lower than in the prior year quarter, with Net Income Attributable to Shareholders of 840 million dollars flat compared to Q2 2014. On a constant currency basis, we have reported a reduction in BOP of around 18 percent for Q2 standalone.
While our Life and Farmers businesses are performing well, we have a weaker than expected combined ratio in some of our GI businesses.

When comparing results this year with last, currency is a significant feature. We report in US dollars but only about half our business is in this currency. This means that the strength of the US dollar has had a negative impact on our reported results.

However, before I go into the details of our results, I will briefly highlight some points on this slide.

We are starting to see the impact of our focus on costs within OOB as costs start to fall in the headquarters. We also benefit from lower financing costs and currency gains in Q2. In prior years there has been a skew in OOB costs to the second half, principally due to the timing of marketing spend and this will continue in 2015.

In the walk we show from BOP to NIAS on this slide, we have realized gains of around 240 million dollars. This breaks down as roughly 140 million dollars on fixed income and 95 million dollars on equities.

Finally, we also have the first charges related to our efficiency programme as we incurred around 70 million dollars of costs in the quarter, related to a combination of restructuring initiatives, impairments of IT and other accounting charges. Additionally, we impaired around 30 million dollars of goodwill in the quarter.

**Slide 11: General Insurance – Topline**

At constant currency, gross premiums written for the second quarter were roughly flat compared to the prior year period, and net earned premiums were up by 1 percent. Looking at the half-year, gross written premiums were up 3 percent, which is broadly in line with our underlying growth rate.

Overall rate increases on renewal for the quarter came slightly down to 1 percent, with the pressure in the US continuing but also in Australia and in Europe.

Global Corporate reported a decrease of 10 percent in local currency for the quarter. This is impacted by timing effects and some other factors and for the half-year growth in local currency was 1 percent. Given market trends, especially in the US, we would see a flat to declining topline as the most likely outcome for the full year for this business.

For NAC, gross premiums were up 5 percent for the quarter with continued execution of our strategic growth initiatives.
Looking at our European business and excluding Russia Retail, top-line is up 1 percent in local currency. Expansion in Switzerland, Germany and Spain was off-set by the UK and Italy.

In International markets, premiums increased by roughly 12 percent in local currency. The majority of this growth is driven by the new extended warranty distribution agreement in Brazil. In our Asia Pacific region, a decline in premiums in Australia is partly off-set by continuing solid growth in Japan and Hong Kong.

**Slide 12: General Insurance – Combined Ratio**

GI’s combined ratio of 100 percent for the second quarter, and 98.3 percent for the half-year, is weaker than our expectations.

This is mainly due to a higher than expected accident year ex-cat combined ratio, which was 97.9 percent for Q2 and 97.4 percent for the first half, compared to 93.4 percent and 94.5 percent in the respective prior year periods.

There are several drivers of the weaker than expected outcome.

First, large losses are around 1.5 points above expectations in both quarters in 2015, with Q2 around 2 points worse than a benign result in the prior year period. For Q2, this includes several large losses across the portfolio, principally affecting the UK and Global Corporate.

Second, the attritional loss ratio for the quarter is around 1 point adverse to Q1, for several reasons that are not indicative of our current run rate. A comparison of the half year attritional loss ratio with full year 2014 is a better reflection of underlying trends. On this basis the ratio is broadly flat.

In terms of underlying trends for the first half, we continue to see improvements in a number of businesses, as well as some pockets of higher frequency and severity in a few US portfolios. Given that the current market environment is unlikely to change any time soon, we will need to continue to drive improvements in the loss ratio through further management actions.

Third, the expense ratio for the second quarter is 31.6 percent. While this is consistent with Q1 and with our prior guidance for 2015, it is 2 percentage points higher than in Q2 2014. The full impact of the expense efficiency initiatives will not start to feed through until Q1 next year.

On the other key parts of the combined ratio, prior year reserve movements were a positive 1.3 percent for the second quarter. And catastrophe losses had a 3.4 percent impact on the combined ratio for the quarter. This was 1 point higher than last year but broadly in line with our expectations, with a
large wildfire and several weather events in the US, storm Niklas in Germany and further storms in Australia.

On the performance by region, the increased combined ratio in Global Corporate is mainly driven by the large losses I mentioned before and catastrophe losses which were higher than our expectation, partly off-set by a better result from prior year reserves than last year.

In North America Commercial an increase in the accident year ex-cat combined ratio was partly off-set by lower catastrophe losses and a higher benefit from reserve releases. The increase in the expense ratio of roughly 2 points was driven by a combination of one-offs, investments in our strategic initiatives, mix of business and higher management expenses.

EMEA’s combined ratio is up 4 percentage points on the prior year period. This is mainly driven by the higher large losses in the UK that I mentioned earlier, a lower level of prior year reserve releases and an increase in the expense ratio, mainly driven by one-off benefits in 2014. These increases were partly off-set by a further improvement in the attritional loss ratio, mainly in Germany, Spain and South Africa.

And the increase in the combined ratio for our International Markets of roughly 2 points is primarily driven by the upfront payment for the new distribution agreement in Brazil and the catastrophe losses in Australia.

**Slide 13: General Insurance – BOP Components**

GI BOP was 460 million dollars for the second quarter, around 40 percent below the prior year in both reported and local currency. This is due to the lower underwriting result.

In terms of other components of GI’s operating earnings, a decline in investment income and in the returns on our hedge fund portfolio were broadly off-set by lower non-technical expenses.

Investment income in Q2 was broadly flat in local currency compared to the prior period. Given some seasonality in the investment income we wouldn’t extrapolate this to the rest of the year, and still expect a decline in investment income of around 100 million dollars for the full year compared to 2014, on a constant currency basis. The positive news here is that we seem to be approaching an inflection point on investment income with the reinvestment yield very close to the book yield in the quarter. Assuming, of course, that interest rates stay at current levels.

Neither the first half or the second quarter results are indicative of what we expect for the future run rate. This is partly explained by the exceptional level of large losses in Q2. We had two fire losses in
Zurich Municipal in the UK which cost us 80 million dollars so far this year. Our Global Corporate business in North America has suffered its highest level of large losses in any half year since 2008. But even with some generous assumptions around large losses, we are not happy about the execution on our plans to improve attritional loss ratios, principally in our Global Corporate business in North America. We will prune the portfolio as needed to maintain the level of profitability that we need to achieve our targets.

**Slide 14: Global Life – New Business**

New business APE volumes increased 15 percent in local currency compared to the prior year period, driven by strong performance in our Europe, Middle East and Africa and Asia Pacific regions.

Europe, Middle East and Africa increased local currency new business volumes 23 percent overall with growth seen in nearly all countries, primarily driven by Corporate Life and Pensions volumes in the UK and Switzerland, and individual savings growth in Banco Sabadell and Italy.

Asia Pacific grew local currency volumes by 47 percent, with strong sales of protection business in Japan driving the result.

While Latin America volumes in local currency declined by 3 percent, this reflects a greater reduction in Zurich branded Latin America business, mostly offset by 15 percent growth in Zurich Santander APE.

North America experienced a 24 percent reduction in APE, reflecting exceptional volumes achieved in the prior year quarter and increasing competition in our target IFA market.

Analyzed by pillar, we again saw double digit growth in each of the businesses in local currency, with Corporate Life and Pensions volumes increasing 21 percent, as well as 11 percent growth in our Bank Distribution businesses and 13 percent in Retail.

New business value was down 4 percent in local currency year on year, as lower yields continued to impact our savings business in Europe. We set the swap rate at the end of the immediately preceding quarter which was broadly the low point for the year so far. Other factors reducing the new business margin included persistency related modeling changes in North America and changes in product mix.

And finally, net inflows were positive for the quarter for all regions.

**Slide 15: Global Life – BOP by Region**

Q2 Business operating profit of 355 million dollars increased 13 percent compared to the prior year period in dollars, and up 29 percent in local currency.
This strong result was driven by two main areas.

First, in Latin America, Zurich Santander earnings grew by 16 percent, or 50 percent in local currency, following favorable experience in persistency, sales volumes, claims, expenses and investment income in Brazil. This continued progress was partly offset by lower earnings in the Zurich branded Latin American business, mainly due to the non-renewal of the SIS contract that we mentioned last quarter, and contributed to a loss in our Emerging Markets Growth bucket.

Second, our Europe, Middle East and Africa business grew earnings by 4 percent, or 20 percent in local currency, with strong results in Germany complemented by profits stemming from the transfer of an annuity book in the UK and lower levels of discretionary policyholder dividends in Switzerland.

While Latin America and Europe, Middle East and Africa showed strong earnings growth, North America BOP was flat, owing to pressure in the IFA business, and Asia Pacific was down 14 percent in local currency.

Adjusting for one-off factors, the underlying improvement in BOP is 19 percent in local currency.

Slide 16: Global Life – Sources of Earnings

Adjusting for various one-off factors, and as explained in the updated Sources of Earnings briefing document, our revenues grew 8 percent in local currency during the first half of 2015. The main driver was 8 percent local currency growth in loadings and fees, where volumes in Zurich Santander and the Isle of Man supported loadings growth of 9 percent, while cross border unit-linked sales in Ireland contributed to fund-based fees growth of 7 percent. This growth was achieved despite offsetting factors in the UK where, in retail, higher margin in-force business is being replaced by lower margin new business, resulting in a decrease in loadings and fees.

Again adjusting for one-off factors and in local currency, the investment margin decreased by 8 percent including the impact of discretionary policyholder dividends, which was expected given continuing yield pressure in Europe and our focus on protection and unit-linked products. The technical margin when adjusted for one-off items grew by 13 percent in local currency, mainly benefitting from higher volumes and positive experience in Zurich Santander and Europe, Middle East and Africa, which also included the proceeds from the transfer of an annuity book in the UK.

Expenses increased by 5 percent in local currency, after adjusting for one-off benefits in the first half of 2014. While operating costs increased by 6 percent, when viewed as a percentage of reserves the KPI is flat. Acquisition costs, excluding the impact of deferrals, grew in line with revenues by 8 percent in
local currency, where commissions related to higher sales in Zurich Santander, Europe Middle East and Africa and Japan were slightly offset by decreased volumes in North America.

This is a good result from our life business, where actions around in-force management initiatives and manage for value operations have begun to show tangible progress. At the same time we will continue to invest in our priority markets to further grow operating earnings and cash in the medium term.

On the next slide I will give you an update on the Farmers Exchanges, which we do not own but are relevant to the performance of our Farmers business segment.

**Slide 17: Farmers Exchanges – KPIs**

Gross Written Premiums at the Farmers Exchanges grew 2 percent overall and 3.5 percent for the core businesses, excluding 21st Century and Business Insurance sold through independent agents. Policies in force also slightly increased over the quarter.

This is slightly below the growth rate in Q1, due to lower growth at Bristol West and Exclusive Agent Business insurance, reflecting the impact of certain underwriting actions taken. The overall picture continues to be positive, particularly for the Exclusive Agent distribution business.

In terms of the combined ratio, both the quarter and the half-year show a 3 to 4 percentage point improvement, which is largely due to lower catastrophe losses. While the second quarter continues to suffer more catastrophes, the level of losses in 2015 is much more in line with our expectations.

Looking at the profitability of specific business lines, it is clear that the combined ratios of standard and non-standard auto are not satisfactory, reflecting unfavorable trends in frequency and severity.

As I mentioned in our first quarter results, the Farmers Exchanges are now taking rate actions in auto business. While the impact of these rate actions on growth for the rest of the year remains to be seen, this is a necessary step.

Finally, the surplus ratio has decreased 1.5 percentage points since the beginning of the year, even though the Farmers Exchanges have added some 100 million dollars to surplus. This is due to the lower Quota Share reinsurance participation and is fully expected.

**Slide 18: Farmers – KPIs**

Farmers Management Services BOP decreased by 9 percent or 34 million dollars.
The biggest factor here is an unfavorable fluctuation in the mark-to-market valuation of securities backing certain employee benefit liabilities, as well as the gain on the sale of the former headquarters building in the prior year period.

The balance is due to marginally lower management fees and slightly higher expenses. Overall, the Managed Gross Earned Premium margin was 7 percent in line with our expected run rate.

Farmers Re BOP improved significantly. While Gross Written Premiums and investment income decreased as a result of the lower Quota Share reinsurance participation this was more than compensated for by an improved combined ratio.

**Slide 19: Group – Balance Sheet and Capital**

There were significant swings in financial markets in the first half. Yields increased and credit spreads widened in the second quarter and more than reversed the movements seen in the first. Similarly the strong appreciation of the US dollar in the first quarter against relevant currencies to some extent was moderated in the second.

As a consequence unrealized gains on investments dropped significantly in the second quarter and together with the payment of the dividend caused shareholders’ equity to decline by 3.5 billion dollars.

Our capital position continues to be strong. Our Z-ECM ratio decreased 2 points to 120 percent at the end of March – higher than we’d previously estimated. Net market movements are estimated to have had a 3 to 4 point negative impact while currency movements were more or less neutral.

**Slide 20: Group – Free Capital Generation**

For the half year we have updated the free capital generation analysis we first disclosed at our 2013 investor day.

Please note that we’ve made one change to simplify the approach this year, basing free capital generation for Global Life on the MCEV free surplus roll forward.

The results are very consistent with last year, with operating capital generation of slightly above 3 billion dollars. This is expected given that our overall earnings level was also broadly unchanged from 2013.

Second, as we showed you last year, a very high percentage of our operating earnings turn into operating capital generation, particularly for GI and Farmers.
And third, our flexible capital structure enables us to facilitate a high rate of conversion of operating free capital generation into net cash remittances, as I will explain on the next slide.

**Slide 21: Group – Net Cash Remittances**

This slide compares BOPAT, operating capital generation and cash remittances by segment, for 2013 and 2014.

As I have said before, most of our cash generation comes from a fairly small number of operations that are close to the central holding companies, and we have a policy of pooling risks as close to the center as possible. This helped our businesses deliver 3.7 billion dollars of cash remittances in 2014, and we expect to achieve a similarly strong result in 2015.

Consistent with last year, we again expect to see some further one-off positives in 2015. As a result, you should not extrapolate our cash remittance expectations for this year into the future. However, we remain very pleased with our progress to date.

**Slide 22: Key messages**

Overall, results in GI for the quarter are short of our expectations. This is partly due to large loss experience but also due to a slower pace of improvement in the attritional loss ratio. This requires additional corrective actions within some lines of business in North America, and this is underway now. This, in combination, with our existing plans and commitments to improve efficiency, will deliver a 2 to 3 point improvement in the combined ratio.

Elsewhere in the group, we continue to demonstrate very good progress. Both our Life business and Farmers have reported good results, and are on track with our expectations.

You can expect to see further restructuring charges in Q3 and Q4 as we continue the implementation of our efficiency program. We estimate that charges in the second half will be around 300 million dollars.

In addition, we continue to generate significant cash remittances at a group level, with 2015 expected to be another strong year. We now expect to achieve cash remittances for 2014 to 2016 of more than 10 billion dollars, well ahead of our target.

Thank you for watching.
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