S&P Global
Market Intelligence

Mapfre, S.A. BME:MAP

FH1 2018 Earnings Call Transcripts

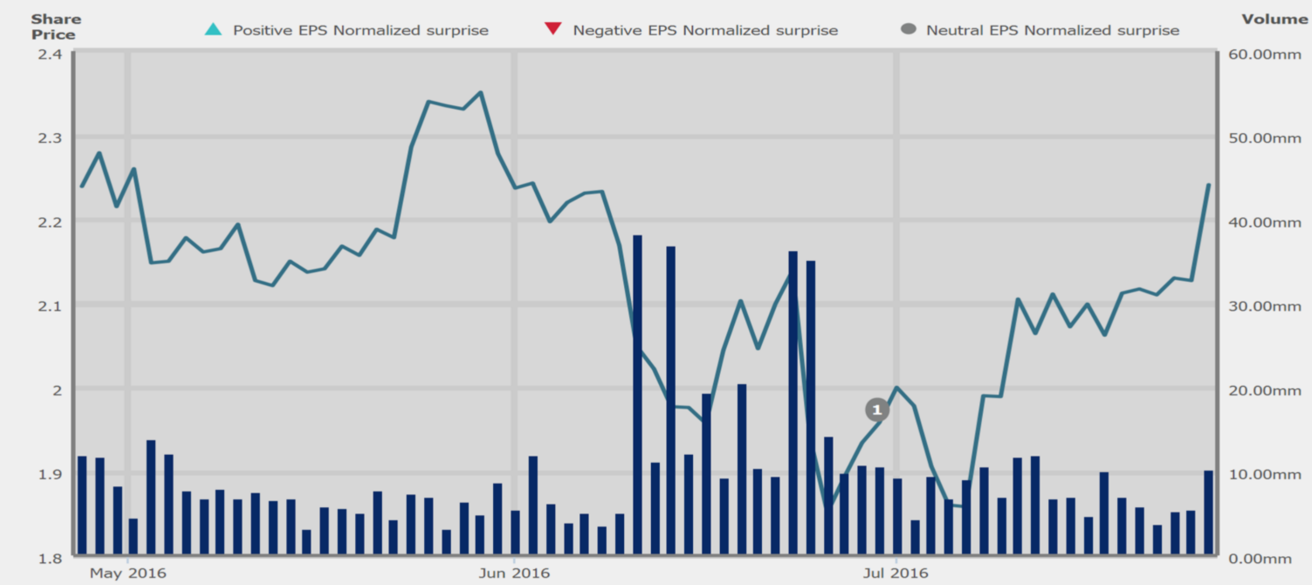
Thursday, July 26, 2018 11:00 AM GMT

S&P Global Market Intelligence Estimates

	-FH1 2018-	-FY 2018-	-FY 2019-
	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	0.12	0.27	0.30
Revenue (mm)	12257.00	23061.67	23492.33

Currency: EUR
Consensus as of Jul-25-2018 11:57 AM GMT

Stock Price [EUR] vs. Volume [mm] with earnings surprise annotations



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FH1 2016	0.12	0.12	1 0.00 %

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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

Welcome to MAPFRE's Results Presentation for the Second Quarter of 2018. As usual, we welcome Mr. Fernando Mata, our CFO and member of the board, who will take you through the main trends of the period. Just as a reminder, during the Q&A, we will answer all questions received at the Investor Relation e-mail address. As you know, for those of you that don't know me, I'm Natalia Nunez, Head of Investor Relation. The team and I will be available to answer any further questions you may have after that.

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 a pleasure to be here with you for our second earnings call of 2018. Let's begin on Slide 2, where you can see the main figures. Revenue and premiums are both down over 8% largely impacted by Forex. As you know, our exchange rates have fallen year on year on most of our currencies. US dollar, Mexican peso and Peruvian sol all down 9% approximately. Brazilian real 16.6%, Turkish Lira 19.8%, and the Argentinian peso the worst with 35% decrease.

At constant exchange rates, premiums are down 2.3% with around 2% growth in life and a 3.4% decline in non-life as a result of a multi-year PEMEX policy issued in 2017. Without this, premiums would have increased by 1.6%.

Financial income is also lower due to the interest rate environment in LATAM, especially in Brazil. Our combined ratio was stable at 97.4% despite several extraordinary impacts during the year. The spend ratio reached 28%, in line as well with our target. The net result stood at nearly EUR 386 million, down around 7%, while the adjusted net result was up 1.1% year on year. The annualized ROE was around 9% excluding the impact of 2017 catastrophes.

Please turn to Page 3. The quarter has been a mix of different trends, but with solid underlying and improving fundamentals. First of all, I would like to mention 2 nonrecurring impacts from corporate restructuring plans. The completion of the US exit plan which had a EUR 7 million negative impact and an extraordinary adjustment in Brazil as a result of our more prudent balance sheet valuation with a EUR 9 million negative net impact. On the other hand, our focus on profitable growth and technical management in non-life is showing results with excellent performance in Iberia and MAPFRE RE. Also, we have consolidated combined ratios close to 95% in LATAM North and South as a result of our efforts over the last years. There had been remarkable improvements in Italy and Global Risks and at MAPFRE ASISTENCIA where the transformation plan is delivering results. Our strict cost constraining policies have also been effective with expense ratio at 28%. Finally, we reported this morning negative runoff from 2017 CAT events which is not relevant. Trends are improving in life with a pickup in savings particularly in Spain in the second quarter as well as return to growth in Life Protection in Brazil. Higher acquisition expenses and a falling financial income in Brazil have been a bit of drag on results, but they are now stable.

Currency movements are still negatively impacting both the P&L and net equity with an estimated EUR 18 million reduction on the net result and EUR 144 million decrease on net equity. Finally, I'd like to highlight our excellent Solvency II position which closed March at 203%.

Please turn to Slide 4. On the right, you can see the development of the main results by region and business unit which we will discuss in more detail in the following slides. Regarding attributable result, Iberia stands out with EUR 250 million, by far the largest contributor. Excluding last year's extraordinary benefit from the consolidation of [indiscernible] provision and also the real estate gains, profit will have grown by over 20%. MAPFRE RE continues to be a strong profit contributor with EUR 102 million net result. The turnaround on MAPFRE Asistencia and better claims experience at GLOBAL RISKS have also improved results this year.

Brazil is still facing strong headwinds from the currency and interest rate environment. The falling results in North America was impacted by a higher level of winter-related claims, EUR 11 million in the first quarter, and the execution of the exit plan, EUR 7 million in the second quarter, as well as still complicated market situation, particularly in automobile. Finally, the decline in Eurasia reflects the situation in Turkey from the 2017 MTPL regulation as well as the depreciation of the Lira.

Please turn to Slide 5. We continue seeing value creation across our main markets as premium growth in local currency is well above inflation rates in many countries. Non-life premiums are down over 3% at constant exchange rates, while life premiums are up nearly 2%. Excluding the already mentioned multiyear PEMEX policy issued last year, total premiums are up 1.6% year-on-year at constant exchange rates. On the right, you have several core business segments have had exceptional performance. Iberia grew over 7% with positive developments in main non-life business as well as a pickup in life sales especially in the agent channel in Q2. The recovery limit activity in Brazil has led to 9% growth in life premiums and in local currency. LATAM North is benefiting from the growth in Mexico where premiums have grown 17% in local currency excluding PEMEX with positive trends in motor and health. There is also double-digit growth in the Dominican Republic, Costa Rica, and Honduras. In LATAM South, the positive trends in Peru are also worth highlighting with nearly 11% local currency growth. Finally, Puerto Rico is up 25% year on year as a result of higher tariffs in commercial lines. And in North America, the northeast continues growing over 2% in US dollars. The Puerto Rico 25% growth is in US dollars as well.

There are a few other regions that are lagging in premium growth but we are setting the foundations for future profitable growth. In Brazil, general P&C premiums are down slightly, and improvement in motor has been modest. Chile and Columbia continue canceling unprofitable business in non-motor lines. And in Turkey, the portfolio is still being reduced in the context of the 2017 MTPL regulation. And finally, business restructuring in Global Risks and Asistencia. And a decline in the northeast region in the US have also contributed to falling premiums.

Please move to the next page. On Slide 6 you can see the breakdown of key non-life figures by region and unit. Here I would like to highlight the improvements again in Iberia which I will cover in more detail later. Regarding Brazil, the combined ratio stood above 100 due to extraordinary balance sheet adjustments. Excluding this, the combined ratio will be 93.5% despite the challenging market situation in motor. And finally, LATAM North and South continue showing improvements across the board.

Please turn the page and I will go through the performance of the non-life business in more detail. We like to highlight the excellent results of the business in Iberia where we're growing and gaining market share in key business lines with exceptional, profitable levels, especially motor, with a combined ratio below 90%. We will discuss these results later, but I would like to briefly mention the General Baremo provision. As you may recall, there were EUR 20 million remaining at the beginning of this year. During Q2, we reallocated these IBNR to case by case reserves mainly resulting from the application of the new Baremo income compensation to bodily injury claims from the old Baremo. This affected a small number of claims and the impact was the EUR 13.5 million in motor and EUR 5 million in commercial TPL. The remaining EUR 1.5 million was released and this was the net effect, EUR 1.5 million profit in the profit and loss account for this 6-month period. In Brazil, results were affected by several nonrecurring adjustments which I will discuss later on.

Please turn to Slide 8. There was a slight increase in the loss ratio at MAPFRE RE due to a higher level of additional claims and a decline in premiums mainly due to currency movement. As you know, a large part of the business is in foreign currencies. In the northeast USA, positive premium trends are mitigating the fall in other states. Regarding results in the US, there have been extraordinary inputs from winter weather and the cost of the exit plan. We have already seen the fruits of the profitable growth strategy in LATAM North and LATAM South where combined ratios are showing positive trends. Premiums are growing across the region in local currency except in Columbia and Chile due to the cancellation of lossmaking portfolios.

Please turn to next page. In Eurasia, German and Italian premiums grew around 1%, in line with current market trends. Turkey showed a decline in premiums as a result of stricter underwriting guidelines as expected in the context of the 2017 MTPL regulation and the related increase in the motor combined ratio. Premiums at Global Risks were down, negatively affected by Forex movements, but the loss experience was positive in the quarter. Business volumes were down at Asistencia as expected as a result of portfolio cleansing and office closings. With a significant, extremely relevant EUR 22 million reduction in losses again, it is not worth it as Asistencia reported a small profit during the second quarter.

On Slide 10 you can see an update of last year's CAT events with EUR 6.7 million negative run-off during the first half of the year. Affected mainly by Puerto Rico where over 7,000 new claims were reported after March in this year. Obviously this trend wasn't expected at that time.

Please turn to Slide 11. We're seeing improving trends in life but it continues to be negatively impacted by currency movements with premiums down by 4%. In Iberia we have seen improvements, especially in the agent channel thanks to sales campaigns. Last year's results included one-offs extending from the cancellation of our provision for Bancassurance contingent payment as well as the DUERO VIDA gain. In Brazil, premiums are up 9% in local currency but continue to be hurt by currency depreciation. Results here are still affected by higher acquisition expenses in order to boost sales especially in the Bancassurance channel. As well as the fall in financial income, around EUR 57 million due to lower returns on floating rate and inflation-linked bonds.

Let's skip Page 12 where we show life highlights and on Slide 13 I would like to talk about the extraordinary items that have affected MAPFRE's net result. The first quarter's result was affected by multiple and severe snowstorms in the northeast USA with an EUR 11.5 million net loss. We already reported that the first quarter and this figure compared to a EUR 43 million net loss from the Coastal Niño last year. There were several corporate transactions in 2017 comprising the sale of the UNION DUERO business, the sale of the life annuity business in Peru, the gain from the purchase of minority stakes in ABDA, Indonesia and the restructuring at MAPFRE Asistencia. These had a total net impact of EUR 16 million positive in 2017. This year, corporate transactions include the negative EUR 7 million impact from exiting business in the US.

Realized gains are down this year due to the absence of real estate gains compared to the EUR 20 million net impact in 2017. Finally, 2017 figures also reflect a EUR 27 million net gain from the reversal of the provision for contingent liabilities in Bancassurance. And all in all, excluding these impacts, the adjusted net result is up approximately 1%.

Please turn to Slide 14. Now I would like to discuss the good performance of non-life business in Spain which is a clear example of the success of the profitable growth strategy. The non-life transformation process implemented in 2015 led to an increase in pretax profit from EUR 259 million to EUR 454 million in 2 years. The main driver of this was the improvement of the combined ratio from 97.2% to 93.7%. Currently, the combined ratio remains quite stable at 93.7%.

In the first half of 2018, MAPFRE has continued reinforcing its leading position in the non-life Spanish market, gaining market share in motor, commercial, health business and condominiums. Despite the stricter underwriting policies and tariff discipline, MAPFRE outperformed the market in motor with 2.9 premium growth. 2.9 as well in retain and to return to growth inflates at 2.4%. On the bottom right, you can see the average motor premium growth. In the first half of 2018, MAPFRE's growth was negative 0.7%, in line with the market, negative as well, 0.5%. In the previous 3 years, MAPFRE growth was well above the market reflecting MAPFRE's strategy for growth and profitability. The current excellent combined ratio allows us to be more competitive in tariffs and return to certain segments such as small fleets. Since December 2017, the motor combined ratio has been around 5 points below the market as a result of initiatives to control and reduce claims and expenses. At the close of June, 2018, MAPFRE's motor combined ratio stood at 89.3%.

Please turn to Slide 15. On June 26 we announced the update of MAPFRE's strategic alliance with Banco Do Brasil. On this slide you have the main features and fundamentals of the transaction. The base price was agreed at 2.4 billion Brazilian reals, around EUR 550 million at the end of June, adjusted for dividends. Equivalent to approximately 1.5x book value. Expected return on investment is 10%. And we have set 3-year targets for the Brazilian business including over 6% average total premium growth, combined ratio below 96%, below 100% in motor, and ROE above 12%.

On Slide 16 you can see historical and June data by holding an entity in Brazil. This is new information, this is the first time we disclose this entity's numbers. The June results were affected by several extraordinary adjustments as a result of a more prudent, I will repeat, more prudent and conservative balance sheet valuation. There were around EUR 24 million in negative adjustments affecting SH2. And a EUR 15 million positive adjustment in SH1. Full disclosure of the adjustments are at the bottom of the slide.

Please turn to next page. We have successfully completed in less than 6 months the exit plan for the US business that was announced at our last Investor Day. This operation had a total EUR 7 million negative impact on June's net result which is small, we consider small considering the scope of the transaction. On the right you can see that our core business region, the northeast, is very profitable with a 22.6 million net result despite the impact of the winter storms and the challenging motor market conditions. The losses in the non-northeast have fallen by over a third to EUR 9 million. And as we have mentioned, there are several profitability initiatives in place to continue improvement results including tariff increases, predictive analytics and agency channel management. Regarding Verti, expenses are budgeted for the launch of operations, especially IT related, and marketing expenses are quite low up to date.

As already announced, the Board of Directors agreed to reorganize the Global Risk business. This slide presents the rationale behind this operation. The restructure for us, greater stability and efficiency, greater client focus and better control of exposures. On the following slides I will discuss the balance sheet items, Solvency II and embedded value.

Please turn to Slide 19. Shareholder's equity has fallen by over EUR 154 million from December to June, to around EUR 8.5 billion. The net and realized gains of the available for sale portfolio fell by over EUR 150 million and currency conversion differences fell by over EUR 140 million. These declines were driven by several market movements, the depreciation of our main currencies during the period as we already mentioned, higher yields in Europe and in the US, and the fall in European equity markets during the period, both Euro stocks and also IBIS 35.

Please turn to Slide 20. On the left, you can see that assets under management are down slightly since the beginning of the year. This is mainly a result of the impact of currency movements on assets in Brazil and other non-Euro countries as well as volatility in preferred bonds. The breakdown of the investment portfolio is on the right. Asset allocation has been stable throughout the year. Equity and mutual fund exposure has slightly fallen due to market impacts in the second quarter. On the right, as you may see, the largest exposure corresponds to Spanish sovereign debt with EUR 16.2 billion followed by Italian sol with EUR 2.3 billion as well.

Finally, I would like to mention that we have achieved our target of EUR 450 million invested in alternative assets including real estate and private equity funds principally, with an expected yield in a range between 4% and 6%. Non-life realized gains in the first half of 2018 amounted to around EUR 6.3 million, sorry, EUR 63 million. EUR 29 million lower than last year due to the lack of real estate gains. During the second quarter, Spanish debt, which is the main asset in our investment portfolio, has been very volatile, but we have been able to take advantage of market volatility to slightly increase or reduce the ratio and prepare the portfolio for an increase in interest rates expected for the second part of next year.

It is worth pointing out the high accounting yields in our portfolios, over 2.3% in non-life and nearly 4% in life, well above market deals.

Please turn to next page. On the left side, you can see the breakdown of the capital structure which amounted to EUR 12.6 billion. We had EUR 260 million undrawn on our credit facility at June 30 and we have significant capacity for new issuances.

Let's move onto Solvency II. The Solvency II ratio stood at 203% at March 31, up 3 percentage points this year and confirming MAPFRE's strong Solvency position and low volatility. We have a high-quality capital base with 93% of Eligible Own Funds in Tier 1. Let's move onto Slide 24 where the value grew over 60% in 2017. This improvement is explained by the inclusion for the first time of Life and Burial business in Peru and Brazil life. So it's an increase in scope. And second, the improvements in the financial margins of the Spanish Life savings products, net of credit risk. A return on embedded value is high, over 18%.

Please turn to Slide 25. To change the focus before coming to the end, in MAPFRE, business is measured in more than numbers. And behind the numbers, there are people. So for now, we will include non-financial indicators in our presentations. These indicators are representative of a social commitment in the company in addition to being profitable must be sustainable and contribute to social development. On this page you can see the most important indicators. The first one is that we are moving ahead on our commitment to equality. We are already very close to complying with the target of 40% of women in managerial positions, which was set for the yearend. MAPFRE also wants to be recognized as an inclusive company which provides opportunities to everyone. We have already exceeded the target of at least 2% of our workforce comprising people with disabilities. And regarding the personal and professional growth of our employees, at the end of the first half of 2018, 7.2% of our workforce has changed positions. The target for the full year is 10%. We are extremely happy with the performance of these 3 indicators.

Our investment portfolio has been adapted to ESG standards and 80% of corporate issuers have a sustainability grading. And 95% of the market value of this group of issuers has an above average scoring. To wrap things up, I would like to make a few closing remarks. First of all, we have achieved our restructuring targets for Brazil and the US and are ready to enter into a strategy execution phase. We are quite pleased with our current business footprint and focus which is now aligned with our strategy and risk appetite.
Finally, this first half of the year has been positive in terms of profit generation in a quite challenging environment. And we are confident in MAPFRE's ability to continue creating value while meeting our commitments with our shareholders and society as a whole in a sustainable and responsible way. That's all from my side. Thank you and now I will hand the call over to Natalia to begin the Q&A session.

Question and Answer

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

Thank you very much, Fernando. It's been a very comprehensive presentation. So now we will start with a Q&A session. The first one comes from Michael Huttner from JPMorgan. It's regarding Asistencia business. Asistencia worsened to 104% combined ratio in Q2 2018 from 102% in first Q. When will this business deliver on your expectations, on your targets? Do you need to consider another round of large provisions like what's done now in Brazil?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Michael. You are looking at the numbers reported by Asistencia. It looks like there is stability to change and we are quite happy after 2 years with the changes, or the fruit of the changes will come up earlier. But in the end, this is the first year. We are happy and we are harvesting the fruit of the implementations made. Asistencia's combined ratio increased 1.7 percentage points to approximately 103%, basically due to the pressure from expenses, where reductions are underway. As a result of measures being successfully implemented, I mean loss ratio had a significant improvement of 3.6 points to a quite low approximately 62%. And the main driver of the improvements comes from the other activities rather than the insurance side results which has already given positive figures with almost EUR 18 million improvement. So let's say that out of this EUR 22 million reduction in losses, practically [88] are coming from other activities, rather than insurance. Regarding future adjustment, as I said, there are very few things left in the assets of Asistencia. So we are quite comfortable. There are perhaps small adjustments in the future, but quite small. And also, we expect this year a single digit loss and this indication will include any potential adjustments. And as we said as well and is included in the financial report, we reported a small profit in the second quarter which is -- we're quite happy with this performance in the second quarter.

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

Thank you. Next block of questions is concerning MAPFRE Brazil. First one comes from Andrew Sinclair at Merrill Lynch. Even excluding one-offs, the Brazilian non-life technical result in Q2 was negative. How soon do you expect to be able to return to a positive technical result?

Fernando Mata Verdejo
Group CFO & Director

Thank you for your question, Andrew. You're right, the non-life technical result in Q2 in Brazil was negative EUR 32 million. The pretax on minority impact on the balance sheet adjustment in non-life were around EUR 90 million, a little lower I think, 88, 89. Therefore, the technical result was roughly EUR 56 million and the combined ratio is clearly on the same path it was, like 93%. Let's say that the underlying performance has been satisfactory. We are confident with the 3-year targets we announced for Brazil for a non-life combined ratio below 96% and motor below 100%.

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

Okay, thank you. Next question also comes from Andrew Sinclair, is if we can confirm that there is no change in ownership of [indiscernible] Brazil from the proposed Banc do Brasil transaction. And yes, we can confirm.

Fernando Mata Verdejo
Group CFO & Director

Yes, Andrew, thank you. Yes, you agree, we can confirm that their stake in H1 remains 25%.

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

This is, if I may add something, this is the life company for the Bancassurance business and it stays the same, with the same stake. This one also from Andrew Sinclair is, what changes do you except for holdings, other business and consolidation adjustments as a result of the transaction? Can you confirm that the pro forma group earnings would have been in the transaction had been completed in 2017? Also, regarding this topic, Michael Huttner from JPMorgan has this question. If I work what works, it implies that the underlying profitability of this business in the past 5 years would have been EUR 50 million pretax lower. And that also changes the valuation on your EUR 0.6 billion investment, from say 10x historic average earnings to around 11.5x. Is this assumption right?

Fernando Mata Verdejo
Group CFO & Director

Yeah, thank you both of you for the questions. As I said, this is the first time we are giving you historical data and then break it down by holdings and entities. I guess with this information you are able to make a better estimation on your estimates. Also, as we mentioned in the past, this minority that we have acquired will have contributed around EUR 420 million over the 7 years of the agreement, I mean from 2010 to 2017. We prefer not to give any further disclosure regarding pro forma figures until the transaction is closed, but we feel you have enough data to make your own estimates together with the guidance we have given. As a couple of comments regarding the adjustments in SH2, as I mentioned, this a [indiscernible] base in a more proven accounting basis. And also, as some of you are mentioning, let's say that the majority of the adjustment will show allocated to prior years. And there's just basis, more prudent basis. It doesn't mean -- it means that the way we will see in the future whether or not we will see positive or negative development of the adjustment made in reserves. But rule one is to have a more solid and robust balance sheet before the transaction date. I'm following MAPFRE's standards.

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

Thank you very much, Fernando. Now this block of questions is concerning Iberia. Sofia Barallat at Caixia BPI, Nicola Dalla Palma from [indiscernible], Ivan Bokhmat from Barclays, and Michael Huttner from JPMorgan have asked about the good evolution of the trends affecting the ABN motor insurance. And the Baremo provision. Motor in Iberia is now at 90% combined ratio. How much is sustainable and how much is due to reserve releases from the Baremo [indiscernible] in 2015/2016? Can you talk about the pricing and claims strength please?

Fernando Mata Verdejo
Group CFO & Director

Thank you, all of you, for the questions. I mean my first conclusion is that we are extremely happy with Iberia performance. Looking back 3, 4 years ago, I mean in the depth of the Spanish crisis and we were suffering, remember 13% decrease in premiums and a combined ratio near 100%, and our captive agent distribution channel suffering because of the fixed costs of this channel. And now we can align the numbers and premium growth, units growth, combined ratio below 90%, we are extremely happy. Let's say that we made our homework and we want to implement a similar trend and similar initiatives in the rest of the countries that are still performing with combined ratio underperforming and with combined ratios over 100. Our goal in Iberia is to grow profitability, but without losing our competitiveness. As I mentioned, this is the first time after 3 or 4 years that we are growing in some segments of business such as small fleets. But we believe that with this combined ratio, there is still room for further improvements without jeopardizing our excellent technical result. Let's say that in the long run, we should consider 92% as a more reasonable level of combined ratio for automobile. It doesn't mean that there is room for a price war. Forget it. I don't want you to -- to understand this. Let's say in the 2, 3 past years, we abandoned some of the [indiscernible] of clients and also we increased studies and now our objective is to have both premium increase and also earnings increase in order to gain market share in both premiums and number of vehicles. Regarding Baremo, we are very happy. And looking back as well in 2015, let me wrap up what we've done with Baremo. In 2015, we increased our IBNR a percent on EUR 35 million in order to cover potential increases in prior years' claims as a result of the new Baremo implementation. I guess, and now the numbers say that we were right, it was a prudent accounting basis and after 1.5 years of experience last year, we have released EUR 15 million of this provision and it was taken into [indiscernible]. After 2.5 years of experience with our actuary teams, by the way weighted against increase in the [indiscernible] claims and also new trends, I think we have enough experience in order to reallocate this IBNR reserve to individual claims. So in the books what we had is reduction of the IBNR reserves for EUR 20 million, EUR 15 million in Automobile and EUR 5 million in general TPL. And an increase in the individual in the case by case reserves by EUR 5 million in general TPL and EUR 13.5 million in automobile case by case and reserve. This increase affected to just if I remember well, 13 individual claims. They were severe claims. And what we see is an increase in the cost of some indemnities for severe disabilities and also deaths. The majority of the judges they are applying for previous volume of claims, the higher range are indemnities which is quite close to the new Baremo. Let's say [social] is like a social try in order to equalize to make equal both Baremo for some severe claims. So in the end, the net effect in the profit and loss account in this first half of the year is this EUR 1.5 million before tax which is nonrelevant and in terms of combined ratio, if I'm making the numbers correctly, is like 15 percentage points reduction in the Spanish automobile combined ratio. So let's say --

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

Sorry, 15 basis points?

Fernando Mata Verdejo
Group CFO & Director

15 basis points. What did I say?

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

Percentage points.

Fernando Mata Verdejo
Group CFO & Director

Sorry, 15, it was nothing relevant. So let's say for MAPFRE, the Baremo discussion practically is over and now what we have to monitor is just the development of these individual 38 claims in order to see if in the end, I mean the final course is the one we have reserved today. That's basically Baremo. Let's say Baremo fortunately is over. Let's say we were right when we increased the IBNR. Perhaps more prudent as we should because it was a release of provisions in two years, one nonrelevant in 2010 and EUR 15 million last year. But as always at MAPFRE, we follow quite prudent accounting basis regarding technical provisions.

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

Okay, thank you very much, very comprehensive response on thoughts around Baremo and I really thank you very much. I hope it helps. Next one comes from Ivan Bokhmat from Barclays. It's about combined ratio in the second quarter appears to be weaker despite reserve releases and due to weather claims. What do you consider to be the appropriate run rate for 2018?

Fernando Mata Verdejo
Group CFO & Director

Well it's very difficult to calculate the run rate for these lines due to the impact of the seasonal related claims, weather-related claims. I'd say that the increasingly combined ratio in the second quarter was due to bad weather conditions that affected to homeowners, condominiums and [indiscernible] insurance. Some -- it was a severe [indiscernible] in commercial lines and also as well as higher frequency in transport line. But let's say the fundamentals are good. We believe that we shouldn't expect any negative trend in the future of the combined ratio.

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

Thank you. This one is regarding life business, Sofia Barallat asking about the expected evolution of life insurance premiums in Spain going forward.

Fernando Mata Verdejo
Group CFO & Director

Thank you, Sofia. As you know very well, it is practically impossible to forecast the expected evolution of the life insurance premiums in Spain. They are up and down, so premium growth of 30% one year without any pressure on [indiscernible] behind it. In Spain, the majority of the life business premiums trend are driven by let's say financial institution appetite. In the majority of the case, they follow different strategies from different financial institutions when they want to increase what deposits or what insurance profits. What I can say is that the expected evolution for MAPFRE, which is the one we monitor, the first quarter wasn't a good one and redemptions, we didn't have practical redemption in the first quarter. So the volume of premiums decreased. But the second quarter has been more positive and more promising and we expect the trend for the remaining quarters to be positive as well. We have been actively launching several new products over the last few months and even just this week we announced a new campaign for dividend beta which is let's say this is the recovering brother, the union link investing in Spanish shares with high dividend. But this is a permanent product and it is performing extremely well. So all in all, let's say that the third and the fourth quarters should follow the second quarter trend rather than the first quarter.

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

Thank you so much. Now the next block of questions is regarding MAPFRE USA. The first one is coming from Michael Huttner of JPMorgan and it's regarding the combined ratio in North America in second quarter that has been 99.8%. Can you say how sustainable this is?

Fernando Mata Verdejo
Group CFO & Director

As I said for Iberia, Michael, we are quite happy as well with the end of the restructuring plan in the US. Now we are in execution phase and figures are more promising as well. We've also seen a strong improvement in the non-northeast region with an over 35% reduction in losses. I didn't say during my presentation, but I can add that a few relevant states have already been reporting profits over the last few months including California with a token profit in June. We're quite happy with this result. California is a quite challenging state as well with a lot of competition. Regarding Verti, the business plan is an initial launch, is a self-launching and happy both are quite conservatives. As I said market in [indiscernible], they are still quite low. And as we said as well during the Investors Day, I mean the lines of Verti business in the US will be revisited every 2 years in order to monitor performance and premium growth. In the US regarding outlook, in the US the second half of the year is usually better in terms of profitability. But in the long run for MAPFRE, for us day one for MAPFRE USA will be January 1, 2019.

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

Okay, thank you. The following question is from Andrew Sinclair of Merrill Lynch. And it is what level of premium increases have you been able to put through on your US portfolio?

Fernando Mata Verdejo
Group CFO & Director

Okay, we usually don't disclose this information, but we have and we're going to do it. We are quite promising with the numbers and it's basically to the rate increase. Great increase. 5% in Massachusetts, in May, 6% in Rhode Island since January. Additional several filings in California as well as in Connecticut and Washington among others. But let's say MAPFRE filings have been in excess of 5%. We expect these hikes to be big enough in order to absorb the current increasing average costs on frequency we've seen in the United States, particularly in motor lines. In Massachusetts we are already seeing a number of players take rate increases as well and following MAPFRE trend. You know that MAPFRE is the leader in case of market share in Massachusetts which is a good sign for the market.

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

Okay, thank you very much. Now the next one comes from Ivan Bokhmat from Barclays. And it's what would you consider to be the normalized operating profit trend rate after the footprint is complete in the US? It appears 2Q 2018 results, so both EUR 7.2 million impact from disposals and EUR 3.5 [heat]from Puerto Rico reserves. Adjusting these results for these moves, should we think of EUR 10 million profit per quarter as a base case that you could aim to improve on going forward?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Ivan, for your questions. First, let's say that the footprint or the results in the US, the current footprint is not the one we expect it to be in the future. As you remember, during our Investor Day, we split the United States in 3 different categories. First is Northeast, Massachusetts and the 4 states around. The exit states and another category in the middle. There is a book of states including California and Florida as well, but those are ones in which we have an agreement with the AAA Motor Club. It means that this main category is under review on a permanent basis and we monitor very closely any state, any line of business, any change of strength in order to make corrections or in order to put in the exit room these operations in these states. Regarding guidance for the US business, the only thing I can say at this moment is that we've reaffirmed the 2020 targets announced at the investor day, our last investor day for MAPFRE Insurance. And I remember excluding Verti, 4% average growth in US dollars and a combined ratio around 97%, and it was excluding Verti. And Verti USA will add around 1 percentage point to this target. And the expected ROI is in line with the US ROE and around 8%.

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

Thank you very much. Paz Ojeda would like to know also regarding VERTI USA the net loss of EUR 5.5 million in the first half 2018, should we expect similar impact in the second half? When will you reach breakeven?

Fernando Mata Verdejo
Group CFO & Director

It is a difficult question, Paz. Let's say most of the loss, they are overheads. Because currently our portfolio is primarily $300,000 US more or less. So let's say that most of the result there are overheads. And let's say that the 5 million loss is in the budget range and the second quarter overheads will depend on how good are we in these finetune adjustments of targets in order to promote an increase in premiums in the second half of the year.

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

Okay, thank you. There is also a question from Paz Ojeda regarding the US business, is can you explain the cost of the minus 7.2 million impact from the exit states? Does it include New York and New Jersey? Should we expect additional impact in 2018?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Paz. These impacts are a result of the completed sales, the 3 ones. The life business, the renewal rights transfer in Tennessee, Kentucky and Indiana, and the third one is the sale agreement for New York and the renewal portfolio of rights from New Jersey. Which the two last operations that are still pending -- sorry, the New York is still pending from the [lottery] approvals. We do not expect an additional impact in 2018, the remaining part of the year. This is our first estimate because the completion date will be we are expecting it the fourth quarter. And the final consideration is quite similar to Brazil will depend on the net equity of after adjustments [indiscernible]. But we do not expect any relevant additional impact on these results.

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

Okay, great. Now we are changing topics. We are moving to MAPFRE RE and GLOBAL RISKS. Michael Huttner of JP Morgan and Ivan Bokhmat from Barclays have asked about increase in the impact of 2017 NatCAT losses. The hurricane loss is continuing to drift upward, abate modestly. Can you explain the driver to this? Also, peers have recently seen negative loss development for Irma and Maria. Is there room for further reserve strengthening?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Michael. This increase is the result of the higher claims reported, new claims reported in Puerto Rico in the first half of 2018. And principally in the second quarter. But I do mention this amount is not relevant. If I remember well it was like 7,000 new claims, 5 in Puerto Rico for Maria Hurricane upped their marks. I mean the cost, the net cost is still in practically in the middle of the range between 150 and 175. I note that it was a positive release, quite small in the first quarter because we are permanently evaluating any potential negative or positive development in the runoff of the CAT losses. And once again, we want to highlight MAPFRE's excellent reinsurance program and the professional capacity of MAPFRE RE executives in order to assess the best estimation for the CAT costs. Let me say that MAPFRE was the first reinsurance in order to publish an estimation comprising the 4 catastrophes in the third quarter 2017 and I'm sure MAPFRE RE is the best reinsurance estimating any change in the net cost of those catastrophes on an ongoing basis.

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

Thank you very much. Andrew Sinclair and Ivan Bokhmat from Barclays, Andrew from America Merrill Lynch, have asked about increasing additional claims. Were there any particular trends here or any specific countries affected?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Andrew. The second quarter we have not been affected by catastrophic events, but we are seeing higher frequency of additional claims. I mean for Global and for MAPFRE RE, additional claims is between 1 and 5 million. Anyway, these claims are within the loss budget and we haven't seen any particular trend. This is let's say that the frequencies are usual and the additional trend is quite similar to previous years. What was different was the lack of additional claims in the first quarter. But this second quarter follows similar trends to what we have in previous years.

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

Okay. Andrew Sinclair also wants to know how much did your reinsurance protection cover renewals increase after the success of your reinsurance program last year?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Andrew, again. It was an expected [indiscernible] season. MAPFRE rates were renewed between June and July in several main markets including the US, the Caribbean and LATAM and followed the strategy we presented, the worldwide dilemma presented at our last Investor Day. We haven't changed our structure and they started to perform very well last year and we want to keep, to maintain the same CAT protection. Nevertheless, the total cost of our rating season protection in this region, I mean in US, Caribbean and especially in Puerto Rico remains stable because we have reduced our exposure to these rates, mainly global rates in order to compensate the increase of rates. There were limited tariff increases in programs not affected by last year's catastrophes, between flat and 5% which we consider is moderate. Due to the still high level of excess capacity and we are still seeing soft market conditions in some regions. But not those regions affected by the CAT losses last year.

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

Good. Next one is from Ivan Bokhmat, Paz Ojeda. They have asked about MAPFRE Global Risk reorganization. How will you be reporting change after the announced adjustments to Global Risk corporate sector? How much of the current premiums and operating result is related to MAPFRE Iberia? And how much to MAPFRE RE? What benefits in terms of profits and synergies can be expected from this restructuring?

Fernando Mata Verdejo
Group CFO & Director

Let's say that the fundamentals and the rationale behind the restructuring was very well explained at the presentation. There is another press release and there is more information in the different documents that are available on our website. Let's say that just to summarize, to wrap up the transaction, basically what we are doing is a transfer of assets of the insurance and reinsurance assets and liabilities to MAPFRE RE in order to have a larger and more solid balance sheet, MAPFRE RE balance sheet next year. Regarding MAPFRE Global Risk unit, we will keep as the current one. Global Risk for us is a unit, it's a strategic unit and we want to give the best service and the best quality of level to our clients. That means that we have to prepare some pro forma information regarding the different premiums that will be spread over primary insurance, particularly in Spain and also in LATAM. And then put together the profit contribution coming from the Global Risk independent entity, also the Global Risk business running in the different primary insurance and also the Global Risk business that is being retained in MAPFRE Quito. So let's say it's just a translation or transaction of balance sheet items to MAPFRE RE and premiums to LATAM and MAPFRE and Iberia. But the unit, the one we have, will remain with the same capacities, competence within MAPFRE Group.

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

Okay, thank you very much. The next one is regarding Brazil. It comes from Michael Huttner, Andrew Sinclair, Sofia Barallet, [William Covat], Paz Ojeda, Farquhar Murray, Silvia Rigol and Ivan Bokhmat. The Brazil -- it's regarding the Brazil provision in non-life that was around EUR 88 million gross of tax and minorities. Can you explain what this relates to and what is the life provision release of EUR 108 million in Brazil?

Fernando Mata Verdejo
Group CFO & Director

Thank you, all of you. I guess this is the topic of the presentation, Brazil. Let me give you my explanation split it into 2 different holdings. Regarding non-life or let's say the future non-life as it's one, that will be run by MAPFRE 100% shareholding. As a result of the valuation process normally in these types of transactions, what we applied is the more conservative and prudent valuation basis to the different balance sheet items. The review has been gradual and some of these adjustments maybe you recall were carried out in the first quarter. I mean it was an increase in reserves for bodily injury, outstanding claims S.A. II. And other adjustments, they were booked in the second quarter. And even the analysis is not finished, it is 99% plus finished, but there is still some adjustment that may come up in July but nonrelevant and minor adjustments. Regarding life, what we want as I said is to have a quite solid and robust balance sheet items at the translation date and following MAPFRE accounting standards. Regarding life, it is one. They will remain with the current structure. In the case of this holding, the reversal of we call it the annex [indiscernible] provision, probably I mean this term is familiar to you, we try to cover premium deficiency on loss maintained products was a result of the change in the Brazilian local accounting standards. These reserves that are coming from previous years, quite long ago, was a calculation on a product by product basis rather than a line of business which is normal in Europe, particularly in Spain. And now the calculation is made on a more aggregated basis. As a result of this, a result of this amount, there was a partial release as well from MAPFRE. Partial means that probably over 2/3 of the adjustment has been booked as of June 30. But there is still further analyses that are being carried out in July and August in order to comply with IFRS accounting principles which is the accounting that we report in MAPFRE. So these adjustments were identified and let's say considered during the assessment process of the transaction. So let's say that the adjustments or the value of these adjustments were considered in the assessment of the entities, therefore part, an integral part of the agreement with Banco do Brasil. All in all, we do not expect in July more in August any net impact or any further adjustment to be significant enough or to be or we consider them as a hard to be [indiscernible] for the profit on account of MAPFRE.

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

Thank you so much. They also wanted to know why do you not adjust for these impacts on page 13 of presentation as you would adjust the results?

Fernando Mata Verdejo
Group CFO & Director

Well, probably you're right. But we considered the majority of adjustment as a prior year's adjustment. What is important is for the net profit generation or contribution of this year, this is one-off. We should remove from further predictions. But we do not adjust as 2018 pro forma because we should adjust as well 2017 and prior years. So if you want to make it, do it. But we consider this as an adjustment not to be adjusted in 2018 net result.

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

Okay, thank you. With regards to the Banco do Brasil transaction, could you clarify whether the 10% ROE on the Banco do Brasil acquisition includes synergies and over what timeframe do you expect to reach the 10% level?

Fernando Mata Verdejo
Group CFO & Director

Yeah, first of all, the synergies are not the main drivers on ROE improvement. I mean the main driver is the room for change that we have identified, particularly motor line business in Brazil. And we are currently implementing. That's all.

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

Okay. The 12th ROE in 3-years' time implies on my numbers more than doubling the current run rate of profits. Which may be challenging taking into account the volatile dynamics of the country's economy and currency. Does this target include some actions in the equity part of the equation, I mean capital repatriation?

Fernando Mata Verdejo
Group CFO & Director

Let's say I don't think so. This is still too early to conclude on this topic, but what we disclosed is the excess of equity and also the cash available at the holding will fully devote to pay part of the consideration. Let's say we expect the most from the Brazilian economy so we should as well to retain some of the results in our equity in order to fund the premium growth we're expecting in Brazil. So let's say that roughly speaking and to be honest, at this point we do not consider any potential repatriation from Brazil.

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

Thank you very much. And now, can you give us some color on the planned measures to being the combined ratio to your targeted level?

Fernando Mata Verdejo
Group CFO & Director

Regarding planned measures, first take into account that we are expecting [indiscernible] to close in the third quarter. And once the transaction is finished and we are ready to have a full implementation of all the actions that as I said, we have identified a large number of different initiatives in order to increase our efficiency there. But anyway, despite this transitional period, we are already implementing some minor measures, let's say to assume life structure and processes, and let me say that we are working on a new organizational chart for SH2 that they will take effect probably in the coming weeks. Remember that we mentioned as well that we sent, we deployed a taskforce comprising a lot of 10 people from MAPFRE Spain, from technical areas and there is a lot of initiatives currently in the pipeline that were identified by this taskforce in February. They are involving actuarial, technical, tariff, commercial [indiscernible], products, claims handling, etc. But all in all, as I said for the US, for MAPFRE Brazil, day one will be next January the first. And the two remaining quarters will be just the initial phase of the execution plan.

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

Okay, Thank you very much. There are 3 more questions regarding Brazil. If you don't mind, to give you a rest, I can answer them?

Fernando Mata Verdejo
Group CFO & Director

Yeah, I need to drink some water. Thank you, Natalia. Too many questions just in a row.

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

Yeah, I can answer them because they are straightforward answers. Could you explain the sense of the Brazilian Life technical result in the quarter? The main figure that has come in this quarter is the reversal of the provision in the SH1 Holding. And it is EUR 108.8 million gross. That is before taxes and minorities which was EUR 50 million after taxes and minorities. And also, we have seen a relative level of claims in Life Protection. Also, there is a question regarding the increase in minorities in Brazil. The increase of minorities in the first half of 2018 versus first half of 2017 is due to a higher amount of results coming from the Life Holding in which MAPFRE has a lower shareholding, 25% only. Regarding the finance of the Brazilian tech section, are you planning to raise that?

Fernando Mata Verdejo
Group CFO & Director

There is no change in the way we're going to finance, I mean the transaction. There is, as I said, there is still an excess of available cash in the insurance holding in Brazil, 100% hold in MAPFRE is well over EUR 200 million. And the remaining part of the consideration, I mean currently we got our credit facility undrawn in order to cover this part. But as I said, we want to keep our Solvency II ratio at the current level. So the most likely situation, we will go for a new issuance when market conditions are more favorable and they probably will be after summer. During August is a quiet season in Spain. And it will be for sure at year two in order to have the same capital level for Solvency II and also for rating agencies. Which is important as well where we are seeing today a quite important valuation of the Real. In order to hedge part of the consideration, we go forward quite efficiently as well. In fact, we book 5 or worse, accumulating EUR 250 million maturing at the end of September on a very good price. So let's say we hit the transaction, we're quite comfortable, I don't want to have additional surprises. The Brazilian real is in up and down move and we consider the most logical and rational decision to hedge this amount.

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

Okay, Thank you very much. There are 2 more questions. One is regarding Asistencia. Asistencia expense ratio close to 40% due to fall of business volume. It looks as turned around. What additional measures, if there are any, are you going to take to allocate the expense structure to the portfolio volume?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Paz. You are right. Remember I think it was last quarter, but we disclosed as well a lot of contention plan for Asistencia with a lot of reductions in overheads. What we've done is to move headquarters to MAPFRE's headquarters in order to have more synergies among the different overheads and also holding things. We are pretty sure that we can reduce overheads, particularly those coming from Asistencia consultants, and also, to be more efficient in the different administrative procedures. We are monitoring this on a monthly basis and there is still some room for further decreasing in overheads, you are right. And also, we have to look as well on the current capital lows at Asistencia because of the reduction of premiums and risk can give us an additional room to optimize the current capital levels.

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

Thank you. There is one question coming from Sylvia Rigol regarding the embedded value on a like for like basis. This is without increase of the scope that we have included for the first time in this business. Sylvia, what we can tell you is that we can talk later on because we don't have the number right now with us. So we can talk about that later on about this. So last one, last question, it comes from Paz Ojeda on regarding liquidity and dividends. [Indiscernible] dipped EUR 140 million and cash at the holding has gone down to EUR 15 million at the end of first half 2018 from EUR 40 million at 2017 year and EUR 50 million at first half 2017. Given the payments that need to be made, like Brazil transaction from [Espania] Bank agreement, what is the outlook for dividends this year?

Fernando Mata Verdejo
Group CFO & Director

Thank you, Paz, you're right. If you look at the balance sheet, there are like over EUR 2 billion currently available at cash. Obviously it is well spread among the different operating insurance entities. There is not any cash restriction currently in order to jeopardize the current outflow of dividends. You mentioned some small transaction from Espania. It is just 4% of the currently shareholders, it's not a big amount. And also, the remaining Bank BMN agreement, this is still under discussions and we do not see any particular date in order to have a cash disbursement regarding this. The different [indiscernible] as well in the cash position basically is due to the different outflow, inflow and outflow dividends. Let's say that our dividend budget made at the beginning of the year is totally under control and there is not any risk of the dividends to be jeopardized or be given risk because of the current transactions or any announced potential increase in the future months.

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

Okay, thank you very much. These were the last questions. As you know, if you have a follow-up question, the Investor Relations team will be available for you to answer all of them. From my side, I hope that Fernando will do the closing remarks, from my said just to wish you a happy summer and see you in the third quarter results. So Fernando, it's your turn.

Fernando Mata Verdejo
Group CFO & Director
Thank you, everybody for joining us today. This has been the longest result presentation since I took over. I think there were a lot of topics to be discussed. I guess the majority of them, they were answered. Just to add that we hope the information has been interesting and both included in the presentation and also in the speech. And just remember that as every quarter, there is a full set of documents in English available

in our website which you can get more information and more explanations regarding our performance. Hopefully we will see you next quarter and have a great summer all of you. Thank you very much. Bye-bye.