magellan

BFF BANKING GROUP

Directors' Report of the Magellan Group for the six months ended 30 June 2017

Finansując zwiększamy możliwości

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1. Legal status and description of the Magellan Group

1.1. General information

The Magellan Group (the Group) is an international financial institution which focuses on providing financial products and services to entities operating in the medical and local government markets, and on factoring services intended for the general market. The Group offers a wide range of services involving the financing of operating and investing activities. It provides off-the-shelf or tailored financial services which enable medical and local government market entities to optimally and effectively manage their funds.

The Group has a strong market position and high growth potential due to the fact that it has more than ten years' experience, offers solutions tailored to its customers' current needs and liquidity position, ensures superior quality Group management and wins investors' confidence, which translates into a high and stable level of external financing.

Since June 2016, Magellan S.A. and its subsidiaries have been part of the Italian banking group BFF Group (BFF). Magellan Group and BFF have joined forces to become one of the largest and fastest growing institutions which provide financial solutions for the public and healthcare sectors in Europe.

1.2. Composition of the Group and capital and organizational relationships

The composition of the Magellan Group as at 30 June 2017:

- **Magellan S.A.** — the parent;
- **MEDFinance S.A.** — a subsidiary; 100% of shares held by Magellan S.A.;
- **Magellan Česká republika s.r.o.** — a subsidiary; 100% of shares held by Magellan S.A.;
- **Magellan Central Europe s.r.o.** — a subsidiary; 100% of shares held by Magellan S.A.;
- **DEBT-RNT Sp. z o.o.** — a subsidiary; 100% of shares held by Magellan S.A.;
- **Komunalny Fundusz Inwestycyjny Zamknięty** — an investment fund; 100% of certificates held by Magellan S.A.;
- **MEDICO Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty** — an investment fund; 100% of certificates held by Magellan S.A.

Associates as at 30 June 2017:

- Kancelaria Prawnicza Karnowski i Wspólnik Spółka Komandytowa;
- Restrukturyzacyjna Kancelaria Prawnicza Karnowski i Wspólnik spółka komandytowa spółka komandytowa (since 8 April 2016, the law firm has been operating as an indirectly associated undertaking, via DEBT-RNT Sp. z o.o., a subsidiary of Magellan S.A).

Details of the Magellan Group companies and the individuals managing and supervising them, and changes in the Group's composition, are presented in Note 1 to the interim consolidated financial report for the six months ended 30 June 2017.

Magellan S.A., as the parent, carries out a full consolidation of the financial statements of MEDFinance S.A., Magellan Česká republika s.r.o., Magellan Central Europe s.r.o., DEBT-RNT sp. z o.o., Komunalny FIZ and MEDICO NSFIZ.

2. Shareholding structure of the Parent

Banca Farmafactoring S.p.A. is the parent and the sole shareholder of Magellan S.A., holding 128,291,677 shares in the Company. Details of the Company's parent are presented in Note 1.3 to the interim consolidated financial report for the six months ended 30 June 2017.

In the reporting period, there were no changes in the shareholding structure of Magellan S.A.

3. Corporate bonds on the Catalyst market

In 2016, the Management Board of Magellan S.A. decided to introduce corporate bonds into the Catalyst market alternative trading system. The Company's corporate bonds, both zloty- and euro-denominated, were introduced onto the Catalyst market, into the Alternative Trading System operated by BondSpot S.A., and into the Alternative Trading System operated by the Warsaw Stock Exchange. The first bond series in the Catalyst alternative trading system was introduced in December 2016 and listed on 28 December 2016 for the first time. Further 16 bond series were introduced in February 2017 and their first date of listing was 17 March 2017.

Details of the bonds introduced for trading on the Catalyst market are presented in Note 12 to the interim consolidated financial report for the six months ended 30 June 2017.

4. Financial position of the Group

4.1. Sales and markets

In the six months ended 30 June 2017, the Magellan Group continued the provision of financial, financial intermediation and investment financing services for healthcare and local government entities, and factoring services for the general market.

The Magellan Group operates in the Polish market (Magellan S.A., MEDFinance S.A., DEBT-RNT Sp. z o.o., Municypalny Fundusz Inwestycyjny Zamknięty, MEDICO Niestandaryzowany Sekurytyzacyjny Fundusz Inwestycyjny Zamknięty), the Czech market (Magellan Česká republika s.r.o.), and the Slovak market (Magellan Central Europe s.r.o.). Until the end of 2016, Magellan S.A. Corporate Branch carried out operating activities in Spain. In order to ensure the operating effectiveness of the Group including Magellan S.A., in 2017, the Company's Management Board decided to close down the branch in Spain.

In the six months ended 30 June 2017, the Magellan Group executed contracts in a total amount of PLN 1,328,775 thousand, up PLN 237,134 thousand, i.e. 22%, compared with the six months ended 30 June 2016. The executed contracts were for the financing of investing and operating activities of entities operating in the medical market in Poland and in the Czech Republic and Slovakia, and the financing of operating and investing activities of Polish local government entities and their suppliers, and factoring services for businesses.

In the six months ended 30 June 2017, the total value of on-balance sheet contracts executed by the Group amounted to PLN 1,014,989 thousand, compared with PLN 823,418 thousand in on-balance sheet contracts executed in the six months ended 30 June 2016, which denotes an increase of PLN 191,571 thousand, i.e. 23%. In the six months ended 30 June 2017, the total value of executed off-balance sheet contracts amounted to PLN 313,786 thousand, up PLN 45,563 thousand, i.e. 17%, compared with the total value of off-balance sheet contracts executed in the comparative period.

On-balance sheet contracts performed correspond to financial assets which, as a result of contracts executed, were recognized in the Group's assets in the respective periods. Whereas, off-balance sheet contracts include framework and conditional agreements concerning the products offered by the Group, which do not increase the value of the Group's assets as at the date of signing.

The Group's contracts performed in the six months ended 30 June 2017 and in the comparative period of 2016 are presented in the following table:

Product type (PLN '000)	Performance 01/01/2017 — 30/06/2017	Performance 01/01/2016 — 30/06/2016*)	Change	Change %
On-balance sheet contracts	1,014,989	823,418	191,571	23%
Off-balance sheet contracts	313,786	268,223	45,563	17%
Total contracts	**1,328,775**	**1,091,641**	**237,134**	**22%**

*) The amounts for the comparative period presented in this table take into account amendments and annexes to the contracts executed until 30 June 2017.

The objective of the Magellan Group is to maintain business relationships with the largest possible number of business partners. During the reporting period, the Group was not dependent on any one business partner. With a view to ensuring the security of its assets, the Group diversifies its portfolio of financial assets and maintains the single client exposure at a safe level relative to the value of the portfolio of financial assets.

The Group believes that its market has potential for growth. Mismatch in cash flows in the healthcare system generates constant demand for the services provided by the Group. Additionally, the Group is active in the market for financial services intended for local government entities. The Group believes that there is a growing demand for the financing of both operating and investment activities also in this market, which translates directly into increased interest in the products offered by the Group. A big potential for further growth is associated with the Group's operation in foreign markets and the addition of factoring services for the general market to the Group's product range.

The public sector, in which the Group carries out its core activities, is characterized by limited risk of impairment of the financial assets acquired. The Group's financial asset portfolio is mainly composed of assets from public healthcare and local government entities which are not subject to bankruptcy law and whose debts are the responsibility of their founding institutions in the event of liquidation. The Group pursues an appropriate policy for recognizing impairment losses, paying particular attention to collateral being commensurate with the corresponding credit risk.

4.2. Proceeds and revenue

Proceeds, commission and commission equivalents comprise:
- proceeds, offsets and deductions concerning the realization of the portfolio of financial assets held — principal repayments (excluding proceeds from loans and finance leases);
- commission income and discount realized on each product;
- interest income from each product, classified as part of the core business activities.

	01/01/2017 to 30/06/2017	01/01/2016 to 30/06/2016
	(PLN '000)	(PLN '000)
Proceeds, commission and commission equivalents	451,936	537,239
Cost of realized proceeds	(365,066)	(465,982)
Realized sales of services	**86,870**	**71,257**
Realized sales of goods for resale	1,025	1,628
Total sales	**87,895**	**72,885**
Proceeds from the repayment of originated loans and leases	354,412	341,329
Total proceeds	**807,373**	**880,196**

In the six months ended 30 June 2017, the Group's turnover defined as the total proceeds from the portfolio of financial assets held (excluding proceeds from the repayment of originated loans and finance leases, and realized sales of goods for resale) was PLN 451,936 thousand, which denotes a decrease of PLN 85,303 thousand, i.e. 16%, compared with the turnover of the corresponding period of 2016. The cost of realized proceeds corresponds to realized financial assets stated at cost.

In the six months ended 30 June 2017, proceeds (including offsets, deductions and accrued income), plus repayments of loans originated by the Group, finance lease proceeds, and sales of goods for resale, amounted to PLN 807,373 thousand, which denotes a decrease of PLN 72,823 thousand, i.e. 8%, compared with the comparative period.

In the six months ended 30 June 2017, the Group's revenue amounted to PLN 87,895 thousand, up PLN 15,010 thousand, i.e. 21%, compared with the revenue for the six months ended 30 June 2016.

4.3.Results of operations

In the six months ended 30 June 2017, the Magellan Group generated a net profit of PLN 24,297 thousand. The net profit for the six months ended 30 June 2017 was PLN 10,777 thousand, i.e. 80%, higher than the net profit generated in the comparative period. The generated net profit was attributable to higher sales and lower costs by nature of expense.

Selected key financial information is presented below.

Category	01/01/2017 - 30/06/2017 PLN '000	01/01/2016 – 30/06/2016 PLN '000	Change (H1 2017 – H2 2016)	Change as % of actual for 2016
Proceeds, commission and commission equivalents, together with repayments of loans originated by the Group and leases	807,373	880,196	-72,823	-8%
Total sales	87,895	72,885	15,010	21%
Cost of financing of the portfolio	32,186	31,279	907	3%
Cost margin (sales less cost of goods sold and cost of financing)	54,723	40,062	14,661	37%
Costs by nature of expense	21,917	24,644	-2,727	-11%
Net profit	**24,297**	**13,520**	10,777	80%
Earnings per share (in PLN)	**0.19**	**2.01**	-1.82	-91%
On-balance sheet contracts – financial assets	1,014,989	823,418	191,571	23%

Value of the portfolio of financial assets (as at the end of the reporting period)[1]	2,144,998	1,740,205	404,793	23%
Operating margin (EBIT/sales)	38%	22%	16 pp	73%
Net profit margin (net profit/total sales)	28%	19%	9 pp	47%
Operating leverage — costs by nature of expense (adjusted for impairment losses and provisions)/sales (adjusted for impairment losses recognized in this line)	21%	31%	-10 pp	-32%
Current ratio (current assets/current liabilities)	0.78	0.98	-0.20	-20%
Liabilities to assets ratio (total liabilities/total assets)	81%	81%	-	-
Financial leverage (interest liabilities/equity)	4.07	3.96	0.11	3%
Book value per ordinary share (in PLN)	3.22	52.34	-49.12	-94%

Contracts performed in the six months ended 30 June 2017 made it possible for the Group to build a portfolio of financial assets of PLN 2,144,998 thousand as at 30 June 2017, which denotes an increase of PLN 404,793 thousand, i.e. 23%, compared with the comparative period.

The growing value of the Group's portfolio of financial assets, despite hard market conditions, stronger competition and reduced profitability of the assets contracted, translated into an increase in sales in the six months ended 30 June 2017 of PLN 15,010 thousand, i.e. 21%, compared with the six months ended 30 June 2016.

The good results of operations of the Group are also attributable to the continued strong cost discipline.

In the six months ended 30 June 2017, the cost of financing of the portfolio of financial assets amounted to PLN 32,186 thousand and it was PLN 907 thousand, i.e. 3%, higher than the cost incurred in the six months ended 30 June 2016. The increase in the cost of financing of the portfolio was directly attributable to an increase in the average level of external financing used — in the six months ended 30 June 2017, the average level of financing was PLN 1,580,512 thousand and it was PLN 271,915 thousand, i.e. 21%, higher than in the comparative period.

In the six months ended 30 June 2017, operating expenses involved in the Group's core business activities amounted to PLN 21,917 thousand, i.e. they were PLN 2,727 thousand, i.e. 11%, lower than in the comparative period.

In the six months ended 30 June 2017, the Group achieved an operating leverage, calculated as the ratio of costs by nature of expense less provisions and impairment losses to sales adjusted by impairment losses, of 21%, compared with 31% in the comparative period, which denotes a decrease of 10 pp, i.e. 32%.

As a result, an increase in sales of 21% and a decrease in costs of core operating activities of 11%, translated into a 113% increase of operating expenses and an 80% increase of net profit.

In the six months ended 30 June 2017, the Group's net profit margin, calculated as the ratio of realized net profit to sales, was 28%, which denotes an increase of 9 pp, i.e. 47%, compared with the six months ended 30 June 2016. There was also an increase in the operating margin, calculated as the ratio of EBIT to sales, which amounted to 38% in the six months ended 30 June 2017, up 16 pp, i.e. 73%, compared with the comparative period.

[1] Assets are presented at fair value equal to their cost of purchase, as adjusted for the measurement of financial instruments using the effective interest method.

In the six months ended 30 June 2017, earnings per share, despite an increase in net profit, were lower than in the corresponding period of 2016: PLN 0.19 in the six months ended 30 June 2017 vs. PLN 2.01 in the six months ended 30 June 2016, which was the result of an increase in the number of shares of Magellan S.A. in December 2016. The number of the Company's shares was 128,291,677 as at 30 June 2017 and 31 December 2016, compared with 6,720,037 as at 30 June 2016.

The increase in the number of shares also contributed to a decrease in the book value per ordinary share: from PLN 52.34 as at 30 June 2016 to PLN 3.22 as at 30 June 2017.

4.4. Structure of the Group's balance sheet assets and liabilities and material off-balance sheet items

As at 30 June 2017, the Group's assets were composed of:
- non-current assets – PLN 1,120,726 thousand (51%);
- current assets – PLN 1,083,741 thousand (49%).

As at the balance sheet date, cash and cash equivalents amounted to PLN 27,202 thousand, which accounted for 1% of total assets.

As at 30 June 2017, PLN 413,275 thousand, i.e. 19%, of the Group's assets were equity-financed. The remaining liabilities and equity, of PLN 1,791,192 thousand, i.e. 81%, were liabilities and provisions for liabilities, including:

PLN 524,629 thousand, i.e. 29% – bank loans and advances;
PLN 257,014 thousand, i.e. 14% – own bonds;
PLN 901,353 thousand, i.e. 51% – loans from related entities;
PLN 108,196 thousand, i.e. 6% – other.

As at 30 June 2017, the financial leverage used, calculated as the ratio of external interest-bearing financing (bank loans, advances and own bonds) to equity, amounted to 4.07 vs. 3.91 as at 31 December 2016 and 3.96 as at 30 June 2016.

As at 30 June 2017, off-balance sheet liabilities arising, among other things, from active pledge limits, framework loan agreements, refinancing of liabilities and conditional agreements in place, amounted to PLN 670,504 thousand vs. PLN 612,597 thousand as at the end of the comparative period. A detailed list of off-balance sheet items is presented in Note 16 to the interim, abbreviated consolidated financial statements.

4.5. Cash flows

In the six months ended 30 June 2017, the Group's net cash used in operating activities amounted to PLN 133,391 thousand, net cash from investing activities amounted to PLN 3,785 thousand and net cash from financing activities amounted to PLN 128,493 thousand.

	01/01/2017 to 30/06/2017	**01/01/2016 to 30/06/2016**
	(PLN '000)	(PLN '000)
Net cash used in operating activities	(133,391)	(17,753)
Net cash from/(used in) investing activities	3,785	(580)
Net cash from financing activities	128,493	63,143
Change in cash and cash equivalents	**(1,113)**	**44,810**

4.6. Investments

The Group's core business activities involve the financing and modification (restructuring) of assets classified as financial instruments, including principal and interest receivables and loans (category:

Loans and receivables originated by the entity) — Note 9 to the interim consolidated financial statements.

As at 30 June 2017, the Group held derivative instruments: forward contracts and an interest rate swap (IRS) transaction, only for the purpose of operating hedging of the risk involved in the core operating activities and not as investments.
The Group does not use or trade in financial instruments — including derivatives — for speculative purposes.

Assets included in the category of loans and receivables originated by the entity are measured at amortized cost using the effective interest method, less impairment losses, whereas derivative financial instruments are measured at fair value through profit or loss. In the reporting period, no changes were made in the classification of financial assets or the manner and method or their measurement.

As at 30 June 2017, Magellan S.A. (the Group's parent) held investment certificates of Skarbiec — Zdrowie Fundusz Inwestycyjny Zamknięty Aktywów Niepublicznych of PLN 5,180 thousand as at the balance sheet date.

The Group's investments made in the six months ended 30 June 2017 are loans made to subsidiaries by the parent Magellan S.A. and loans made to Magellan S.A. by its subsidiaries.
In the six months ended 30 June 2017, Magellan S.A. did not make any loans to subsidiaries. All the loans made by Magellan S.A. to its subsidiaries in previous periods were repaid and their outstanding balance was nil as at 30 June 2017.
In the period covered by this Directors' Report, Magellan S.A. made use of loans made by its subsidiary MEDFinance S.A. and Komunalny FIZ. The outstanding balance of principal amounts of the loans made to Magellan S.A. by its subsidiaries amounted to PLN 2,800 thousand as at 30 June 2017. The loans were made on market terms.

4.7.Anticipated growth areas

The Group assumes that it will continue its core business activities in the near future. The Company believes that changes in the financing of the healthcare system in Poland initiated with the enactment of amendments to the Act on Publicly Funded Healthcare Services, the so called Hospital Network Act, will not bring about any fundamental change in the liquidity position of hospitals, which is the source of demand for the Company's services. At the same time, the Group conducts development work on expanding its product range and seeking new markets (in Poland and abroad).

The Group believes that despite growing competition, in the first instance on the market for direct financing of hospitals in Poland, demand for the Group's services will remain stable. At the same time, further growth in the area of financing of local government entities in Poland and abroad is envisaged (both in the area of direct financing and in the area of financing of suppliers' receivables), as is further growth of the business line of factoring for the general market.

Due to its membership of the BFF Group, the Group intends to take advantage of market synergies more actively and intensify its partnering with multinational corporations for the purpose of meeting their liquidity needs.

4.8. External and internal factors material to the development of the Group

External factors affecting the Group's environment and operating conditions and exerting a major influence on its growth prospects include:

- The current political situation and official statements regarding proposed healthcare system changes;
- Changing macroeconomic indicators and the general situation on the financial markets;
- General economic situation in Poland — in the first instance, changing the liquidity of the healthcare and local government sector entities;

- Changes in the business strategies of competitors and banks;
- Changes in reference interest rates and cost of external financing used by the Group;
- The regulatory environment, in the first instance court decisions involving the Company's products.

Internal factors on which the Group's steady growth rate is conditional include:

- Continuation of the existing business line and growth strategy;
- Rapid business development in foreign markets and further development of the business line dedicated to the financing of investment processes in the healthcare sector;
- Development of the business line dedicated to the financing of local government entities and the factoring line intended for the general market;
- Retention of and further cooperation with key accounts;
- Joining of the international BFF Banking Group by Magellan S.A. and its subsidiaries and the resulting opportunities:
  - (i) change of the structure and availability of financing by using the parent's financing;
  - (ii) possible increase in the scale of the Company's business in the Polish market due to the use of financial leverage effects;
  - (iii) economies of scale of the newly established group, based on relationships with suppliers to healthcare entities;
  - (iv) benefits of risk diversification and optimized use of resources as a result of the integration of BFF and the Company.

5. External financing

As at 30 June 2017, the Magellan Group's external financing amounted to PLN 1,682,996 thousand, compared with PLN 1,529,997 thousand as at 31 December 2016 and PLN 1,392,056 thousand as at 30 June 2016. The fact that the level of external financing was higher as at 30 June 2017 was mainly attributable to the changes in the structure of financing due to an increase in the value of loans received from a related party (an increase of PLN 857,067 thousand compared with 30 June 2016) and a decrease in the value of bank loans and advances (a decrease of PLN 194,931 thousand compared with 30 June 2016) and bonds issued (a decrease of PLN 371,196 thousand compared with 30 June 2016).

In the six months ended 30 June 2017, the average level of external financing was PLN 1,580,512 thousand, PLN 271,915 thousand, i.e. 21%, higher than the average level of external financing in the comparative period.

5.1. Bond issue schemes

In the reporting period, the Group's parent Magellan S.A. had active bond issue schemes in place.

As at 30 June 2017, the Company was running three bond issue schemes used for the financing of its core business activities, i.e. the funding and restructuring of medical sector entities. The Company issues bonds:

- as part of the Raiffeisen Bank S.A. scheme — discount bonds maturing within one to 12 months; scheme value: PLN 90 million;
- as part of the Alior Bank S.A. scheme — coupon or discount bonds maturing within one to 12 months; scheme value: PLN 110 million;
- as part of the mBank S.A. scheme — coupon bonds maturing within 360 days to five years; scheme value: PLN 750 million.

Under the schemes managed by Alior Bank S.A. and mBank S.A., the Company may issue own zloty-denominated or euro-denominated bonds.

The value and structure of bonds issued by the Company depends on the current and forecast need for cash and the maturities of the financial assets financed with the bond issues.

As at 30 June 2017, the value of bonds issued was PLN 257,014 thousand vs. PLN 628,210 thousand as at 30 June 2016, which denotes a decrease of PLN 371,196 thousand, i.e. 59%, in the level of financing with bonds.
In the six months ended 30 June 2017, the average level of bond financing was PLN 350,715 thousand and it was PLN 245,500 thousand, i.e. 41%, lower than the average level of bond financing in the corresponding period of 2016.

In the six months ended 30 June 2017, the Company did not make any bond issues.
In the six months ended 30 June 2017, bonds repaid amounted to PLN 118,900 thousand and EUR 9,725 thousand (PLN 159,521 thousand in total).
In the comparative six months ended 30 June 2016, bonds in totalling PLN 113,450 thousand and EUR 10,023 thousand were issued (PLN 156,999 thousand in total). Bonds repaid in that period amounted to PLN 96,420 thousand and EUR 7,229 thousand (PLN 126,601 thousand in total).

Limit utilization (par values) as at 30 June 2017:

- as part of the Raiffeisen Bank S.A. scheme:
  PLN 90,000 thousand — limit granted;
  PLN 0 thousand — bonds issued;
  PLN 90,000 thousand — unused limit.
- as part of the Alior Bank S.A. scheme:
  PLN 110,000 thousand — limit granted;
  PLN 0 thousand — bonds issued;
  PLN 110,000 thousand —unused limit.
- as part of the mBank S.A. scheme:
  PLN 750,000 thousand — limit granted;
  PLN 255,094 thousand — bonds issued;
  PLN 494,906 thousand — unused limit.

5.2. Bank loans and advances

As at 30 June 2017, the Magellan Group was making use of bank loans and advances in a total amount of PLN 524,629 thousand, compared with PLN 388,505 thousand as at 31 December 2016 (an increase of PLN 136,124 thousand, i.e. 35%), and PLN 719,560 thousand as at 30 June 2016 (a decrease of PLN 194,931 thousand, i.e. 27%).

In the six months ended 30 June 2017, the average level of financing with bank loans and advances from non-related entities amounted to PLN 501,085 thousand and it was PLN 211,297 thousand, i.e. 30%, lower than the average level of such financing in the comparative period.

As at 30 June 2017, the following Group entities had outstanding bank loans and advances from non-related entities:

- the parent Magellan S.A. — working capital loans and overdraft facilities - the limits available: PLN 337,760 thousand;
- a subsidiary - MEDFinance S.A. — loans made by non-related entities, of PLN 225,000 thousand.

5.3. Loans from related entities

As at 30 June 2017, the Magellan Group had liabilities for loans made by a related party, Banca Farmafactoring S.p.A. (the parent of Magellan S.A.), in the carrying amount of PLN 901,353 thousand, compared with PLN 44,286 thousand in loans received as at 30 June 2016.
In the six months ended 30 June 2017, the average level of financing with loans from related entities amounted to PLN 728,712 thousand.

6. Risk management

6.1. Market risk

Market risk is the risk that the market will be lost, i.e. that the demand for the financial services provided by the Group will decline. The Group believes that such risk is limited. Depending on the current liquidity of the sector, the Group is prepared to operate both in low liquidity conditions (receivables financing) and high liquidity conditions (working capital financing, current and future receivables financing and investment financing).

6.2. Currency risk

The Group's activities are exposed to limited financial risk arising from fluctuations in foreign exchange rates. The currency risk involves changes in the value of assets, equity and liabilities of the Group as a result of changes in foreign exchange rates. The Group carries out and expands its activities involving the provision of receivables financing services by its subsidiaries in the Czech and Slovak market. Such business activities are carried out in the local currencies. Thus, each foreign operation has closed currency positions and does not generate currency risk. What is exposed to currency risk is the value of the Group's shareholdings in the Czech and Slovak subsidiaries.
The Group pursues a currency risk management policy whereby any position exposed to currency risk is hedged with forward contracts. The Group hedges 100 percent of its currency position.

6.3. Interest rate risk

Market conditions and the ever changing shape of the yield curve, as well as the level of market interest rates, are the source of interest rate risk. The Group mitigates the risk using an active asset profitability maintenance policy to ensure an appropriate margin on transactions to cover the risk of changes in the cost of financing.

6.4. Credit risk

Credit risk is the risk that a counterparty will fail to pay its liabilities, which will expose the Group to financial losses. The objective of credit risk management is to build a stable and balanced portfolio of financial assets and to minimize the risk of occurrence of credit exposures threatened with impairment, while maintaining the expected levels of profitability and value of the loan portfolio at the same time.

The Group follows a policy of entering into transactions exclusively with parties with proven creditworthiness; if necessary, appropriate collateral is obtained as a tool for reducing the risk of financial losses due to default on contractual terms and conditions. The Group's exposure to counterparty credit risk is monitored on a continuous basis.

The Group's operations cover both the public sector and the non-public sector.
A credit risk analysis for the Polish market is presented below.

For public sector entities, the assessment of creditworthiness is considered in the context of the risk of failure to pay liabilities in a timely manner and the risk inherent in the transformation into commercial entities. The principles of transformation of medical entities are described in detail in the provisions of the Act on Medical Activity (AoMA). Pursuant to the provisions of the amendment which came into force on 15 July 2016, establishing entities are no longer obliged but are merely entitled to transform independent public healthcare institutions into commercial companies. A material factor which contributes to a reduction in the credit risk of transformed medical entities, arising from the amendments to the AoMA, is the obligation for the transforming entity to hold shares in a newly established company with a nominal value of at least 51% of the share capital and

to have the majority of votes at the General Shareholders' Meeting. Moreover, in the case of a majority shareholding, the AoMA makes it impossible to pay a dividend. Such provisions of the AoMA effectively discourage private investors from taking up shares in transformed medical entities, and holding shares in entities which demonstrate no capacity to go bankrupt reduces the risk of credit-like events.
The Company also recognizes and monitors the risk of a significant curtailment of a medical entity's operating activities and entrusting these activities with a private operator. Such activity generates the risk of delays due to an abrupt decrease in the medical entity's revenue.

For entities in the non-public sector where the risk of bankruptcy exists, the Group makes use of a comprehensive credit risk assessment.
For each transaction, credit risk is measured at the stage of analysing a transaction request and then regularly in the course of monitoring, taking into consideration changing external conditions and changes in the financial standing of debtors. The expected credit risk level is secured with collateral accepted by the Group and impairment losses (provisions) on credit exposures. The value of the accepted collateral is monitored and depreciated. The Group monitors the level of concentration of exposures to individual entities or groups of related entities. In assessing credit risk, the Group makes use of external databases about debtors.

In connection with financing, the Group is also exposed to a risk arising from the activities of a dishonest and unreliable counterparty. Before disbursing financing, the Group mitigates this risk by verifying the information obtained to the extent verifiable — e.g. in the case of factoring — by confirming the existence of debtors and debt. However, it cannot be ruled out that, in spite of the activities undertaken by the Group, this risk will materialize as a result of a counterparty's dishonest practices.

In 2016, MEDFinance S.A. added loans to doctors conducting business activities (MEDLekarz loans) to its product mix. The assessment of an applicant's creditworthiness is based on information obtained from the Credit Information Office about the applicant's monthly loan liabilities, scoring, the adopted disposable income ratio, revenue matrix, and a product amount availability curve. For the portfolio of MEDLekarz loans, as a homogeneous portfolio, the Company recognizes allowances for losses incurred but not reported (IBNR), and in the event of indications of impairment it records specific allowances.

The procedures for making lending decisions and concluding transactions in place within the Group provide that lending decisions can only be made by the authorized persons. Each potential transaction is subject to a lending decision made by the persons specified in the Rules on Credit Competencies adopted internally for each Group company.
The assessment of credit risk and the monitoring of the portfolio of assets of all the Group companies are performed by the Risk Department of Magellan S.A. and are independent of the business divisions.

The percentage of assets from entities with bankruptcy capacity (other than independent healthcare entities) in the Group's portfolio of financial assets was 7.45% as at 30 June 2017, compared with 8.46% as at 30 June 2016.

The following table presents the structure of the Group's portfolio as at 30 June 2017 and 30 June 2016 as analysed into entities with bankruptcy capacity and entities without bankruptcy capacity:

Debtor type	As at 30/06/2017	As at 30/06/2016
Public entities	**81.01%**	**79.80%**
Independent healthcare entities	*73.48%*	*72.40%*
Local government entities	*7.53%*	*7.40%*
Entities with bankruptcy capacity	**18.99%**	**20.20%**
Non-public healthcare entities	*11.54%*	*11.74%*
Other	*7.45%*	*8.46%*

Collateral for financial assets

At the stage of concluding an agreement, the Group assesses the credit risk relating to the transaction in question. The basis for assessing this risk is, on the one hand, an evaluation of the economic and financial position of the debtor and, on the other hand, the record of cooperation to date, current exposure level and proposed collateral. For assets with an increased risk level, the Group requires establishing collateral. The forms of collateral used include assignment under a hospital's contract with the National Health Fund (NFZ), tangible fixed assets, movables and a blank promissory note.

The Group may use the collateral in the event of delays in payment provided for in a repayment schedule.

Credit risk management also involves monitoring the portfolio — both the economic and financial position of debtors, factors indicating a risk of transformation of medical entities into commercial companies, entrusting operating activities with an external entity, as well as timeliness of payments. The Group monitors the timeliness of payments on a current basis — before the maturity dates of instalments — and, in the event of delays, it takes measures to improve portfolio performance or collect dues from the debtor.

6.5. Liquidity risk

Liquidity risk is managed by the Group through the application of payment schedules confirmed by the debtors to the major part of its portfolio of financial assets, maintenance of an appropriate level of free cash, use of banking services and standby lines of credit, ongoing monitoring of forecast and actual cash flows and matching the maturity profiles of its financial assets and liabilities. The joining of the BFF Group has consolidated the Group's liquidity position and provided it with access to stable financing from the parent.

In order to minimize liquidity risk, the Group follows a policy of conservative financing of assets, which consists of:

- close monitoring of proceeds and a pro-active policy for managing delays, implemented by a specialized and experienced team;
- ongoing forecasting and day-to-day realignment of forecasted proceeds in the short-term, medium-term and long-term;
- managing the structure of the equity and liabilities side of the balance sheet by selecting appropriate sources of finance, taking into account the structure of the assets side of the balance sheet and the nature of individual products, in particular the stability and predictability of financial proceeds from these products;
- limiting the values of liability ratios (e.g. equity/borrowings, equity/EBIT, etc.) to a conservative level, which guarantee the development of business activities but which also ensure, based on past experience, the security of the Company's liquidity;
- maintaining stand-by sources of finance for current payment purposes.

In addition, a high level of cash flows into the Group's accounts guarantees a stable liquidity position in spite of temporary irregularities and delays in repayments made by debtors.

6.6. Legal risk

Legal risks in the area of financing of local government entities

The Group operates in a market niche and offers non-standard products and services whose structure, in the absence of detailed legal regulations, is based on general legal principles. Some legal issues and related controversies are typically resolved by means of court proceedings whose final outcome is binding. Frequently changing medical legislation and differences in its interpretation by courts are also of key importance for products offered as they affect the Group's products.

The ruling of the Supreme Court, stating that Magellan S.A.'s solutions involving pledge-based products or warranty claims governed by the Civil Code violate the provisions in Article 54 of the Act on Medical Activity, is an example of such an interpretation. By adopting that interpretation, the Supreme Court changed the sentencing standards of general courts, which, over the period of existence of these provisions, were of the opinion that the above products did not violate the provisions in Article 54 of the AoMA (in the years 2012 to 2014, out of the 685 proceedings with final and binding rulings, the outcome was favourable to the Company in 656 cases). However, considering the said position of the Supreme Court, the Company has been phasing these products out. The share of assets arising from such agreements has been falling in the portfolio of its financial assets.

Yet another change of sentencing standards concerning Article 54 of the AoMA involved a conclusion that the Company's products related to the consortium agreement were a practice intended to circumvent the above provisions. In the light of the current position of the Supreme Court, an agreement between a creditor under an agreement for a specific performance and an entity which does not take part in such performance but only obtains the right to remuneration under such an agreement is an act which may seek to replace the creditor within the meaning of Article 54.5 of the AoMA.

A similar situation has been unfavourably interpreted by the Supreme Court with regard to the transfer (*przekaz*) structure governed by Articles 921^1 to 921^5 of the Civil Code (the "CC").

We draw attention to the fact that an SP ZOZ (independent public healthcare institution) lodged a cassation appeal concerning the alleged violation of Article 54.5 and 54.6 of the AoMA by the Company, which had executed an outsourced factoring contract with its client. The SP ZOZ's position is that the statutory ban on transfer of receivables by means of the Company's repayment of amounts due to the Counterparty from the SP ZOZ has been circumvented. Magellan S.A and the Counterparty submitted their responses to the above cassation appeal wherein they denied the SP ZOZ's allegations of violation of Article 54.5 and 54.6 of the AoMA, arguing that an outsourced factoring contract was not a legal act seeking to replace the SP ZOZ's creditor.

Consequently, there is a risk that further rulings of the Supreme Court may evolve towards a broad interpretation of Article 54.5 of the AoMA, however they are unlikely to apply to any other products offered by the Company. Currently, products offered by the Company do not involve the Company's status as a creditor of SP ZOZs, therefore, the Company believes that Article 54.5 of the AoMA should not be applicable here.

The Company submitted an objection against the relevant provisions in the Act on Medical Activity to the Constitutional Court. Violation of one of the basic freedoms, i.e. the freedom of business, is the key objection. If the interpretation presented by the Supreme Court is adopted, then the freedom of business of suppliers to hospitals will be significantly limited, in the first instance with regard to business growth which requires financing, which, under the adopted interpretation, would be extremely hard to obtain given the prohibition against disposing of the Supplier's assets.

As far as cooperation with creditors is concerned, the Group retains the role of an entity supporting Counterparties. Negotiations are also undertaken with interested parties to amicably relieve hospitals of their debts, resulting in agreements signed.

Legal risks in the area of financing of local government entities

As regards the financing of local government entities, Magellan S.A. offers financial services which complement traditional financing provided by banks. Thanks to the instruments proposed by Magellan S.A., local government entities may obtain financial means to conduct EU projects and continue pending investment projects. Unlike traditional products offered by banks (e.g. bank loans), the Company's products are structured in accordance with various civil law provisions based on the freedom of contract principle (e.g. subrogation, sale and lease of properties, equity financing, etc.). Definitions of such transactions are contained in various legal regulations (the Civil Code, the Accounting Act, tax laws, etc.).

Audit institutions (Regional Audit Boards, the Supreme Audit Office) operate in the area of financing of local government entities and interpret products offered to local government entities by non-bank financial institutions. Such products are reviewed by the audit institutions in terms of their effect on the level of debt of local government entities, in the context of the existing prudence mechanisms. Reviews carried out by the audit institutions give rise to proposals to enact various legal regulations to enhance control over incurring liabilities by local governments using non-traditional financial instruments, mainly in the context of the principle of information access and transparency of public finance. The audit institutions propose legislative changes intended to modify financial reporting of non-bank financial products and enhance the monitoring of debt levels of local government entities. Therefore, discussion is under way concerning the nature of expenditure made by local governments for such non-traditional financial services, provided by non-bank institutions. Such discussion is part of considerations concerning changes to the broadly-defined procedures for the setting of terms and conditions of and procedures for incurring liabilities by local governments, including the allocation of each debt to the relevant debt category within the classification in place at local government entities. Wide use of non-traditional financial transactions is a relatively new experience for Polish local governments, therefore the audit institutions initiate a debate on potential statutory changes intended to change the existing laws concerning the incurring of liabilities by local governments, as stated in public finance regulations, and, at the same time, ensure higher liquidity in this area. The audit institutions point to the need for local governments to strengthen financial discipline, in the first instance in the context of their expenditure, which may have an effect on the scope of services provided by the Company on the local government market. Some voices have been raised in favour of a reform of the financial autonomy of local government entities, in the first instance as part of the discussion concerning system changes in the area of local government. There are plans to reform Regional Audit Boards, in order to strengthen their authority, also in the area of auditing the economic efficiency of local governments and municipal enterprises.

The Supreme Audit Office recommends the implementation of mechanisms of ongoing monitoring of local governments incurring liabilities under non-standard financial transactions. Growing levels of local government debt using non-standard financial transactions should, in the opinion of the audit institutions, be subjected to the same procedures as those mandatory for local governments in respect of taking out loans or advances (Article 89.1.(2-4) of the Public Finance Act), including the obligation to consult the relevant Regional Audit Board as to the ability to repay such debts.

We draw attention to the fact that the use of civil law solutions which are different from the traditional financial instruments governed by the provisions in the Civil Code or the Commercial Companies Code, as supplemented with the principle of freedom of contract, may not be treated in the same way as sources of financing such as loans, advances or issues of securities. A rational legislature has not imposed the limit defined for a budget resolution of a local government entity thereon or imposed the obligation to obtain an opinion of the relevant Regional Audit Board as to the ability to repay such debts (Article 91 of the Public Finance Act *a contrario*). The list of circumstances which warrant the use of loans, advances or securities under Article 89 of the Public Finance Act does not contain other civil law solutions, based on general regulations, either. Therefore, opinions which equate — without a clear legal basis — the above civil law agreements with traditional financial instruments in terms of their legal and economic consequences raise legitimate doubts. Non-standard financial services in the local government market are part of the canon of laws, therefore the omission of such structures by the provisions in the Public Finance Act cannot be treated as a legal loophole. The opinion that civil law contracts other than traditional financial instruments function outside the control mechanisms applied by public institutions, which may result in a dangerous growth of debt levels on the part of local governments, should be considered groundless. The specific legal regime within which they function does not mean that such debts cannot be controlled or monitored but rather that the audit institutions need to take a different approach to the debts in question. Hence, the chief principle of the financial autonomy of local governments should be respected, also as far as the discretion of local governments to use non-traditional sources of financing is concerned.

6.7. Business environment risk

The position of the Company and the Group is significantly affected by the macroeconomic environment, including the legislature and actions of direct competitors. As the healthcare system is overwhelmingly public and financed with public funds, there is a risk of the legislature and, subsequently, the government administration, taking measures intended to change the operation of the public healthcare system, in the first instance the operation of the financing system in that sector. The existing principles of operation of the healthcare system and the applicable legal framework significantly shape the Company’s business — they have an effect on the structure of the products offered thereby, the level of risk, profitability and sales volume.

The diversification of business, both in geographical terms (foreign operations — the Czech Republic and Slovakia) and in business terms (the product range supplemented with financial services intended for the general market), mitigates business risks involved in legislative changes concerning public entities and changes in the healthcare financing system.

Creation of the hospital network — Polish market

In the Company’s opinion, the creation of the hospital network will have no effect on its core business, as about 95% of SP ZOZs, i.e. key partners of Magellan S.A., have found their way into the hospital network.
Hospitals qualified for the network will have their National Health Fund contract guaranteed — without the need to take part in a competitive bid process. Therefore, the Company’s counterparties, i.e. mainly SP ZOZs, will have their financing from the National Health Fund guaranteed, which means that the credit risk level of the portfolio held will not grow, either.

Due to the nature and scope of its business, the Group does not use hedge accounting for completed or contemplated business transactions.

7. Events with a significant effect on the Group’s business activities and results of operations

On 20 February 2017, Magellan S.A. was refused an advance tax ruling on the merger of Magellan S.A. with Mediona Sp. z o.o. of 16 December 2016.

On 7 March 2017, Magellan S.A. filed two requests for the elimination of a law violation, one with the Development and Finance Minister and the other one with the Head of the National Revenue Administration.
On 28 April 2017, the Company received a reply from the Head of the National Revenue Administration to its request for the elimination of a law violation, filed in connection with the refusal to issue an advance tax ruling on the merger of Magellan S.A. with Mediona Sp. z o.o. of 16 December 2016. The Head of the National Revenue Administration upheld the position expressed in the said refusal to issue an advance tax ruling.

On 29 May 2017, Magellan S.A. filed a complaint against the refusal to issue an advance tax ruling with the Provincial Administrative Court in Warsaw via the Head of the National Revenue Administration.

There were no other events with a significant effect on the Group’s business activities and results of operations other than as described above.

8. Additional information

8.1.Proceedings before courts or public administration bodies

As at 30 June 2017, the balance of receivables subject to court proceedings was PLN 170,753 thousand, which accounted for 8% of the value of the portfolio of financial assets, compared with PLN 151,391 thousand (9% of the portfolio) as at 30 June 2016 and PLN 160,236 thousand (8% of the portfolio) as at 31 December 2016.
Given the nature of the Group’s activities, instituting legal proceedings with respect to an asset is one of the typical stages of recovering receivables as provided for by the Group’s operating procedures. The credit risk of such assets is comparable to that related to other financial assets repayable by debtors without an agreed repayment schedule.

As at the date of this Directors’ Report, no other significant proceedings against the Group are pending.

8.2. Registered audit company

On 23 November 2016, the Company's Supervisory Board appointed an auditor to perform an audit of the financial statements of the Company and the Magellan Group, which was PricewaterhouseCoopers Spółka z ograniczoną odpowiedzialnością, with its registered office in Warsaw, al. Armii Ludowej 14, entered in the list of registered audit companies by the National Chamber of Statutory Auditors with the reference number 144.

The auditor's responsibilities include auditing the annual separate financial statements of the Company and the consolidated financial statements of the Group, as well as auditing and reviewing the Group's consolidation packages prepared in accordance with the standards applicable within the BFF Group.

The registered auditor was appointed in accordance with the Company's Articles of Association and the applicable laws. The new auditor was appointed in accordance with the requirement to ensure consistency with regard to auditing the BFF Group to which Magellan S.A. belongs.

Łódź, 2 August 2017

Signatures

Krzysztof Kawalec	Urban Kielichowski	Rafał Karnowski	Emanuele Bona	Radosław Moks
Board Chairman	Board Member	Board Member	Board Member	Board Member