Investor & analyst call - Edited transcript

2019

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Company participants

- Fernando Mata Verdejo, Chief Financial Officer and Member of the Board
- José Luis Jiménez Guajardo-Fajardo, Chief Investment Officer
- Natalia Núñez Arana, Investor Relations & Capital Markets Director

Presentation

Natalia Núñez Arana

Good afternoon, and welcome to MAPFRE's results presentation for the first half of 2019. This is Natalia Nunez, Head of Investor Relations. First of all, I would like to give a warm welcome to our CFO, Fernando Mata. As in previous quarters, he will take us through the main year-to-date figures and trends. And it is also a pleasure to have here with us today Jose Luis Jimenez, our Chief Investment Officer, to discuss our investment portfolio and answer all the questions you may have regarding this topic.

Allow me to remind you that you can send questions to the Investor Relation e-mail address, and we will try to answer them during the Q&A session, as time permits. If there are any pending issues after that, the IR team will be delighted to answer them.

And now let me hand the call over to Fernando.

Fernando Mata Verdejo

Thank you, Natalia. Hello, everyone. Welcome to the presentation of our half year results. As always, it is a pleasure to be here with you. We are now six months into our three-year strategic plan. And as you can see, the numbers are very positive, fruit of the transformation that we are implementing, and aligned with this strategic plan.

Looking at the key figures for the quarter, revenue is up almost 7 percent, mainly due to the rise in premiums and higher financial income, stemming from the rally in financial markets. Overall, premiums are up nearly 5 percent, with similar growth rates in Life and Non-Life. At constant exchange rates, there is little variation.

Our combined ratio has improved 150 basis points and is now under our target of 96 percent. The net result of almost EUR375 million has fallen 2.9 percent, mainly as a result of lower financial gains, together with weaker performance in Life that we will cover later. Shareholders' equity is up 10.6 percent, mainly as a result of the fall in interest rates, as well as currency appreciation. The ROE, excluding the 2018 goodwill write-downs, would have been almost 8 percent. And the Solvency II ratio stood at around 189 percent at the close of March, quite stable compared to the previous period.

On the next slide, we'll take a look at the key figures by unit. On the right side, you can see the KPIs by region and business unit. Regarding attributable result, I would like to highlight, first, Iberia continues to be the largest profit contributor with close to a EUR232 million net result, and solid underlying performance, especially in Non-Life. Second, there were strong improvements in Brazil, up EUR19 million and in North America, up EUR41 million, resulting from improved underlying performance as well as an absence of negative extraordinary items.

Third, LATAM North and South were also strong contributors to results, which is reflected in their low and improving combined ratios. Fourth, MAPFRE RE, which comprises traditional reinsurance and the Global Risks business, contributed EUR85 million, despite a large industrial claim and the impact of the drought in Brazil. Lastly, Eurasia and ASISTENCIA continued facing profitability challenges in Turkey and the United Kingdom, respectively. We expect this trend to change over the coming quarters.

In ASISTENCIA, the majority of countries are making profit, and the losses are concentrated in the UK Travel Assistance business, where measures are already being taken. Regarding premiums, growth is very strong in Iberia and LATAM North, the latter fueled by a large multi-year contract we will comment on later. In addition, appreciation of the US dollar and some Latin American currencies have also supported premium growth, while the Brazilian real is still a drag on premiums, but to a much lesser extent than last year.

On Slide 4, we will look at the adjusted attributable result and I will comment on the extraordinary drivers of the result. As a reminder, last year, the US was impacted by severe winter weather. Fortunately, this didn't happen this year. There were a few large claims affecting MAPFRE RE that we will discuss later, but they have not been considered extraordinary. The reorganization of our US operations has had a positive net impact of EUR4.5 million in 2019, driven by a net financial gain from an investment portfolio existing at the time of the Commerce acquisition, which was partially offset by operational restructuring costs. Realized financial gains decreased by almost EUR23 million in our actively managed portfolio, and the transactions made were exclusively in equity.

Despite the current rally in bond markets, we didn't realize gains in this period in order to protect our accounting yield. And regarding real estate, we have not completed any transactions, despite having some units available for sale. The adjusted attributable result, excluding all these impacts, is down by around EUR11 million, largely driven by the fall in the Life result, which we will discuss on the next slide.

Iberia is performing well, maintaining the same positive trend. As it is well known, in Spain, we are expecting a new regulation, updating Life actuarial tables for longevity by year-end. And as we did with the Baremo, we have been gradually provisioning for this effect over the last few quarters, starting last year. At the end of June, we have already expensed over 80 percent of the cost based on our estimate of EUR56 million before taxes and minorities.

The fall in Brazil is explained by the non-recurring reversal of a provision in 2018 in the bancassurance channel, which had a EUR109 million positive impact on the gross results, and EUR15 million after tax and minorities. There has also been an increase in acquisition expenses this year in the bancassurance channel in order to boost sales. The fall in LATAM North is due to higher claims in large corporate Life Protection policies in Mexico. In LATAM South, there were negative adjustments in Colombia, affecting annuity runoff portfolios as a result of updating long-term financial assumptions, as well as a lower extraordinary results in Peru compared to same period last year. And finally, MAPFRE RE realized gains are slightly down, and there has also been a negative impact from some annuity contracts in Latin America.

Please turn to the next slide. On the left, you can see the breakdown of the capital structure which amounted to EUR13.2 billion. Our credit metrics remain quite strong, with leverage around 23 percent, affected by acquisitions, financing, as well as transitory funding of subsidiaries. Leverage should go back down to target levels over the course of the year.

Interest coverage is around 20x earnings before interest and tax.

And on the next slide, we'll take a look at our equity position.

Shareholders' equity is up 10.6 percent, to over EUR8.8 billion. The main reasons behind these improvements are: first, a EUR707 million increase of unrealized gains on available -for-sale portfolio, net of shadow accounting. The change is based on the strong fall in interest rates in Europe. Second, the appreciation of all main currencies with the exception of the Turkish lira, which has had a EUR50 million positive impact during the year. And finally, the decrease of EUR262 million corresponds to the dividend paid in June.

I will now hand the floor over to Jose Luis, and we will take a look at the investment portfolio.

José Luis Jiménez

Thank you, Fernando, and good afternoon to everyone. On this slide, you can see on the right-hand side the assets under management, which are up by 7.8 percent, driven by: first, improvements in the financial markets after the important correction at the end of 2018; second, FX; and third, the consolidation in March of Banco Mare Nostrum bancassurance operations. And fourth and last, the value of real estate increased due to the application of IFRS 16, which was already reflected in the first quarter of the year.

The breakdown of the investment portfolio is on the left. Asset allocation has been relatively stable through the year and exposure to government and corporate debt remains mostly unchanged. The largest exposures correspond to Spanish sovereign debt with EUR18 billion and Italian debt with EUR2.7 billion. As we have mentioned in the past, the majority of these investments are in immunized portfolios.

Our cash position is up to EUR2.4 billion and includes short-term investments and temporary cash balances. Exposure to equity and mutual funds has gone up slightly, thanks to the positive recovery in financial markets. The strong rally in financial markets is also reflected in our assets under management, which are up nearly 8 percent year-on-year.

On the bottom right-hand side of the slide, you can see the unrealized gains in our actively managed portfolios in MAPFRE RE and Iberia. At the end of June, there were over EUR42 million from equity and mutual funds and EUR324 million from fixed income investments.

On the next slide, we will look at our actively managed investment portfolios.

First, I would like to comment on our actively managed portfolios. Yields are still quite high, around 2 percent in Non-Life and 3.7 percent in Life, well above market yields. Nevertheless, the downward trend continued deteriorating our financial income. We partially neutralized this effect by slightly increasing duration and allocating part of reinvestment to alternative assets, something that we plan to increase in the future. Duration went down, as we sold Global Risk's asset portfolio last year, as part of the business reorganization, and proceeds have been gradually reinvested through the year. Realized gains in the euro area reached nearly EUR50 million during the first half of the year, over EUR30 million less than the previous one.

Asset sales continue to be selective as we expect the positive trends in markets to continue, and we prefer to protect the recurring yield of our fixed income portfolio. Analyzing the recurring financial income in Non-Life, we can see that geographic diversification is playing an important role. Duration increases have contributed to enhance our fixed income portfolio yield, especially in Latin America. In Brazil, market yields have begun to increase and our accounting yield is even slightly up since the start of the year.

In the Rest of Latin America, we are actually seeing an increase in portfolio yields of 50 basis points. In North America, the accounting yield has been stable since the start of the year, around 3 percent, despite the strong fall in rates. And duration is around five years, which offers us some protection with the recent fall in yields. In Eurasia, we have seen a very limited decrease, around 10 basis points.

And now I will hand the call over to Fernando again.

Fernando Mata

Thank you, Jose Luis; a very comprehensive speech.

Please turn to the next slide, where we will begin a breakdown by business, starting with Iberia.

In Spain, premium performance has been excellent. We are outperforming the market in our main lines of business, both in Life and Non-Life. In Motor, premiums are up 2.3 percent, with positive developments, both in retail and in fleets.

General P&C growth was mostly driven by Homeowners and Condominiums, helping to offset the fall in commercial lines. Sales campaigns in both agent and bancassurance channels drove the Life business. It is also important to keep in mind that we wrote a large group policy in the first quarter for EUR45 million in the bancassurance channel.

Moving to results and combined ratio, Motor maintained an excellent ratio in a very competitive market environment. We've seen rising claims costs, affecting property damage, mainly, and a slight rise in frequency trends in full coverage products, but both are in line with our expectations. In General P&C, we have seen a nearly 3 percentage point improvement, thanks to the Homeowners, Condominiums and General Liability segments.

The improved result in Portugal with a strong reduction in the combined ratio is also worth highlighting.

Let's take a look now at Brazil. Premiums grew almost 2 percent, over 5.6 percent in local currency, especially in the Life Protection, Agricultural and Multi-risk segments. There was a fall in Motor premiums as a result of selective underwriting guidelines. The attributable result amounted to almost EUR49 million, up nearly EUR19 million compared to last year. The largest profit contributor was General P&C, driven by improved underlying technical performance, now that the operations are fully normalized.

Losses in Motor are slightly down with a 7 percentage point reduction in the combined ratio, thanks to stricter claims management and new pricing tools. Overall, the new business model has greater technical control and discipline, and we are now on track to meet our 105 percent Motor combined ratio target for year-end. Financial income is up, mainly in the Life business, due to opportunistic realized gains, mainly during the first quarter, as well as resilient portfolio yields.

Regarding Life Protection, variations were discussed at the beginning of this presentation.

Finally, the negative impact of the depreciation in the Brazilian real and average exchange rates has been less than previous quarters.

In LATAM North, I would first like to highlight the extraordinary combined ratio, which stands at 93.1 percent, with a more positive currency scenario. Excluding the multi-year PEMEX policy, Mexico has strong premium growth of almost 15 percent [in local currency] in the Motor, Health and Life segments. The Motor combined ratio went down over 7 percentage points to below 94 percent, thanks to tariff and risk selection measures. General insurance has also seen an improvement in results.

Regarding Central America, Panama experienced an increase in the loss ratio in Motor, General P&C and Health – practically all lines of business. But the newly appointed CEO, starting last year, is implementing technical measures, including tariff increases, to correct this trend. Honduras continues to have excellent recurring results with the combined ratio below 86 percent, while El Salvador is also performing well. The Dominican Republic saw strong local currency growth in premiums and a resilient combined ratio under 87 percent. Please turn to next slide.

LATAM South has an extraordinary combined ratio standing at 95.7 percent. With the exception of the Argentine peso, there were overall strong local currency trends across the region and tailwinds from currencies.

In Peru, premiums were up 8.6 percent in local currency, with a strong technical performance, reducing the combined ratio by 3 percentage points, driven by Motor and Health and Accident. In Colombia, there was a reduction in the combined ratio, offset by negative adjustments in the annuity runoff portfolios, as a result of updating long-term financial assumptions, mainly minimum wage, already discussed in previous presentations. Financial performance improved, mainly as a result of the increase of the market value of the trading portfolio.

Chile saw local currency growth of 16 percent. There was a higher combined ratio in Motor as well as an uptick in General P&C due to storms in the central region of the country, offset by strong improvements in Health and Accident. Argentina saw a decline in premiums, driven by currency depreciation. There was also an increase in the combined ratio in General P&C and in Motor.

Let's move to North America.

The appreciation of the average dollar exchange rate has positively impacted both premiums and results. Premiums are down almost 8.5 percent in local currency as a result of the exit from five states in 2018, as well as from underwriting measures.

Underlying results have improved in the US, with a 3 point improvement in the combined ratio, especially in personal Motor. We are reducing our exposure in those areas where we aren't profitable. We have stopped commercial line renewals this quarter, the second quarter, in all states but Massachusetts. And we are also working on improving client segmentation in several regions, including California, to attract and retain the clients we truly want. Outside of the Northeast, in the Western region, states like Washington and Oregon have improved significantly, as you can see on this chart. Results are also benefiting from lower weather-related losses, as well as the exit of five states last year, already discussed.

As I said, 2019 results are also benefitting from a EUR4.5 million net positive adjustment, which comprises, first, EUR19.2 million net financial income arising from equities and high-yield bonds that existed before MAPFRE's acquisition of Commerce. We sold equities for a gain, while we booked a provision for the bonds; and second, a EUR14.7 million extraordinary expense related to business restructuring. Half of this amount corresponds to the write-off of assets, including accounts receivable as well as layoffs, which were the consequence of our exit plan. The other half corresponds to a general provision to cover any potential runoff from Commercial Lines outside Massachusetts, which we stopped renewals on.

Finally, positive premium and profitability trends continue in Puerto Rico after the two hurricanes that hit the island a couple of years ago. Please turn to next slide.

In Germany, premium trends continue to be positive with an improving attributable result and resilient combined ratio.

In Turkey, average exchange rates for the lira are down 22 percent, and premium growth in local currency was up around 10 percent, as we continue reducing our MTPL exposures. The attributable loss reached EUR3 million at June, compared to a nearly EUR9 million net profit last year. The loss is mainly due to MAPFRE's participation in the high-risk MTPL pool, which had a negative impact of EUR4.6 million. This pool is compulsory, and losses are allocated in proportion to the entities' market shares.

Italy experienced strong premium performance, driven by the dealership channel and a strong improvement in the combined ratio, down 4 percentage points. As we announced last quarter, we are working on the process of transforming our Italian entity into a VERTI Spain branch under EU regulations. The transformation will allow us to optimize capital and reduce cost. So far, we're happy, the plan is moving forward according to schedule.

Please turn to the next slide to discuss MAPFRE RE. Premiums are benefiting from currency movements, especially the US dollar. MAPFRE RE has an excellent combined ratio of 94.5 percent. It is up on the year as a result of, first, a large industrial claim that we already commented in the first quarter amounting to almost EUR20 million, of which 12 million comes from Global Risks; second, the loss from the Brazilian drought amounting to nearly EUR12 million pre-tax, net of reinsurance; and last, net earned premiums, which are down, resulting from a different distribution of earned premium accruals with more weight in the second half of the year. The impact will be neutral for the full year. The Life business is down year-on-year, mainly due to some annuity contracts in Latin America affected by the update of long-term financial assumptions, which we already explained in the earlier slides for direct business. And finally, financial gains are down EUR4 million to EUR14.8 million.

Please move to the next page.

Solvency II figures as of March 31 continue to reaffirm MAPFRE's solvency position. The 189 percent Solvency II ratio is based on a high-quality capital structure of EUR8.8 billion in eligible own funds, of which 87 percent is unrestricted Tier 1 capital and the remaining 13 percent is Tier 2. The ratio in March is quite similar to the year-end, but even so, on the right, you have a breakdown of the variation of the different components of our eligible own funds. Also, more detailed information regarding solvency figures can be found in our financial report. Further, you can find the information for Embedded Value for 2018 in our new Financial Documentation Center on our website.

Please turn to the next slide, for closing remarks.

We are clearly seeing a turnaround in both the US and Brazil. We expect the improvements to gain momentum throughout the year. And both operations are on the right path to meet our targets. In Iberia, both premium and profitability performance have been excellent and are in line with our expectations, even in a very competitive market environment. MAPFRE RE has had resilient results, and will continue to be an important contributor to our earnings. Growth trends are good in LATAM North and South and profitability trends continue to improve with combined ratios consistently below 96 percent. Regarding Turkey, we're carefully monitoring profitability, but our outlook for the second half of the year is slightly better. MAPFRE continues to boast an excellent financial position. We expect leverage and solvency ratios to converge to targets. All in all, we consider the first half results to be a very good start to meet the group objectives set in the new strategic plan.

And now I will hand the call back to Natalia to begin the Q&A session.

Natalia Núñez Arana

Okay. Thank you very much, Fernando. So, we are going to start with the Q&A now, with the questions we have received from you. We are trying to group them by topics as best we can.

Q&A

Natalia Núñez Arana

Okay, the first questions are about Brazil. Ivan Bokhmat at Barclays, Andrew Sinclair at Bank of America, Alfredo Alonso at BBVA, Michael Huttner at JPMorgan, and Sofia Barallat at Caxiabank have the following question: Brazil already performs at a low combined ratio of 91.6 percent, considerably below the 96 percent hurdle outlined in the strategy. What went better than your assumptions here? And what level should we consider sustainable for 2019, 2020?

Fernando Mata Verdejo

Thank you, everybody. First of all, this is the first half-year of a three year strategic plan; it's too early to reach a general conclusion. We're happy, as I said, with both Brazil and also USA - we'll discuss them later, I'm sure there will be questions coming. We're very happy with Brazil. As a reminder, the targets we set are for a medium and long-term basis. The Non-Life combined ratio should be, in 2021, lower than 96 percent. And for Motor, the combined ratio last year was more or less 115 percent. And what I said in different presentations is that the underlying should be between 110-111 percent, more or less. The target for 2019 is 105 percent; for 2020, 103 percent; and for 2021 it's 100 percent – 1 percentage point improvement from expenses, and the rest is a reduction of loss ratio. What are we doing? We're more focused on medium and long-term results rather than on a quarterly result, which could also be affected by transitory effects. But the target for 2019 remains at 105 percent.

Natalia Núñez Arana

Okay. Thank you very much. The next question is from Andrew Sinclair: Why were minority interests so high for Brazil in Q2, given better P&C profitability, where you have greater ownership and lower Life profitability?

Fernando Mata Verdejo

Yes, Auto is where we have the greatest share, it's 100 percent MAPFRE. The bancassurance channel with the joint venture we have with Banco do Brasil also includes Agro insurance, which is Non-Life, where we have a 25 percent share. Plus, if you recall, in the first quarter of the year, Agro was affected by a drought in Brazil. This, by the way, is the same drought that has affected MAPFRE RE during the second quarter. This is basically the explanation for the question.

Natalia Núñez Arana

Okay, thank you. Also, Andrew Sinclair has the following question: Should the new lower level of expenses for Brazil P&C in Q2 be seen as a reasonable run rate?

Fernando Mata Verdejo

Thank you, Andrew. We're work on reducing costs in Brazil. As you see, the loss ratio is fine in the majority of the Latin America countries, but the expense ratio is pretty high. It's mainly due to the acquisition expenses that in Latin America are consistently higher than in Europe and in mature countries, like the US. We're doing a lot of things, but as I said before, we are focused on the medium and long term, and we're looking forward to the next quarters. We are working on reducing expenses, but it is still too early to reach a conclusion.

Natalia Núñez Arana

Okay, great. Now we are moving to the balance sheet and investment portfolio. Ivan Bokhmat at Barclays has the following question: 2Q19 realized gains continue to track below last year's result and below full year indications of a stable result. Could you share your views on the tactical asset allocation and timing for portfolio sales, particularly considering a strong increase in unrealized gains?

Fernando Mata Verdejo

Yes, you're right, Ivan, we're below average in realized gains. But let's say that not just MAPFRE, but the entire sector and the entire finance industry, have been navigating choppy waters during the first half of the year. I wouldn't say that I am 100 percent happy. I would rather see -- or would be happier looking at higher numbers. But the reality is that we should be quite satisfied according to the current scenario, and that we realized almost 35 million in financial gains, in IBERIA, mainly in equity. We are confident that we can achieve for the entire year the same level of realized gains that we achieved last year.

Our balance sheet has enough volume of unrealized gains, particularly in equity, to meet the targets, or meet the average. And also, in real estate, as I said during the press presentation, we have four or five relevant units on the market currently available for sale. We haven't completed any transactions so far, but there are good opportunities. One is in Spain, another two or three in Europe, and one as well in Latin America. All in all, in the current situation, we're confident that we will achieve, if there are no extraordinary events - and we cannot anticipate any unexpected events at the moment- a similar level of realized gains to what we did last year.

We're talking about more or less EUR100 million, comprising both real estate and financial investment. And as I said, the fixed income portfolio remains untouched. We want to protect our recurring financial income from fixed income. The curve is quite clearly down. And we want to protect our investment portfolio, which, by the way, we consider it to be quite privileged. I don't know if you want to add anything, Jose Luis, but this is basically the overview regarding capital gains.

Jose Luis Jimenez

Absolutely. Well, I think we are on the same page. And we probably have lower equity capital gains, but it depends on the market. So probably, right now we are in a much better position and we hope this trend will continue from now until the end of the year. But on the fixed income side, we prefer to keep what we have on our book yields, because probably, we see that we have a low interest rate scenario for longer. So low for longer is our main case.

Natalia Núñez Arana

Okay. Thank you, Jose Luis. I guess that this one is also for you. Ivan Bokhmat at Barclays and Farquhar Murray at Autonomous have both asked about the drivers of the increase in duration to eight years in the actively managed Non-Life portfolio.

Jose Luis Jimenez

Basically, I would say this is due to current market conditions. We decided to slightly increase the duration. And so far, I think it was the right decision. But, well, keep in mind that we have the burial business in the Non-Life portfolio, which is, roughly speaking, less than 20 percent of the total portfolio on the fixed-income side. So we increase, from time to time, the duration on the burial portfolio; this slightly affects the total duration.

Natalia Núñez Arana

Thank you very much, Jose Luis. The next one is, "What guidance can you give for investment income in each of your key regions, given recent bond yield moves?" Paz Ojeda at Banc Sabadell would also like to know what your investment strategy is, given the low interest rate outlook for Europe and Brazil.

Fernando Mata Verdejo

Sorry about that, but we don't give any guidance regarding future expectations on our financial returns. Sorry about that. The second question is for you, Jose?

Jose Luis Jimenez

Yes. So, how we are going to deal with the low interest rate environment in Europe and in Brazil. Well, I would say, in Europe, we are really active in doing a lot of these income operations. As I said before, our base scenario is low for longer. And probably, we will continue seeing low interest rates for at least one or two more years. So, as Fernando said before, we try to keep the high yield that we have in most of our securities in the portfolio. But on the other hand, we are starting to diversify.

We also pointed out at Investor Day, there are different drivers. One is the fee-based business, where we expect, as I said before, 8 percent growth on the asset management side, I think this is good business. This happens as well with Life on the unit-linked side. So the fee-based business will continue to grow. And on the other hand, we are starting to diversify our investment portfolio more and more to alternatives. Because, probably, this is a thing that we have to do. We have low exposure, broadly speaking, 0.6, and this is due to grow in the coming years. So we have margin of manoeuvre to fight in this low interest rate environment.

Natalia Núñez Arana

Talking about alternative assets, Rahul Parekh from JPMorgan wants to know if there are any specific targets for alternative assets.

Jose Luis Jimenez

Well, in terms of the philosophy, I would say, we are extremely prudent and cautious in the way we manage money. So most of it will go to real estate. You probably know that we have launched several funds with different partners in a co-investment philosophy. We will continue with that trend. So far, I would say, it's good, it has worked extremely well, and we will continue with that. On the other hand, we will do a little bit in private equity and private debt.

But mostly, it would be real estate. It's a kind of bond proxy. And probably, this is a way to continue with another EUR500 million, that has been approved by the Board. So in this scenario, we will move from zero, two years ago, to 1 billion in the coming years. And this is a source to increase yield, on one hand. And on the other hand, to try to diversify our assets more within the portfolio.

Natalia Núñez Arana

Okay. Thank you very much, Jose Luis. Now we are moving to North America. Andrew Sinclair at Merrill Lynch, has this question: After a positive technical result in Q1, what led to a negative technical result in Q2, which tends to be a lighter quarter?

Fernando Mata Verdejo

Yes, Andrew, thank you. Basically, the answer is the restructuring cost that we have accrued in the second quarter in MAPFRE USA. Half of this comes from the cost of our exit states, and the rest from the general provision amounting to approximately EUR8 million after-tax to cover any potential runoff from the commercial lines outside of Massachusetts that we stopped renewals on in the second quarter. So both effects are a relevant impact in our combined ratio; I estimate one percentage point for now for North America, roughly.

Natalia Núñez Arana

The next question is about Solvency II. Farquhar Murray at Autonomous would like to know the following regarding solvency: Interest rates were down in Q1 '19, and I would have expected that to support the Solvency II ratio. Please, could you explain the flat outcome? And looking into the second quarter of 2019, is it fair to assume that tighter Spanish sovereign spreads will have been supportive to the ratio?

Fernando Mata Verdejo

Yes, fortunately, there is a sort of symmetry in the effect of lower interest rates, and that is affecting both eligible capital, because we have more net equity under IFRS, as well as the change in the value of BEL. The interest rates in the first quarter are one of the main drivers of that. So, there was an approximately 7.4 percentage point uplift in net equity, but that is also reflected on the liability side with a more or less 5 percentage point decrease in the other changes in the Best Estimate of Liabilities, due, obviously, to lower discount rates that we applied to estimate the liabilities.

The improvement in the Spanish sovies in the second quarter of the year will be supportive to the ratio. But again, the solvency ratio is made up of several moving parts, not only Spanish sovies. As a conclusion, we have a very strong solvency position, as you have seen over the last few years, and we tend to move in the upper part of our target range. And we have buffers, such as the partial model and also the future profits for Life that are not accounted for yet. And there are additional buffers that if we needed to, we could put in the formula.

Natalia Núñez Arana

Okay. Thank you, Fernando. I guess that also answers the question coming from Sofia Barallat at Caixabank regarding solvency, asking: Could you elaborate on the changes in discount rates during first quarter? And should we expect more impact of this sort during the second quarter or third quarter, given recent yields evolution?

Fernando Mata Verdejo

Well, if there is any change in the third quarter, we expect a sort of symmetric effect in both IFRS and also in the best estimate of liabilities. So we do not expect any relevant change in our Solvency II ratio for the remaining part of the year.

Natalia Núñez Arana

Okay. Now we have questions regarding MAPFRE RE. Ivan Bokhmat of Barclays and Michael Huttner of JPMorgan ask about the Life results for MAPFRE RE which were affected by negative impact from annuity contracts in Latin America. Can you provide a bit more details? Is that group or external business? Will there be any recurring impact, looking forward?

Fernando Mata Verdejo

Yes. Thank you, Ivan and Michael. We've seen, let's say, a temporary lack of profitability in Life, both in direct business and also in reinsurance. In the case of direct, in Colombia, it's sort of structural; there is a lack of matching between assets and liabilities. In the case of reinsurance, the decrease in profitability in Latin America is the main effect. There is still a decrease in profitability in Europe, which is not that big. The main effect is in Colombia, which is external business, not coming from a MAPFRE subsidiary, and also in Peru. I do not expect those effects to be recurring and hope the Life business to come back to healthy levels, probably at the end of this year.

Natalia Núñez Arana

Great. Thank you. And with regard to reinsurance and Global Risks, Alfredo Alonso of BBVA would like us to provide a breakdown of the one-off issues in the quarter. Are there signs of deterioration overall?

Fernando Mata Verdejo

Yes, first, the Global Risks business is pretty competitive globally. It's not affecting MAPFRE exclusively, it's affecting the entire globe. In the first half, performance of our reinsurance business, in general, has been excellent. Results were affected by a lower level of realized gains that we expect to catch up in the second part of the year, and also a large industrial claim that we already reported in the first quarter, in Asia. It was a fire in a power plant, affecting both Global Risks and also the traditional reinsurance business. Also, in the second quarter, we had the Brazilian drought that impacted our second quarter reinsurance results and our first quarter direct business results in Brazil. The fall in Life business result, already discussed, is from the application of more conservative long-term hypothesis on Life annuity contracts in LatAm. Basically, it's the difference between inflation rates and also the minimum wage.

Natalia Núñez Arana

Okay. Thank you. The next set of questions are regarding Iberia business. Ivan Bokhmat of Barclays, Michael Huttner of JPMorgan, Alfredo Alonso of BBVA, and Sofia Barallat of Caixabank have the following question regarding the worsening of Iberia's combined ratio. What were the drivers for that? How does this affect your outlook for the year?

Fernando Mata Verdejo

Yes. Let's say that what MAPFRE is reporting in Iberia regarding Non-Life is something that we expected, and also discussed in previous presentations. The Automobile combined ratio was extremely low. It was something that we knew several quarters ago wasn't sustainable in the long run. The current combined ratio in Auto is in line with our expectations, between 92 percent and 94 percent. This is a long-run sustainable combined ratio.

And also, in the past, we had a pretty high combined ratio in Homeowners, Condominiums and also Third Party Liability in General P&C. And what we've seen, during this first half of the year, is an increase in the Motor combined ratio and a relevant reduction in other lines of business. Particularly in Homeowners, there is a reduction of 2.5 percentage points, it went from 95 last year, and currently it's 92.6 percent.

In Condominiums the reductions are even greater, from 94.3 to 89 percent - lower than 90 percent. And in General Third Party Liability, the reduction is quite significant as well, going from a 95 percent combined ratio last year to 83 percent. So there are significant reductions that help MAPFRE to offset a slight increase in the Automobile combined ratio.

Regarding the outlook, we should expect the three relevant lines to be at this level, a combined ratio for Condominiums and Homeowner below 95 percent, and as I have said, for

Motor, in a range between 92 and 94 percent.

Natalia Núñez Arana

Thank you very much, Fernando. Paco Riquel at Alantra and Paz Ojeda at Sabadell asked about the updating of mortality tables. Press has leaked potential new provisioning needs for up to EUR2 billion in the Spanish insurance sector, resulting from the updating of life expectancy tables. Can you please comment on this, and if we should expect any impact at all from MAPFRE?

Fernando Mata Verdejo

This question arose at the press presentation we held just a couple of hours ago, and we discussed it then. I'm more than happy to comment on our view with you here. As you know, MAPFRE is actively participating, at a technical level, in the meetings and conversation between UNESPA, which is the Spanish National Association of Insurance, and the DGS, which is the Dirección General de Seguros, the supervisory body. We feel that the proposals made by UNESPA, together with - well, it was based on a report made by the largest reinsurer - is a solid starting point. Our view is that we should be quite careful to avoid unnecessary adjustments, unnecessary buffers, since the insurance companies in Spain, and around the globe, have got buffers everywhere - on the balance sheet, in Solvency II, and also in the actuarial longevity tables. At the press presentation, we disclosed the numbers that we have. Our best estimation of the impact on Life provisions, currently, is EUR56 million before taxes and minorities, without any buffer. And so far, as of June, we already booked around 82 percent, I think -- I don't remember if I said 82 or 83, but more or less, 83 percent of this effect is already expensed and booked in our financial statements as of June.

For MAPFRE, this is an ongoing process. It's business as usual. What we're doing with this update of the longevity actuarial tables is to anticipate our financial statements to the new regulation. And starting several quarters ago, we started provisioning for this effect little by little. Because we consider that it's fair, it's the normal thing, to have your provisions according to the most recent biometrical assumptions. I don't know what they do in the rest of the sector. For MAPFRE, we're very prudent. The same thing we did for the Baremo some years ago, we're doing now with the actuarial tables.

Natalia Núñez Arana

Thank you, Fernando. There’s a second question from Paco Riquel: Can you update on any potential interest that you may have regarding Caser?

Fernando Mata Verdejo

I'm going to repeat the same thing I said at the press presentation. We didn't get any answer from the letter sent by MAPFRE. As I said at the press presentation for the first quarter, this process for MAPFRE is over. No additional comments, please.

Natalia Núñez Arana

Okay. Thank you. Andrew Sinclair from Bank of America Merrill Lynch asks about Iberia P&C. Was there anything exceptional, or one-off losses, or reserve releases during the second quarter that we should be aware of?

Fernando Mata Verdejo

No, there's nothing significant. The sufficiency we're holding now in our P&C reserves in June is quite similar to last year. There are no relevant changes. There are minor changes, perhaps, in some line of business or reclassification between the lines. But overall, there is no change in the level of sufficiency.

Natalia Núñez Arana

Okay, thank you. Now the next question is regarding ASISTENCIA. Rahul Parekh from JPMorgan has the following question: He wanted to understand the development of MAPFRE ASISTENCIA in first half 2019 versus first half 2018.

Fernando Mata Verdejo

Yes. The net loss of the MAPFRE ASISTENCIA is practically equal to the losses coming from the UK, which is travel assistance. Fortunately, all the changes implemented in this unit are giving fruit, and the majority of the countries are in breakeven or even giving a small profit. We haven't found the right button to fix the UK business and travel assistance. We have a full, dedicated team in order to get the right answers, and it is the only unit and country that is still on the radar.

Natalia Núñez Arana

Okay. Thank you very much. The next question is regarding Brazil. Michael Huttner at JPMorgan has the following question. On Slide 4 of the presentation, for first half 2018 comparative, you did not adjust for Brazil Life accounting one-off gain? Why not?

Fernando Mata Verdejo

We didn't adjust last year in the presentation, but we discussed it at that point; we even gave you the information in order to do your own estimation of the adjusted net result. Some of you analysts and investors want to calculate on your own the adjusted net result. Obviously, last year, there were both affects – one in Life and another in Non-Life - and also a net effect. But we think it's clear to put the net adjusted result as we've done this quarter.

Natalia Núñez Arana

There is one more question from Paz Ojeda of Banco Sabadell regarding Brazil. What are the drivers in order to reach the ROE target of 12 percent?

Fernando Mata Verdejo

The main driver should be an improvement in net income, Paz; it's quite clear. It has been a good start for the 3-year strategic plan. And we expect, I said as well in the press presentation, we expect good news to come for the remaining quarters from Brazil. The team is working together with the same level of commitment. And now that the operation is fully normalized, there is one leadership only, particularly in Non-Life business. Last year there was, let's say, a shared decision between managers from the Banco do Brasil and also from MAPFRE; now it's completely different. And regarding the outlook, our view is much better. So the main improvement will come from net income. We shouldn't expect any relevant change in the equity base, the capital base, in Brazil.

Natalia Núñez Arana

Okay. Thank you. The next question is regarding investments. Paco Riquel at Alantra has another question: The interest rate cycle has turned for the worse. Can you comment what assumptions you considered in your strategic plan and how it could impact your financial income? Any new mitigating measure that you may consider?

Jose Luis Jimenez

Thanks, Paco. We had already contemplated the fall in interest rates in the assumptions of our strategic plan. We hope for the best, but we plan for the worst. And also, as Fernando has said several times, we are putting more focus on the technical side, rather than on the investment side. It is true that in terms of mitigation measures, we had the alternative diversification with the first 500 million and now another 500, in a very cautious way, as I said before, in partnerships with big players. We expect to get something between 4 percent and 8 percent in this type of asset class.

The other mitigating measure is to try to grow even more on the asset management side or what you call the fee-based business, which is basically about mutual funds, pension funds, and unit linked, which is an area where we are really, really committed to grow in the coming quarters and years. Also, it is true that the low interest rate is not good news in the US and Europe. But on the other hand, you should also bear in mind that this is extremely good news for emerging markets, where we have, I would say, our highest pusher. So if the rates continue low, probably the economic activity in these markets will continue rising as well.

Fernando Mata Verdejo

If I may add something, Paco, we are not concerned regarding the fall of interest rates. We're really concerned with the improvement we can apply in our operations in order to reduce our combined ratio. And fortunately, what we're reporting from the majority of the countries, particularly in LatAm, is relevant reductions in combined ratio, like the reduction in Mexico in Auto, or the combined ratio we reported in Central America, also in Colombia, and Peru. This reduction is big enough that it's able to offset any reduction in yields. So we have to focus on what we can change in our operations rather than on external factors affecting financial markets.

Natalia Núñez Arana

Okay. Thank you, Fernando. Now we have a question regarding North America. Paco Riquel at Alantra asks: Can you update on the US restructuring plan, and whether you are considering to exit from further states?

Fernando Mata Verdejo

Yes. In this case, there has not been an official notification or a press release, but what we've done is stop renewals for commercial lines, both Auto and also Property, in all the states but Massachusetts. It's a relevant reduction. Last year, there was around USD 44 million in commercial lines outside Massachusetts. And this is basically the restructuring business plan that we are implementing. Any other states, as we said at our Investor Day, would be unveiled after the summer, but I don't see that we will leave any additional state in the short run. Where we had to focus was on the non-renewal of commercial lines, and trying to reduce our expenses in order to get a lower combined ratio.

Natalia Núñez Arana

Okay. Thank you. And now, also regarding North America. Alfredo Alonso from BBVA asks: What are your expectations in the financial results in this unit?

Jose Luis Jimenez

I think in terms of the investment portfolio, in the US, the portfolio is quite strong, quite solvent. I think the fixed income part of the portfolio is great, with a 5-year duration. So we we will try to keep the yield as much as possible. But on the other hand, we have started as well to diversify the portfolio. So we are starting to do more in alternatives because we have a lot of room – the majority is traditional securities. And I think this year, we started to increase our alternatives. So we are looking forward to next Wednesday to seeing what the Fed has to say. But we think that the portfolio is well prepared for lower interest rates in the coming years.

Natalia Núñez Arana

Okay. Thank you very much, Jose Luis. The last question comes from Alfredo Alonso at BBVA, regarding the Life business.

I think we have already answered this. The profit performance of the Life unit in the quarter, we have already mentioned, about Brazil's performance and the increase in provisions. We have mentioned several times that you cannot consider provisions and financial income separately. So you can look at both together in order to see what the evolution of the trend in the Life business is. So, provisions plus financial income. If you need any further explanation, we are available for this later on.

Fernando Mata Verdejo

Yes, Alfredo, just a very quick comment. The main change in Life was due to the cancellation of the provision in Brazil last year. Life results are quite stable, and particularly in Spain. You can see the numbers are quite positive, quite stable. And even with the update of the actuarial tables; we haven't seen a change in the profit contribution from MAPFRE Vida. So we're quite happy. The level of Life contribution in terms of profit is very good. And Malta is also performing very well. The only variation that could affect MAPFRE is from countries or operations smaller than Spain, particularly in LATAM.

Natalia Núñez Arana

Thank you, Fernando. That's all from the Q&A. So, I guess, this is the end.

Fernando Mata Verdejo

Okay. Thank you, everybody. This has been a long presentation; the speech was, I think, the longest yet. Hopefully, the explanations will help you to better understand our business. We wish all of you a great summer and vacations. See you for the presentation for the third quarterly results. Bye.

Natalia Núñez Arana

Thank you. Bye.