S&P Global
Market Intelligence

Mapfre, S.A. BME:MAP

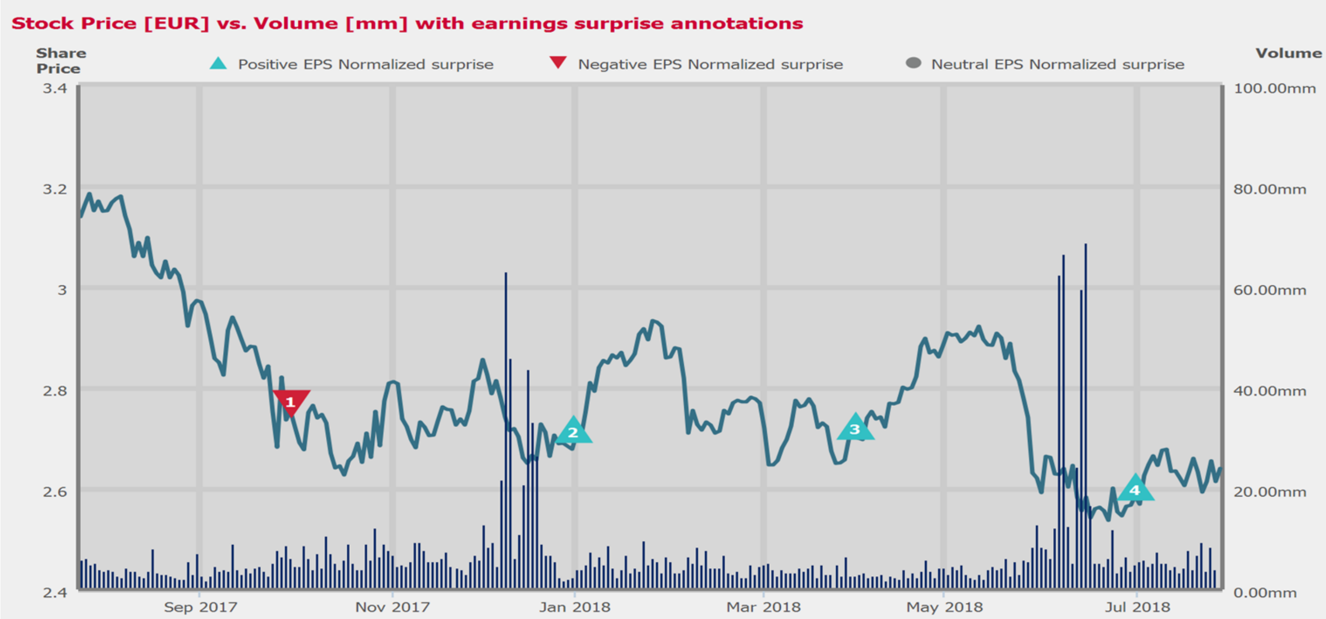
FQ3 2018 Earnings Call Transcripts

Thursday, November 08, 2018 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FQ2 2018-	-FQ3 2018-		-FY 2018-	-FY 2019-
	CONSENSUS	CONSENSUS	SURPRISE	CONSENSUS	CONSENSUS
EPS Normalized	0.06	0.06	▲(33.33 %)	0.27	0.29
Revenue (mm)	-	4877.00	▲7.61	22533.70	23092.72

Currency: EUR
Consensus as of Nov-07-2018 12:30 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2017	0.02	0.01	▼(50.00 %)
FQ4 2017	0.06	0.09	▲50.00 %
FQ1 2018	0.05	0.06	▲20.00 %

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Call Participants

EXECUTIVES

Fernando Mata Verdejo
Group CFO & Director

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Presentation

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Good morning, and welcome to MAPFRE's Results Presentation for the Third Quarter of 2018. This is Natalia Núñez, Head of Investor Relations. And here with us is, as usual, Mr. Fernando Mata, our CFO and member of the board. He will take us through the main trends of the period.

Just as a reminder, during the Q&A, we will answer all questions received at the Investor Relations address. And after that, the IR team will be available to answer any further questions you may have.

And now with no further ado, let me hand the call over to Fernando.

Fernando Mata Verdejo
Group CFO & Director

Thank you, Natalia, and good morning, everyone. It is my pleasure to be here with you again for our third quarter 2018 earnings call.

Let's begin on the Slide 2, when I will run through the main figures. First of all, I would like to highlight that we are still facing significant headwinds from foreign exchange movements, especially for our 2 largest exposures, the U.S. dollar and the Brazilian real. At constant exchange rates, premiums are up 2.2%. And the net results stood at around EUR 529 million, up nearly 19%, largely driven by lower NatCat losses. At constant exchange rates, euro had grown close to 26%. Shareholders' equity is down 4% year-to-date, again mainly as a result of currencies. I would like to highlight that currency movements have lowered net equity by over EUR 850 million, in that case, since January 1 last year. Our combined ratio close at 98.1% and includes the snowstorms in the U.S., balance sheet adjustments in Brazil and the recent Typhoon Jebi in Japan. The ROE was over 9%, improving 2 percentage points compared to September 2017.

Please turn to next slide, and I will briefly comment on the main highlights. Currency headwinds had been quite strong, and they are expected to continue being a drag on the P&L during the coming months but to a lesser extent. That's the good news. Regarding Brazil and the U.S.A., the restructuring process needs to gain momentum. In Brazil, we will introduce the MAPFRE business model when we close the transaction with Banco do Brasil, which will be key to improving results in Motor. In North America, Puerto Rico has had a solid recovery after 2017 NatCat events. And as mentioned, the Northeast U.S.A. was affected by winter storms during the first quarter of the year, and the non-Northeast combined ratio is improving, but is still too high and is being carefully monitored. We expect 2019 to be a turning point for both U.S.A. and Brazil operations. Iberia, LATAM North and South and also MAPFRE RE are the strongest units in terms of profit contribution. ASISTENCIA and GLOBAL RISKS show significant improvements in results. Trends are improving in the Life business. In Spain, growth in Life Savings has been quite strong even when excluding a large policy issue in the third quarter. Underlying profitability is also growing. In Brazil, there has been return to growth in Life Protection but results still need to catch up.

Talking about our capital position, it remains strong, with a Solvency II ratio above 200% at June. Our financial flexibility was underpinned with the successful issuance of EUR 500 million in subordinated debt in this quarter. Finally, MAPFRE's strong financial situation has been confirmed by the main rating agencies throughout the year.

Please turn to next page. In this challenging context, I would like to highlight MAPFRE's resilience, which allows us to reaffirm our commitment to stable and growing dividends within our 50% to 60% payout range -- 50% to 65%, sorry, payout range. Of course, the main driver of dividends will be results. Our goal is to surpass last year's net result around EUR 700 million, assuming ordinary NatCat losses in the fourth quarter. We are currently working on our new 3-year strategic plan, will be announced at our AGM next March, and we'll continue to focused on profitable growth and business transformation.

Please turn to Slide 5. On the right side, you can see the main drivers of results here by region and business unit. Iberia continues being a strong driver of profitability with a EUR 354 million net result, and also excluding real estate gains unless this is extraordinary benefits from, probably you'll remember, the cancellation of our bancassurance provision, profit would have grown by over 3%. Again, outstanding results for Iberia.

MAPFRE RE was the second largest contributor with EUR 113 million net profit. Results in LATAM North and South are consistently improving year-on-year, while Brazil is still facing headwinds. And the turnaround at MAPFRE ASISTENCIA and absence of cat losses at GLOBAL RISKS help us improve results this year.

Please turn to Slide 6. This slide shows the effects of a currency depreciation on P&L. The Argentine peso and the Turkish lira were the worst performers, with a 39% and 25% fall in average exchange rates, respectively. The Brazilian real is still down over 17% year-on-year. And we have also seen an over 7% decline in the Mexican peso. And the U.S. dollar has fallen over 5%.

On the left side, you can see both premium and operating profit figures at constant exchange rates. Premiums grew 2.2% at constant exchange rates and 3.4% excluding the 2 following extraordinary singular policies: the biannual payments policy, you know it very well, for approximately EUR 500 million issued in 2017; and a life group policy for EUR 282 million issued in Spain in the third quarter of 2018.

Regarding the results of insurance business, which was stable year-on-year, we've grown over 9% at constant exchange rates, with a strong growth in both Life and Non-Life.

On the next slide, I will go through the main highlights by the different regions. In Iberia, we've seen a strong underlying growth both in the Non-Life at 7% and Life at 11%. The combined ratio is under 94%, with an outstanding 90.7% in Motor, well below the market average.

In Brazil, on the right of the slide, we're beginning to see a pickup in local currency growth, 10% in Life and 3% in General P&C, while Motor growth is more modest. Regarding profitability, there were further balance sheet adjustments in the third quarter, mainly in the Motor business. Even excluding -- we exclude this adjustment, the line is still underperforming. Lower financial income and higher acquisition expenses are also still weighing on results. We expect profitability measures in Motor to begin to deliver in the coming quarters. And meanwhile, we reaffirm the 3-year combined ratio target of below 100%.

In North America, the Northeast U.S.A. is growing around 1% in U.S. dollars on the back of tariff increases, while premiums in the non-Northeast region are still being reduced. In Puerto Rico, premiums are up 26% in dollars as a result of higher tariffs in commercial lines.

And finally, LATAM North and South, there are positive premium trends across the region, with Mexico up 14% in local currency, in that case, excluding PEMEX. Peru is up 14%, and we've seen relevant growth across Central America countries. Premiums in Chile are still down year-on-year due to the cancellations of unprofitable business, which is having a positive impact on results. In addition, the sale of a building this quarter has had a EUR 22 million net impact on group results. Finally, in Colombia, additional provisions have been made in annuity and Workers' Compensation runoff portfolios. As a result, it was mentioned in previous presentations of updating local-term financial assumptions. As usual, following a quite prudent, balanced MAPFRE's valuation policy.

Please turn to Slide 8. In Eurasia, Italy continues growing both premiums and results. Turkey is facing a reduction in Motor portfolio, which has a higher combined ratio due to both the already known 2017 MTPL regulation as well as a higher inflation. In Malta, premiums are up 10% year-on-year, thanks to Life Savings. They're performing very well.

Profitability is excellent at MAPFRE RE, as I mentioned, despite an increase in attritional claims during the third -- first quarter, already mentioned as well, and a large event during the -- this third quarter.

And finally, ASISTENCIA and GLOBAL RISKS continue reducing premiums as a result of an ongoing business restructuring. As you can see, the improvement in underlying results in ASISTENCIA was EUR 36 million; and in GLOBAL RISKS, around EUR 18 million. Again, it's underlying results because in absolute terms, the reduction in GLOBAL RISKS was almost EUR 80 million.

Please turn to Slide 9. Here, I would like to talk about extraordinary impacts that affected results. Weather-related and NatCat claims are down over EUR 150 million year-on-year. Hurricanes and earthquakes affected direct insurance, MAPFRE RE and GLOBAL RISKS in 2017, as you know. This year, there had been severe winter storms in the U.S. during the first quarter, with an EUR 11.5 million net loss for MAPFRE U.S.A. and EUR 7.6 million for MAPFRE RE due to the quota share agreement -- reinsurance agreement. Also MAPFRE RE was affected this quarter by Typhoon Jebi in Japan, with an initial estimated net loss of EUR 39 million.

There were several corporate transaction in 2017, and they're fully disclosed in the footnote, with a total net impact of EUR 15.7 million. This year, corporate transaction include the negative EUR 7 million impact from the U.S. exit plan and also EUR 4 million hit from closing the GLOBAL RISKS office in Germany. The last was taken in September of this quarter.

Realized gains are stable year-on-year, real estate is up, and financial investment are down in a volatile market context. This year's transactions include the sale of the 2 buildings: 1 in Chile, already commented; and another in Portugal, with a EUR 22 million and EUR 8.5 million net impact, respectively, both in the third quarter. Finally, 2017 figures also reflect a EUR 27 million net gain from the reversal of our provision for continued liabilities in bancassurance. Taking into account all these effects, the adjusted net result is down around 2%.

Please turn to Slide 10. There were additional extraordinary adjustment in Brazil in September as a result of a final -- I want to emphasize the final review to achieve a more conservative balance sheet valuation, with a EUR 22 million negative net impact during the third quarter, reaching EUR 31 million total for the year. On -- this is a good news. On November 6, the last approval was received by the SUSEP -- from the SUSEP. And in this context, the transaction will be completed on November 30. Full disclosure of these adjustments, which are mainly related to Motor and Life business lines is at the bottom of this slide.

Please turn to next page to look at the main figures of the Non-Life business by region and business unit. Here I would like to focus on the combined ratio. As you can see, there have been solid improvements in Iberia and LATAM North and South, thanks to the successful implementation of our profitable growth strategy in these regions. The combined ratios at MAPFRE and GLOBAL RISKS had been exceptional, especially when considering the current market context. Brazil has been affected by the balance sheet adjustment that we just commented on the previous slide. And excluding these adjustments, the combined ratio will stand at around 91%.

Please turn to Slide 18 when I briefly comment on the balance sheet and solvency position. Shareholders' equity has fallen this year by over EUR 340 million to around EUR 8.3 billion. The net unrealized gains on the available for sale portfolio fell by over EUR 200 million. And currency conversion differences fell by over to EUR 210 million during the year. These declines were driven by several market movements: first, the depreciation of our main currencies; second, higher yields in Europe and in the U.S.; and finally, the fall in European equity markets. As you can see on the right, these currency conversion differences have been the largest in Brazil, followed by the Turkish lira. Also, the diversification of our balance sheet has helped mitigate these changes, and we have seen positive contributions from the U.S. dollar and the Mexican peso.

Please turn to Slide 19. On the left, you can see that assets under management are down slightly since the beginning of the year. This is driven by volatility in the stock markets and peripheral bonds as well as currency movements, mainly again the Brazilian real.

The breakdown of the investment portfolio is on the left. Asset allocation has been relatively stable throughout the year. And our cash position is up from EUR 2.2 billion to EUR 2.6 billion during the quarter, mainly as a result of the recent subordinated debt issuance. The largest exposures correspond to a Spanish sovereign debt with EUR 16 billion. And Italia [sovies] our exposure is EUR 2.8 billion, close to the EUR 3 billion limit recently approved by the board. It is worth highlighting that over 2/3 of these positions are located in immunized portfolios, as you can see on the bottom-right chart, so how it limits our risk exposure.

On the Slide 20, we will look at our actively management investment portfolios. Our portfolio yields are quite high, 2.3% in Non-Life and nearly 4% in Life, well above market yields. Duration in Non-Life has slightly increased throughout the year, trying to keep accounting yields quite stable. Regarding realized gains, during the third quarter, Spanish debt has been very volatile. Realized gains reached EUR 73 million in the Life portfolios, down around EUR 36 million compared to last year. Gains are also slightly down in Life portfolios, basically due to MAPFRE RE.

Please turn to the next slide. On the left you can see the breakdown of the capital structure, which amounted to EUR 12.3 billion. During the quarter, we issued EUR 500 million in subordinated debt with an effective yield of under 4.2%, 20 basis points lower than the last debt issue last year. With this bond, leverage has increased to over 20%, still a very low levels compared to our peers. We now have EUR 680 million undrawn on our credit facility, which give us a significant financial flexibility.

Let's move on to Solvency II figures. Solvency II ratio stood at close to 202% at June 30, above our 200% target range, confirming MAPFRE's stern and stable solvency position even in a year marked by high market volatility. We have a high-quality capital base with 93% of eligible own funds in Tier 1. And the new subordinated bonds is Tier 2 debt and will be reflected in the September figures, those are as of June, when we will release.

Let's move on the last slide, and I will make a few closing remarks. Regarding currencies, we have faced significant headwinds during the recent quarters, and we expect this to continue to a lesser extent in the coming months. Again, this is a consequence of our diversified business model, which, in the long run, provide us with the balance sheet resilience, earning stability and also growth opportunities. We have achieved our restructuring targets for both Brazil and the U.S., and we expect these processes to gain momentum after the transactions are closed. As we previously mentioned, for MAPFRE, day 1 will be January 1 next year. We are pretty confident in the outlook for Brazil. The economy is improving. The political situation is stabilizing after recent elections. And we will be able to optimize the new agreement with Banco do Brasil in a more favorable environment. In U.S.A., we are now beginning to see the effectiveness of the new profitability initiatives already implemented. And California is a very good example of how we can implement the turnaround in other states. We believe that MAPFRE's capabilities are greater than what current numbers are showing. Several important units are performing well, Iberia, LATAM North and South and MAPFRE RE, which is proof of our ability to successfully implement our profitable growth strategy. Finally, MAPFRE has a solid capital position, which will underpin dividends -- sorry, which will underpin dividend stability and allow us to continue to meet our commitments with shareholders.

That's it from my side. Thank you. And now I will hand the call over to Natalia to begin the Q&A session.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Thank you, Fernando. But before the Q&A, I would like to make one quick announcement. I am pleased to let you know that we will be hosting our next Investor Day on April 8 following the AGM in March. We will provide you with the specific details at a later date, but we can anticipate that the agenda will cover the main topics from the new strategic plan, and we look forward to sharing this opportunity with you again. So now we can start with the Q&A session.

Question and Answer

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

The first question comes from Ivan Bokhmat from Barclays. It's in Iberia regarding the combined ratio. The combined ratio appears weaker in 3Q across the board, Motor, General P&C, Accident and Health. Is there a trend behind losses?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you, Ivan. First, a general comment is about the weather seasonality in Spain. Usually, severe rains happens before summer. This year, it's happening mainly in September, also in October. So those rains -- these rains are increasing the combined ratio in -- both in Auto and Homeowners. This is seasonal. And we have to look at the combined ratio in the long run in order to see future trends. We keep our best class -- our best-in-class combined ratio in Iberia. We are extremely satisfied with all the measures implemented, and we are pretty, pretty satisfied with the excellent performance in the area -- in the country. The combined ratio in Spain goes from 93.5% in June this year to 93.7% at the end of the third quarter. And it was, as I mentioned, due mainly to weather-related claims affecting these 3 lines, Motor line, also Homeowners and Agricultural lines, which is very important. I would like to mention the very positive evolution of the combined ratio in Portugal from 101% in June this year to 97.2% at the end of the third quarter. And it was thanks to a relevant improvement in our claims experience. In particular, Workers' Compensation, this is our line of business we're leaving due to the high loss ratio.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you. Another question from Ivan is, what is MAPFRE competitive strategy in Spain at this moment? You mentioned in the second quarter 2018 that low combined ratio left room for market share gains.

Fernando Mata Verdejo
Group CFO & Director

Yes. Let's say, Ivan, that the growth is important, but the profitable growth is even more important. And this is the main message I want to send to you and to the rest of your colleagues. Iberia has a leading position in the main Non-Life segment in Spain and a very low, very good level of combined ratio, approximately is below 94%. In Motor line, what we're seeing is further improvement from there year-by-year. And our view is that the current 90% level will be quite challenging to keep in the future, especially to gain market share. On the long run, what we're seeing is a 92% combined ratio for Automobile as a more reasonable level. Obviously, this gap allow us to be a little bit more competitive in terms of tariffs but keeping our stricter underwriting policies and also our prudent guidelines. With the recent insurance data published by ICEA in June 2018, we're still maintaining a gap of nearly 5 percentage points versus the market in the combined ratio. For growth opportunities, we are looking at the different opportunities we can see in the market but always focused on profitability. As we already mentioned in previous presentation, we have begun to strategically grow again in the fleet segment, the small, Ivan, fleets, and after several years of reducing exposure. It will give us a room for growth in Automobile, which is very important for MAPFRE. In other Non-Life segments, we saw -- we've seen some room for improvements in Homeowners and third-party liability combined ratios, that our view is that, currently, there are room for improvements in both line of business.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. I mean looking for another question that is regarding Iberia. Yes, this question comes from Farquhar Murray from Autonomous. And he say, could you outline whether you expect the wealth tax changes related to unit link to have a material impact on the sales, reserves and operations of MAPFRE VIDA in Spain?

Fernando Mata Verdejo
Group CFO & Director

Well, first of all, I mean it is not a change, this is a proposal. We have to see whether or not will we come to a law enforced. And so far, I wouldn't like to comment on this topic. But anyway, in the -- if in the end, it is a levy on these products, I don't think it will affect neither our balance sheet, nor our sales in MAPFRE VIDA.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. Now Ivan Bokhmat from Barclays ask about the increase in the loss ratio in the reinsurance and GLOBAL RISKS businesses in the third quarter and if we could give more details of the geographic distribution of losses.

Fernando Mata Verdejo
Group CFO & Director

Yes, first of all, let me take a positive view on both entities and to highlight the excellent combined ratios in MAPFRE RE and GLOBAL RISKS, which both are around 96%. And both have improving comparison with last year when we're affected by the 5 catastrophic events in the third quarter. Let's say that the improvement is the result of our strict technical management, underwriting guidelines and our effective reinsurance strategy based on quite low risk appetite. With regard to this quarter, we have seen an increase in non-catastrophic losses, what we call attritional losses, in both units, which have led to a slight increase in the third quarter in some regions, worth mentioning Europe and the U.S. regions, for example. But all in all, we are very proud of the -- of this technical management, especially in a quarter affected by large catastrophes.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you so much. Now another one from Ivan from Barclays is regarding LATAM. And he say, strong improvement was seen across LATAM North and LATAM South in both Life and P&C. How sustainable is this result?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Ivan. It was said many, many years ago that the MAPFRE wouldn't achieve a combined ratio in LATAM North and LATAM South below 100. Fortunately, I mean those forecast, they were wrong, and we're happy with the current performance that we've seen in both regions. Last year, they were around 98%; and this year, are below with 2.4% decrease and 1.9% decrease in both regions. MAPFRE has proved a high level of expertise and track record in emerging countries. And now we are harvesting the fruit of the -- all the initiatives implemented in majority of the countries and also the know-how and the expertise that MAPFRE is able to deliver in these regions. In LATAM North and LATAM South, the main drivers are value creation and long-term resilience, as we said, earnings stability and also a -- and strong capital position. So despite the economy, which is cyclical, and the insurance market quite complex, we are extremely confident in our current footprint in both regions, LATAM North and South.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you. Now there's a question from Michael Huttner from JP Morgan and is regarding the strategic targets. What is the sustainable profit run rate once the planned Brazil and North America restructurings are complete?

Fernando Mata Verdejo

Group CFO & Director

Well, we're about to complete the -- both countries' restructuring processes. Michael, as we said, day 1 for MAPFRE in both countries is January 1. And also, you know that we're currently preparing the new strategic plan, which will be finalized over the next few months and approved by the board at the end of the year or beginning of next year and presented at our AGM in March 2019. At that point, we'll be able to provide you with a clearer picture of the -- and also the new financial targets. Anyway, in any case, we do not expect any major change from our current strategy as we are convinced that we are the current one. But there will be a greater focus probably on transformation and innovation in order to adapt the company to the new market trends. In a nutshell, we're looking at where we want MAPFRE to be in the long term, not only a 3-year plan. So at the AGM, we will give you more information regarding the financial targets.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. Now the -- also from Michael Huttner. The commitment to at least flat earnings for the full year '18 versus full year '17 seems relatively undemanding given 2017 was affected by extraordinary NatCats. What is your view? And also in line with this question, given the strong solvency of 203% (sic) [202%] at June and that the full year '17 period was affected by extraordinary NatCats, the commitment to a stable dividend seems to be relatively modest. Why not pay more?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you again. And as we mentioned, our target is stable and growing dividends within a 50%, 65% payout range. Stable dividend for the current year 2018 makes sense when taking into account the current economy and also the market context. The underlying result was down 2% year-on-year, and we didn't exclude the adjustment in Brazil that we're still facing. And also, we are still facing currency headwinds and also the low level of interest rates, and in several markets and 2 key units, the need to gain momentum in the restructuring process. Overall, we are satisfied with the results we've seen. Iberia continues with an excellent performance. MAPFRE RE and GLOBAL, as I mentioned, have combined ratios around 95% even after higher NatCat quarter. And LATAM is proof of the success of our effective profitable growth strategy. Further improvements in results and ROE will help us to continue to grow dividends in the medium terms. So all in all, I mean we're looking at improving our results and also improving dividends, but both figures, they have to be together.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you, Fernando. Next question regarding LATAM was sent by Francisco Riquel from Alantra. As for Argentina, what is the impact from hyperinflation accounting perspective in Q4 both in P&L and in equity?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you, Francisco. We have included a full disclosure of the hyperinflation accounting on Page 22 of our financial report on Management Discussion and Analysis, which is already available at the CNMV. And -- but there is a proxy effect because we haven't registered -- we haven't booked it in our financial statement, the hyperinflation effect. Let me see the numbers. Also, I have to mention that the importance of Argentina in the financial statements of MAPFRE taken as a whole is quite reduced. Our current MAPFRE Argentina equity is approximately EUR 30 million without restatement. And after restatement, it will be grow -- it will grow to EUR 45 million.

Regarding profit, we have restatement, the profit contribution from Argentina is EUR 15.7 million and restated is EUR 1.5 million. So the net impact will be a reduction of the benefit of almost EUR 12.2 million. Please, as an advice, I mean you shouldn't extrapolate, I mean these figures for the full year, first, because the -- for hyperinflation countries, the currency rate applied is the end of the period. So at September, the current exchange rate for peso Argentina was ARS 47 for EUR 1. And currently, it's like ARS 40, so it means there is an appreciation of the Argentinian peso during this month, the month of October. So probably, I mean the effect on the P&L will be lower if we -- if the Argentinian peso keeps the same trend for the remaining part of the year. But for sure, I mean we will include the hyperinflation accounting rules in the annual accounts for the full year.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. Next question comes from Ivan Bokhmat, Silvia Rigol from BBVA, Michael Huttner from JP Morgan, Andrew Sinclair from Bank of America Merrill Lynch and Paco Riquel from Alantra. So these questions -- this set of questions are regarding Brazil. And as we can see, it has raising a lot of interest. First one is regarding the combined ratio in 3Q 2018. That continue to deteriorate. When we should -- when should we start seeing an inflation point?

Fernando Mata Verdejo
Group CFO & Director

Well, first of all, it's a general comment. In Brazil, we have a quite well-diversified position in this country. And what we've seen in the third quarter is a deterioration of basically Motor line business and -- but in the Agricultural business, the combined ratio is quite low. And also, we've seen quite good profit coming from the Life business. We're pretty confident for the outlook in Brazil. The agreement with our partner has been reinforced, and we will leverage MAPFRE's expertise and our proven track record in the Motor business. As already mentioned in previous presentation, we are already implementing some of the initiatives, some measures to streamline the organizational structure and processes in order to have a more efficient decision-making process. There are several initiatives in the pipeline that were designed by the task force in February involving actuarial, technical and commercial concept. I said in the pipeline because some of the pipelines are -- some minor initiatives have already been implemented, but we have to wait. This is -- as you know, there's insurance -- in the insurance business increases in tariffs, reduction of some agents' accounts and also the streamline of some -- or reduction of coverage in some products. It take time to see the -- or to harvest profits, so we have to wait a little bit longer. And probably next year, we'll be the first one to see a more -- a better performance in Automobile.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Regarding politics, do you anticipate a change in policy or economic direction from Brazil presidential election?

Fernando Mata Verdejo
Group CFO & Director

Well, we don't like to comment on political issues. But as a general view, I mean, the greater political stability is always good news for a democracy like Brazil. Markets have reacted positively, with the Brazilian real exchange rate recovering nearly 20% from minimal levels. Remember last month when we see BRL 5, and now it's like a 40, 23, 25. It's like we've been in some lateral movements for the last weeks. So let's say that the markets have welcome, I mean the new government in Brazil. We're quite confident as well that the new government will help Brazil to enter this phase of economic recovery and maybe will adopt the measures and reforms that we consider, and the society will recover the stability that Brazil needs for its long-term growth. But we're quite happy. I mean it's like there are 3 situations: I mean the new agreement with Banco do Brasil; political, social stability; and macro figures. That the 3 things, they're good factors to improve and to grow our operation in Brazil.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Thank you. There's one also around Brazil. Considering the restructuring costs booked in Brazil, the new measures and higher acquisition expenses to pay to Banco do Brasil, could we consider that the actual price for the operation is not EUR 490 million, but it could be higher? Were all these charges already included in negotiation talks and already discounted from the final price, thus your 10% ROI target for the operation include all these charges?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you, Silvia. I mean the value of the business consideration has been discussed for many, many months since we announced this transactions. I mean frankly, this is an acquisition that is being made not from scratch. MAPFRE has managed this company -- both companies for almost 7 years, and we know very, very well the business, both the strengths and the weakness. And both was taken into consideration when we value the business and the transaction. What I mean is that the -- when we -- the value we announced at the original, the transaction was a fair estimation, was a market valuation, and we consider it that is absolutely valid at this moment. And also, I would like to reaffirm that when we made the targets, we knew the situation of the company. We are quite confident with a 3-year target that we announced. There is no changes. We reaffirm the targets for the 3-year period that we announced some months ago. That I don't mind to repeat it, a combined ratio below 96% in Non-Life and below 100% in Motor. If you eliminate the effect of those adjustment in Motor line, you will get an underlying combined ratio for Automobile lower than the numbers published. And you see that the reduction in combined ratio is quite achievable.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Thank you very much. We have seen -- regarding Brazil, we have seen adjustments to reserves every quarter since you announced the deal. What is the reason for these adjustments?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you. First of all, I mean again, a general comment, and we have to put this adjustment to reserves in the proper context. MAPFRE has been extremely prudent on balance sheet evaluation. This is part of the tradition, our conservative view on our D&A, and we have seen when we booked a special reserve for the Baremo implementation in Spain and also when we increase our mathematical provisions in some countries in Latin America in order to mitigate perhaps future increases in yields. And regarding particularly Brazil, this has just been our result of the valuation process that we started at the beginning of this year, and they're quite normal in this sort of transactions. And what we're trying is to apply the more conservative and prudent valuation basis in the companies. The review has been a gradual process, and some of these adjustments were booked in the first quarter, some in the second quarter. And other minor adjustments could be applied -- were booked in the third quarter. And -- but let's say, as I mentioned during my presentation, the analysis -- the final analysis was made at the third quarter, and we shouldn't expect any relevant deviation from those estimates during fourth quarter or next year. And that's all from my side.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. Now we have more questions from Brazil, and this comes from Paz Ojeda from Banco de Sabadell. Day 1 in Brazil from 1st January 2019, could you elaborate, please? Does it mean day 1 in order to start executing restructuring and cleanup portfolio measures or day 1 to start bearing the fruits of the balance sheet cleanup made in 2018 so far?

Fernando Mata Verdejo
Group CFO & Director

No, it means -- day 1 means that the -- in January, we will have a proper organizational -- new organizational chart, a new business model ready to be implemented. And also, throughout the 2019, we expect to see the fruits of some of the restructuring and cleaning up portfolio.

Natalia Núñez Arana

Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much. Now the next set of questions are regarding the reinsurance business. Farquhar Murray at Autonomous has sent us the following questions. Is there any risk of adverse loss development emerging on Hurricane Maria in the future? And what are the reinsurance covers remaining against this? Also, Paco Riquel would like an indication of the NatCat losses expected in the fourth quarter for the reinsurance business.

Fernando Mata Verdejo
Group CFO & Director

First of all, let me emphasize again the strength of our reinsurance protection -- cat reinsurance protection, which is supported by top-quality counterparties. And regarding the coverage remaining in Maria, from Hurricane Maria, we still have a significant, and I will repeat, significant excess reinsurance capacity to cover any further potential deviation. And the net retaining losses are not expected to change. And you see, it was quite a small increase during the second quarter in our net loss and has been a small release in the third quarter. But also, I would like to highlight as well that MAPFRE's capacity to assess cat events like those that happened last year and being one of the first insurers to come out to the market with an estimate and quite small variation from the initial estimate to the final loss. Also, as you -- as we discuss in previous presentations, has been a small increase in claims in Puerto Rico, and -- but it wouldn't affect our net returns here. In summary, practically in Puerto Rico, 95% of the claims have been settled. And also, it was another line of business that was a little bit controversial. We have a low exposure in 2 business interruption coverage.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Regarding the question from Paco Riquel, would you like to give us an indication of the NatCat losses expected in the fourth quarter of this year from the reinsurance business?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you, Paco. Nobody knows what is going to happen in cat exposure and -- but so far, and we have disclosed this information in the management discussion and analysis in the caption of subsequent events, has been another cat event in Japan, Hurricane Trami. And what we disclose is that the impact is much smaller that Typhoon Jebi. Also, Michael, that affected -- the Hurricane Michael, that affected the U.S. The effect on our U.S.A. operation is practically negligible. So and other runoff of third quarter catastrophes, I mean it's too early to say, but we shouldn't expect any relevant deviation from our current -- or from our preliminary estimate of Typhoon Jebi in MAPFRE RE.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Thank you. Andrew Sinclair from Bank of America Merrill Lynch asks, can you please give us an estimate for your losses from Hurricane Michael as your peers have done?

Fernando Mata Verdejo
Group CFO & Director

It's -- as I mentioned, it's practically negligible.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you. Now we are moving to MAPFRE U.S.A. Paco Riquel from Alantra asks. Can you update on the restructuring plan in the U.S. and what states will you be looking to exit?

Fernando Mata Verdejo
Group CFO & Director

Yes, thank you, Paco. Our exit plan has been executed in line with expectation. I will say that probably it was in a quite short period. We expected to be quite long at the beginning. But in the end, I mean we'll finish the -- before schedule. And we'll be looking at this and a strong improvement in the non-Northeast region, with a strong reduction in losses, under EUR 15 million compared to EUR 18 million last September, and over 3 points in the combined ratio. As you know, the final clocks in for a transaction in the year-on-year is expected for year-end. And we do not expect any major impact, say, from now until then. I mean it is an ongoing business, but we must keep in mind that the New Jersey and also New York businesses will remain on our balance sheet until then. We expect our best estimation is that we expect to complete both transactions by year-end. Regarding other states, there have been few relevant states that have reported profits over the last few months, including California. I would like to mention that the California combined ratio was approximately 113%, if I'm not wrong, with a reduction of almost 10 points in 2 years. So we're quite happy with California that it will be a key state for future development. On the other hand, Florida is still underperforming, I mean it's a more complicated state. In California, we are operating only in personal lines, while in Florida, we have Homeowners and also Commercial -- Auto Commercial lines, which is more difficult. Tariffs are more challenging as well. And the cat reinsurance coverage costs are affecting as well our Florida exposure. Regarding VERTI, the business plan and [additional] lines have both been conservative. VERTI will play 2 different roles quite similar to Spain. It will be a business unit, but it will be as well a sort of business laboratory for MAPFRE. And for instance, technology, the new insurance sold where we implemented in VERTI will help us to have a more efficient technology platform probably in the future in the traditional business in the U.S. So we have to look at VERTI with both views, I mean business unit and also the innovation of this business, the insurance laboratory for MAPFRE. Regarding further exits, we're constantly analyzing all the states, profitability in all markets. And what we haven't seen is that we have enough flexibility to reduce exposures or to exit other states if necessary. But so far, and we're happy with the current -- the first wave of reduction of states, and I don't see any further reduction in the short term. Again, for us, 2019 will be the turning point, day 1 for MAPFRE U.S.A.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations

Okay, thank you very much, Fernando. This is the last question. There are no more questions. So the last one is from Paz Ojeda from Banco de Sabadell. And she asks, net profit above EUR 700 million implies close to EUR 180 million of recurring net profit in Q4, adjusted for inflationary impact in Argentina. This seems to be quite challenging, taking into account the current pace and the usual claims seasonality of the -- of this quarter. How confident are you on reaching this level? And what could be the drivers supporting this level?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Paz. As I mentioned before, we are happy, I mean, with the results we're seeing even in a very complex environment. We have to look at the -- our MAPFRE capabilities and to look at the good performance of MAPFRE Iberia, MAPFRE RE, LATAM North and LATAM South as well in order to have a proper projection for the fourth quarter; and also, MAPFRE's flexibility in realizing gains in both financial instruments and also real estate. As you know, the third quarter was extremely difficult, I mean, for market -- for both, I mean the bond markets and also the stock market. But this flexibility allows us to sell a couple of units. And there are more units in the pipeline. This is part of the rotation -- the schedule of units rotation. And we will be able to come back to the normal pace of realizing capital gains. We're confident of reaching this level with -- we said that EUR 7 million is because we're quite confident, and we can reach this. If not, we will not have given this guidance. We did mention that this target depends on our ordinary NatCat loss experience so far. And although -- only Typhoon Trami, it was a relevant one during the fourth quarter. But we have a standard loss experience for the fourth quarter. We're pretty sure. I'm pretty sure. That's why we have given this guidance. We will achieve EUR 700 million even with the -- we're trying to improve, I mean last year results means that we will achieve this number. And also, we will repeat dividend and -- as we mentioned.

Natalia Núñez Arana

Deputy Director Capital Markets & Head of Investor Relations

Thank you very much, Fernando. This is all from the side of the questions we have received. So thank you very much to you all. And thank you, Fernando, for your explanations.

Fernando Mata Verdejo
Group CFO & Director

Okay, thank you for joining us today. We hope the information has been interesting. We'll be back again next year when we'll release our full year results. And as we mention every presentation, there are plenty of financial information available both at CNMV and also our web, which we expect would be of your interest. Thank you, and enjoy the long weekend. Bye-bye.

Natalia Núñez Arana
Deputy Director Capital Markets & Head of Investor Relations
Thank you.