Investor & analyst call - Edited transcript

Q1 2018

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Company participants

- Fernando Mata Verdejo, Chief Financial Officer
- Natalia Núñez Arana, Investor Relations & Capital Markets Director
- Ramón Carrasco, Chief Risk Officer

Presentation

Natalia Núñez Arana

Good morning everyone, and welcome to MAPFRE's Results Presentation for the First Quarter of 2018. I am Natalia Núñez, Head of Investor Relations and here with me is Fernando Mata, our CFO, and Member of the Board. He, as usual, will take us through the main trends of the period.

Today it's also a pleasure to have here with us Mr. Ramón Carrasco, MAPFRE's, Chief Risk Officer. He will run through the Solvency figures for the full year 2017, and at the end of the presentation, he will also participate in the Q&A session.

Just as a reminder, during the Q&A, we will answer all questions received at the specified email address. The Investor Relations team 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

Thank you, Natalia and good morning everyone. It's a pleasure to be here with you for our first earnings call of 2018. We'll begin on slide 2, where you can see the main figures for the quarter, and then I will go over the main highlights in the following slides.

The result stood at over €187 million, with the underlying result slightly under €174 million, down only 0.3% year-on-year with an annualized 9% ROE, excluding the impact of 2017 catastrophes. Annualized means that the base for calculation is the current quarter and the last three quarters of last year. This is why we're excluding the cat effect. The quarter has been a mix of different trends, the measures we are implementing to improve profitability have been overshadowed by currency movements and low interest rates.

Please turn to page 3. On this page, you can see the main highlights for the period. Profit and loss account was hit by negative forex effects for all main currencies. So U.S. dollar is down 13%; Brazilian real and Turkish lira 16% each; the Mexican and Chilean peso 6% each; the Argentinian peso, 32% down and the remaining are down between 10% and 20%. The Non-Life business fueled by Spain and MAPFRE RE showed healthy performance. Despite the decrease in euros, Non-Life premiums grew over 2%, at constant exchange rates, reflecting positive trends in several markets, which we will discuss in more detail later on. The combined ratio improved by one percentage point to 96.5%, with a 2.5 percentage point reduction in the loss ratio and an uptick in the expense ratio mainly from acquisition expenses, but is still in line with the 28% target.

In addition, the low interest rate environment in Europe and lower rates in LATAM, especially Brazil, are affecting both the sale of Life products as well as financial income. There was a 9.6% fall in Life premiums at constant euro as a result of challenging market conditions in Spain where we're seeing lower sales in unit linked products and in general in Life savings. Finally, I'd like to highlight our excellent solvency position which closed last year at over 200%.

Please turn to slide 4. As you know, there are several units that are now benefitting from the successful implementation of MAPFRE'S profitable growth strategy. First, we continue to see solid results in IBERIA and MAPFRE RE. Second, LATAM NORTH & SOUTH continue improving with the combined ratio below 97%. Third, losses have been significantly reduced at MAPFRE ASISTENCIA and in Italy, but the latter, Italy continues being affected by the highly competitive Italian market, particularly in the direct business. Fourth, it's also worth mentioning the return of profitability of GLOBAL RISKS after a very complicated 2017, as you remember in terms of claims experience.

In Turkey, the USA and Brazil measures are being taken. However, regarding results, they will not be completely seen until restructuring plans have been fully implemented. In USA the exit plan is on track. We have already sold the renewals rights for Tennessee, Kentucky and Indiana and we expect New York and New Jersey exits to be complete by the second quarter, as well as the sale of the Life business.

On the other hand, winter conditions were difficult, but somehow manageable. The results continue showing the challenging market situation particularly in retail Motor. In Brazil, the combined ratio has proven resilient, thanks to the performance of Agro insurance, while Motor is still far from the turning point. Finally, in Turkey, as we expected, we are feeling the full annualized impact of the compulsory rate discounts introduced in MTPL in April last year. We continued diversifying into other lines of business to mitigate the impact and focusing on underwriting discipline.

On slide 5, you can see the breakdown of premiums and results by region and business unit. On the right, we have the evolution of results by business unit, which we will discuss in more detail in the following slides. Regarding attributable result, IBERIA stands out with €118 million, by far the largest contributor and continues benefiting from the economic recovery in Spain, and which is more important, the profitable growth strategy. Excluding last year's extraordinary benefit from the cancellation of a bancassurance provision, attributable result would have grown by 17%. MAPFRE RE continues being a strong driver of profit for the group, no doubt. Results grew over 22% in a quarter free of relevant cat events. The attributable result in North America has fallen due to a higher level of winter-related claims approximately €11 million as well as the still complicated market situation.

Gross losses for the cat events amount to approximately $60 million, €50 million, demonstrating the highly effective reinsurance protections we implemented after the 2015 losses. As we mentioned, in 2015 which is the peak in these losses, and thanks to the reinsurance protection, we are able to manage, this winter exposure we have in the Northeast of the U.S. The decline in Eurasia reflects the situation in Turkey that I already discussed. Finally, the results in Brazil are facing strong headwinds from the currency and interest rate environment.

Please turn to slide 6. Revenue was down around 1% at constant exchange rates reflecting a fall in premiums as well as lower investment yields in LATAM, especially Brazil. Non-Life premiums are down 0.4% at constant exchange rates, reflecting the following underlying trends:

- Nearly 5% growth in IBERIA with positive developments in main Non-Life business lines.
- Slight decline in local currency in Brazil as a result of a 3% fall in General P&C and flat premiums in Motor.
- Local currency growth is strong across LATAM NORTH with double digit growth in Mexico and the Dominican Republic.
- In LATAM SOUTH there are also positive trends in main geographies except Chile, which continued with the cancellation of unprofitable business in non-Motor lines.

Life premiums were down over 9% at constant exchange rates. As I mentioned the decline was mainly driven by Spain due to the absence of sales campaigns in a very volatile financial market scenario. On the other hand, the recovery of lending activity in Brazil has led to 6% growth in local currency.

Let's move on to next page please. On slide 7, I would like to take a look at the extraordinary impacts that have affected MAPFRE's net result. The quarter results were affected by multiple, but not severe snowstorms in the Northeast USA with €11 million net losses compared to a €19 million net loss from the coastal El Niño that affected mainly Peru, Colombia, and MAPFRE RE last year; 2017 figures also reflect a €27 million net gain from the reversal of a provision for contingent liabilities in bancassurance.

And finally realized gains are relatively stable year-on-year. We're proud of the numbers we got from equity markets in these financial difficulties. Excluding these extraordinary impacts the underlying net result has proven stable at around €174 million.

On the right side, you can see the improvement in the Non-Life underwriting result amounting to €16 million. This figure is before tax and minorities. It was driven mainly by IBERIA and MAPFRE RE as well as the better claims experience at GLOBAL RISKS. The result of the Life business is down €66 million also before taxes and minorities. And this was mainly due to lower financial income and increasing acquisition expenses in Brazil, as well as currency effects. Obviously the impact is less on the bottom line due to the share of non-controlling interests in this business and also the high tax rate that we have in Brazil.

On slide 8, you can see the breakdown of key non-life figures by region and unit. I would like to emphasize the following positive trends in combined ratio. The improvements in IBERIA, which I will cover in more detail later, the resilient combined ratio in Brazil, which has still improved despite the challenging market situation in Motor, thanks to the Agricultural business.

LATAM NORTH and SOUTH show improvements across the board, in the combined ratio, GLOBAL RISKS has improved over 17 percentage points to 92% due to the absence of large claims. The uptick in EURASIA is due to the situation in Turkey that I have already mentioned and the increase in North America is to a large extent driven by the snowstorms.

On slide 9, I would like to take a quick look at the evolution, the runoff with 2017, in nat-cat events during the quarter by unit and country. Good news, there are insignificant variations in the runoff by geography and the total net loss is €157 million. Obviously this is evidence of our insurance protection effectiveness.

On slide 10, we disclose the main Non-Life trends. I would like to highlight the excellent performance of the business in IBERIA. First of all we are growing and gaining market share in all our main lines of business with exceptional profitability levels.

Performance in Motor has been excellent with retail premiums up 3.4% in Spain and the combined ratio down by 1.7 percentage points, at around 90%. We are also seeing positive growth and combined ratio trends in other main lines of business thanks to the profitable growth strategy and more benign weather.

Please move on to slide 12; we're going to skip 11. As we mentioned, the first quarter was challenging for the Life business. Premiums are down due to the adverse and volatile market conditions for sales campaigns as well as lower sales for unit-linked products in Spain.

It is also worth remembering that 2017 premiums included approximately €17 million from UNIÓN DUERO VIDA, a former subsidiary that was sold last year. The total market decrease in savings premiums for the first quarter is 17% with some competitors down by over 30%.

The fall in results in IBERIA is due to the cancellation of a provision for bancassurance contingent payments in 2017, you know it very well, which had a €29 million impact. This is before taxes again.

In Brazil, currency depreciation is still hurting premiums despite the 6% increase in reals and thanks to the recovery of lending activity. Results here are still impacted by higher acquisition expenses that were mainly in order to boost sales, especially in the bancassurance channel as well as the fall in financial income (around €30 million) due to the lower returns on floating rate and inflation-linked bonds.

Just a remark, the SELIC rate was 6.5% at the close of March compared to 12.3% a year ago, practically half, and inflation was around 2.8% compared to around 4.5% last year. Obviously we're very happy with this inflation reduction that will help our operation and also the country, but obviously it's hurting our financial income.

Moving on to slide 13, you can see the breakdown of shareholders' equity and its evolution during the first quarter, which has fallen by over €145 million from December to March to around €8.5 billion. The decline was largely driven by the depreciation of our main currencies during the period and lower retained earnings. On the other hand, the recent improvement of the Spanish sovereign rating had a double effect. On one side, it had a positive impact on financial assets available for sale. And on the other, this increase in financial assets is offset by a negative impact on shadow accounting as a relevant volume of this investment portfolio corresponds to Life portfolios with profit sharing.

As you can see on the right side of the slide, net unrealized capital gains grew by €31 million and stood at a comfortable €651 million, providing MAPFRE with a flexible capital buffer.

Please turn to slide 14. On the left, you can see that assets under management continued to grow steadily driven by the good performance of the Spanish fixed income portfolio, on the back of the improvement in the sovereign rating.

Nevertheless, this positive impact has been offset by the weak performance of equity markets after January, which is reflected in the 0.9% decrease of the mutual and pension fund businesses. Part of the decrease has been recovered in April with the wonderful performance of the market.

On the right, you can see the breakdown of the investment portfolio. Our investment strategy has been stable throughout the year with a slight increase in fixed income assets.

Realized gains in Non-Life were around €32 million, similar to last year. During the quarter, we were able to take advantage of market volatility and a narrowing of the Spanish risk premium to realize gains in both equity and fixed income portfolios.

Realized gains in equity were made basically in January and fixed income in February and March. I would like to point out that despite the fall in the equity market in March, the unrealized gains in our equity and mutual fund portfolios (around €50 million) remain at very comfortable levels. And performance in equity markets in April has been quite good, returning to similar levels as at the beginning of the year. This will continue to give us leverage to take advantage of future opportunities. Finally, it's worth pointing out, the high accounting yields in our portfolios, 2.4% in Non-Life and nearly 4% in Life, well above market yields.

On page 16 on the left side, you can see the breakdown of the capital structure at the close of March, which amounted to €12.7 billion. There are no significant changes compared to last year, so we're going to move on to Solvency II. And on the next few slides, we will take a closer look at these figures for the full-year 2017 with Ramón Carrasco, our CRO, who is with us. Ramón, the floor is yours.

Ramón Carrasco

Thank you, Fernando. Solvency II figures as at 31st December 2017 confirm MAPFRE's strong solvency position. The 200.2% Solvency II ratio is based on the high quality capital structure of €8.9 billion in the eligible own funds of which 93% is unrestricted Tier 1 capital and the remaining 7% is Tier 2 subordinated debt. On the right side, you can see our sensitivity analysis. As you can see, the impact on the solvency position from the various events is limited. The greatest impact occurs when an increase of 50 basis points is considered in the corporate and government bond spreads, in which case the ratio would stand at 190%.

Please turn to the next slide. On this slide, you can see the main drivers of the change in our Solvency II ratio during 2017. This position is explained largely by the impact of the currency movements affecting both Eligible Own Funds, as well as the SCR. Regarding Eligible Own Funds, the IFRS equity decreases, largely driven by currency movements.

This impact is reduced by the following Solvency II adjustments:

- There are lower reductions in intangible assets following the write-down of goodwill and VOBA in Brazil, the sale of UNIÓN DUERO business, as well as currency movements;
- ABDA is excluded from the Solvency II perimeter, and therefore it is valued at zero;
- The impact of the phase out of the transitional measures, which includes the elimination of the transitional from UNIÓN DUERO.

The fall in capital requirements is driven by lower capital requirements for the entities under equivalence, mainly as a result of the depreciation of the U.S. dollar and Brazilian real. In the next two slides, you can have more information regarding solvency.

That's all from me. Thank you for your attention. I will now hand the floor back over to Fernando Mata who will wrap up the presentation.

Fernando Mata Verdejo

Thank you Ramón, for the detailed and interesting information. To draw the presentation to a close, I'd like to outline some conclusions regarding MAPFRE's performance this quarter. First of all, performance has been excellent, particularly in the Non-Life business, thanks to robust fundamentals based on the solid contribution from MAPFRE IBERIA and MAPFRE RE as well as significant improvements in LATAM, both NORTH and SOUTH.

Secondly we're fully focused, you know very well, on completing the transformation initiatives in two relevant countries, the U.S. and Brazil, in order to improve our results. Discussions with Banco do Brasil regarding the update of the agreement are progressing without any relevant issues and we expect them to conclude in the coming weeks.

We expect an uptick as well in Life sales in a less volatile market scenario this year in Spain and a more favorable context in Brazil. I would like to say that most of the Life Savings campaigns are scheduled for the three remaining quarters.

And to wrap things up, we will continue implementing our profitable growth strategy supported by our financial strength and continuous commitment to value creation for our shareholders.

Thank you and now Natalia will begin with the Q&A session.

Q&A

Natalia Núñez Arana: Thank you, Fernando. Now please let's move into the Q&A. The first question comes from Sofia Barallat from Caixa BPI. It's regarding MAPFRE ASISTENCIA. Following the improvement in MAPFRE ASISTENCIA, do you expect to reach breakeven this year?

Fernando Mata Verdejo: Thank you, Sofia. I mean, it's still early to say. It's just the first quarter of 2018. We are particularly happy with the results. And as you know, the transformation we're making in MAPFRE ASISTENCIA, this is the third year, and we expect to see the benefits of the actions taken during the last two years in 2018.

Our balance sheet is quite solid, and there aren't many surprises left on the asset side – we expect a significant reduction in losses in 2018. Guidance, as we mentioned in previous meetings, let's say single-digit will be fine, although this is still too soon to talk about any specific date for the breakeven. But we are happy with the first quarter result of MAPFRE ASISTENCIA.

Natalia Núñez Arana: Thank you very much. This one comes from Ivan Bokhmat from Barclays. It's regarding Solvency, so I guess that Ramón will take that. And the question is, why was ABDA excluded from Solvency II perimeter?

Ramón Carrasco: Yes. Thank you, Ivan. First of all, implementing Solvency II is not easy, it involves a lot of costs from implementing new processes and requires a lot of data, and a lot of processes to be included in the company. It is more difficult in those countries where we're not used to Solvency II processes and therefore we decided not to implement Solvency II in ABDA at this moment.

Natalia Núñez Arana: Thank you very much, Ramón. Next question comes from Rahul Parekh from JP Morgan. And it's regarding the underlying combined ratio run rate in the U.S. What is the underlying combined ratio run rate in the U.S. ex snowstorms? And what is the trend in pricing there?

Fernando Mata Verdejo: Thank you, Rahul. The underlying combined ratio in Massachusetts, which is the main state of the Northeast, was around 100%, and in the remaining states it was around 117%. That's excluding the impact of the extraordinary storms. And now we are eliminating those cat events that were categorized as such by the U.S standards.

We are not happy with the results, and 100% is not an acceptable combined ratio. And we're implementing additional actions in order to improve it. Regarding pricing, which is the most relevant, we have submitted rate filings in several states.

I remember last year at the Investor Day, we said that we presented filings for 32 rate increases in 18 states. In that case, we´ve got filings in Massachusetts, it is an approximately 5% increase and also in California with – I don't remember – if I remember well, it's around a 7% increase.

Natalia Núñez Arana: Thank you. This one comes from Andrew Sinclair from Bank of America and also Niccolo Dalla Palma from BNP Paribas, Exane BNP Paribas. They had the following question. What would the combined ratio have been for the USA, excluding the states which are being sold?

Fernando Mata Verdejo: Well, what we know is the exit states were around 3.5%, more or less, between 3% and 4% of total premiums, with a combined ratio of around 128%, but we don't have the figures excluding these states, but we can provide you with this figure in further calls.

Natalia Núñez Arana: Okay. Thank you. Sofia Barallat at Caixa BPI and Andrew Sinclair both have questions regarding the developments of the restructuring in the U.S. business. The questions are, more or less, when do you expect to receive the proceeds from the sale of renewal rights plus U.S. disposals, and can you give us any color on amount of proceeds?

Fernando Mata Verdejo: Yes, let's say that the sale of the renewal rights in Indiana, Tennessee and Kentucky, is the only operation that has been completed, I mean we already have the transaction finished and we receive an upfront payment. It's just an upfront payment. There is as well, a sliding commission and a variable payment or variable assessment that will be made at year-end and probably will be assessed once the calendar year is finished. But nevertheless, we do not expect any significant amount out of these portfolios, they're quite small.

Regarding New York and New Jersey, we are quite positive. We've been positively surprised with the noise that is currently there and the good vibration that we have in the U.S. and we've seen a lot of appetite for the transaction, and we will keep you informed when we have more information. What I can say now is that the potential buyer is carrying out the due diligence exercise, it's coming to an end at the end of this month of April. We have some good vibrations, good expectations, but it will take some time still to see the impact on results. We haven't discussed yet any value for the transaction, nor a potential consideration for this operation.

Natalia Núñez Arana: Thank you very much. Now, we have a set of questions coming from Andrew Sinclair, also Ivan Bokhmat, Niccolo Dalla Palma, and Sofia Barallat. This set of questions is regarding IBERIA. The first one is, can you quantify the benefit from benign weather in IBERIA during this quarter?

Fernando Mata Verdejo: Not really. What we can assess is the effect of the severe weather last year. And in 2017 the weather-related events resulted in approximately 60,000 claims, more or less €16 million. These losses affected basically homeowners, condominiums, and the small and medium enterprise property insurance. More or less, let's say that the combined ratio impact is like 4 percentage points of General insurance in IBERIA.

Weather was benign in Spain in terms of strong winds and heavy rains, and also the Agricultural business performed very well. But there is still another quarter to come, and usually some of the heavy rains occur during the first quarter, and other years in the second quarter. So we have to wait just to see the end of the first half of the year, before we say that the results in Spain are wonderful.

Natalia Núñez Arana: Okay. Thank you. And now, regarding the very strong Non-Life result, especially in Motor in IBERIA with a combined ratio of 90.3% and good premium growth. The question is, how sustainable is this performance?

Fernando Mata Verdejo: Well, let's say that every year is a nice surprise and because we're improving year-by-year, our loss ratio and our combined ratio. I mean, we're harvesting the results of the profitable growth strategy. Before this presentation, I was reviewing the historical data for Spain, when I was CFO for this unit and from the period, of the five consecutive years between 2008 and 2013, the combined ratio was in the range between 89% and 93%. And the majority of the quarter it was in the low 91%. And this was after three years of the main crisis. And so let's say that we'll repeat the same schedule. I mean this is a good moment for automobile, particularly for MAPFRE. We have got a wonderful and very efficient operation. And our expectations are superb, and we would like to say that we do not expect any relevant deterioration so far of the automobile unit in Spain.

Natalia Núñez Arana: Good, thank you. Now regarding Life premiums, in IBERIA, Life premiums declined 19% year-on-year, a substantial drop even adjusting for UNIÓN DUERO VIDA, what drives the decline?

Fernando Mata Verdejo: Okay. Let's say that for the first quarter, basically, premiums are coming from two different sources. First new products or new business, and also renewals. Regarding renewals, practically there were no maturities of products sold in previous years. And regarding new business or new products, the current financial scenario was a deterrent to sell new products in both, fixed income and also in equities. So looking forward, in the coming quarters, the majority of the sales campaigns are scheduled for the second and third quarters based on renewals. So if there is more stability in the financial markets, and we believe that we will be able to increase both new products and also our renewals in the remaining quarters.

Obviously, I mean, UNIÓN DUERO VIDA was sold last year, but premiums there were not relevant. In the first quarter, there are some products like annuities and also the DIVIDENDO VIDA, a unit linked that invest in Spanish shares, with high dividend, and they performed very well. But not enough to allow it to sustain enough premium growth in this quarter.

Natalia Núñez Arana: Okay, thank you. This one is regarding MAPFRE RE unit. And it comes from Ivan Bokhmat from Barclays. He asked the following question. Could you please quantify the low NatCat impact? How much did that take out of the combined ratio versus normalized. The result is even better than 1Q 2017?

Fernando Mata Verdejo: Thank you, Ivan. The result of the Non-Life business improved from €63 million to almost €75 million in the first quarter of this year. We've seen an improvement in the financial result as well as in the technical results, thanks to improvement in claims and growth in premiums earned, compared to last year.

In addition, we should bear in mind that MAPFRE RE was affected last year by one-off losses resulting from the Niño Costero, which have not repeated this quarter. I'm not sure I'm answering the question. But you know we don't disclose the underlying combined ratio for MAPFRE RE or the budget, but we're quite happy with MAPFRE RE results. The absence of NatCat events other than a small mudslide in California and the heavy snowstorms in New England. Those are the only events to highlight this first quarter. We're quite happy, but I mean that's all.

Natalia Núñez Arana: Thank you very much, Fernando. The next question is regarding investments. We have received several questions regarding investment results. So Ivan Bokhmat at Barclays has the following questions. Considering the move in interest rates across geographies in 1Q 2018, how do you think of your regular income development in 2018 and 2019? Is that a headwind for the business in general? Could you quantify how much drag on operating profits should be expected? Also I would like to continue because these questions are regarding the same topic: what level of unrealized gains is MAPFRE carrying currently? How do you think about crystallizing them?

And the last one regarding this topic, Farquhar from Autonomous also has a question on the investment portfolio. More generally, how do you expect Non-Life investment income to develop? In particular, how does the new money investment rate compare to the current portfolio yields? So a lot of questions regarding investments, but we thought we could put them together.

Fernando Mata Verdejo: Yeah. Thank you everybody. Let´s say that the low yield scenario and financial income from fixed income are not headwinds this year, particularly this quarter. It’s something that we have been managing and coping with for the last three, four years. Fortunately, we´ve got a privileged portfolio as we said, and particularly in Spain. So far, the high yield scenario in LATAM helped us to compensate part of the reduction we saw in Europe, mainly in fixed income.

If we look at this by geography we could say that in Europe we are expecting a change in trend in 2019. Furthermore, we are working according to plan. We have an alternative investment program committed to reach €500 million by 2019. So far, we have already signed commitments for approximately €300 million, with more or less €100 million already paid out of this €300 million, mainly in real estate when we saw good opportunities and according to MAPFRE’s risk profile.

In the U.S., we've seen an increase in the accounting yield in the first quarter, but this trend we believe will continue in 2019. In Brazil, it’s true that the decline in accounting yield is still significant due to lower interest rates. We’ve got short duration as well in the majority of the countries, but particularly in Brazil. When we speak about Life, we don't remember, but in Brazil what we have is a protection portfolio, and as you know we are trying to match asset and liability duration. It doesn't make a lot of sense to have longer durations in the asset side in countries like Brazil. So let's say we have some exposure to volatility in yields in Brazil. If you compare SELIC rates, basically this year is half of what we had in this quarter last year.

During the quarter, capital gains have performed really well and financial capital gains – let's say investment, because in real estate we were quite active but we didn't see any good operations to rotate our assets. But on the financial side, Spanish debt had a fantastic evolution overall, due to the improvement of the sovereign rating to A by Standard & Poor's and other rating agencies. This means minus 40 basis points on the 10-year bond. On the other hand, equity capital gains have been reduced on the actively managed portfolio to €50 million, but this has recovered during the month of April.

Realized capital gains, in terms of crystalizing them, it was a hard quarter. Let's say that we did well, or we were lucky, or both. Realized capital gains were approximately one-third on equities and two-thirds on bonds. Equity realized gains were made in January. Basically, the Spanish IBEX 35 index grew 6% and there is a 10% growth expected for the full year. So at that point we decided to realize some gains.

And realized gains on fixed income were made in February and March, taking the opportunity of the movements in the yield curve. For the remaining quarters, as we discussed before, we strongly believe we will be able to repeat the €100 million realized gain amount that we reported last year. We know that it's been challenging in the current financial scenario, some real estate units are in the market and we expect some realized gains as well from real estate. But let's say that realized gains have become and are a permanent source of income in our profit and loss account. And we're relying on the ability and capacity of our CIO and MAPFRE Inversión in order to get this number.

Natalia Núñez Arana: Thank you. Thank you so much. The next one is regarding the Life results. Rahul Parekh of JP Morgan would like to know if the €130 million that we have reported as Life net profit is also equal to the underlying net profit in Life. Also Farquhar Murray from Autonomous has asked the following: Please, could you explain the fall in the Life technical result and also the fall in Life investment income? How should we think about the likely future evolution of these lines over the remainder of full year 2018?

Fernando Mata Verdejo: Yeah. Thank you. Regarding Rahul's question, you are right, there are no extraordinaries in the €130 million reported life result, the underlying and accounting result is the same. What I have to say is that we do not consider as an extraordinary, the effect of the negative currency differences, which obviously were part of the results in Life business, those coming from Brazil. The total effect that we assess was like a €9 million loss, net of taxes and minorities, but we do not consider it as an extraordinary.

For the second question, the fall in the results of the Life business was largely driven by the fall in Brazil. Financial income is still suffering from lower yields. And there has also has been a pick-up in acquisition expenses, especially in the bancassurance channel. Probably you remember, the third quarter and also the fourth quarter, we increased our acquisition expenses, basically commissions in order to boost commercial activity. We have seen part of this action with the 6% increase in Life premiums during the first quarter in the bancassurance life channel. Also the currency impact has been significant in Brazil.

The other main Life business is Spain. We must keep in mind that there is a high share of Life saving products, and in this case, you must always look at the total result of the Life business, not the technical result on its own, as the increase in financial result is often offset by an increase in liabilities because of the matching of both figures. Also, the fall in IBERIA is explained by the €29 million extraordinary item last year.

Natalia Núñez Arana: Okay, thank you so much. The next one is regarding the ROE. There are two questions regarding ROE. One is from Rahul Parekh and the other one from Michael Huttner. They want to know what is the ROE achievable in 2018 given that the target is still 11% and 1Q of 2018 was 7.4%. Regarding the same topic, Michael Huttner from JP Morgan would like to know if you can talk to us about the potential areas of improvement.

Fernando Mata Verdejo: Okay, let me start with the first question. The underlying ROE is 9%, and we are still working towards achieving the target initially set when we announced our three-year strategic plan. Obviously, we already said that we are moderating expectations, and we said that it was very challenging. In the end, it's crystal clear that this objective is extremely difficult to achieve.

Nevertheless, we're happy because in the long run we see an improvement in the underlying ROE. Regarding any guidance, with the current volatility of the market, and also this is only one quarter, it is extremely difficult to estimate how our capital base is going to evolve throughout the rest of the year, which could increase the volatility of the ratio. So far, looking at the currencies, probably we can expect further reductions in some Latin American currencies that will help us improve our ROE. But as we said many times, we would like to increase and to improve our ROE through the top line. I mean, through net income rather than with a decrease in our capital base.

Regarding the second question from Michael Huttner, thank you, Michael. You have already seen the results in Spain. This is the first country where this strategy was applied, even before we launched the three year strategic plan. We set the 80/20 plan in order to cancel non-profitable portfolios, starting in Spain, at the beginning of 2014, when we saw the first above hundred combined ratios, particularly in third party liability and also in some segments of business in Automobile, particularly fleets. Then the strategy was applied in other countries and we've seen improvements in LATAM SOUTH, LATAM NORTH, Italy, ASISTENCIA, where we have completely turned the business around.

Now, we're working in the other regions, especially in Brazil and the U.S., where the new plan should accelerate profitable growth and we will see the results in the upcoming quarters, but it´s still too early – this is what I can say. I mean, this is still too early a stage to give you additional guidance regarding both countries.

Natalia Núñez Arana: Okay. Thank you. Now, this block of questions is concerning the developments in Brazil, also, from Sofia Barallat, Andrew Sinclair, Rahul Parekh and Ivan Bokhmat. The first one is: can you provide any update on discussions with Banco do Brasil and when we should expect to hear more about that?

Fernando Mata Verdejo: Well, it is still too soon to give you details on discussions and the main aspects of the future agreement. As we said at the AGM, there is a six-month period in order to complete the transaction and the contract, but also I said that we expect the contract to be completed in April. We're late, it's not going to be in this month, but May is very likely. I mean, the majority of the discussions are coming to an end. There is very, very little discussion, very few open issues and everything is going well. And just to adapt compulsory approvals and compliance for the governance of both entities and all in all, May looks quite likely, in order to be completed. Regarding conditions aspects, as we said, we do not disclose any information. I will give you probably a full presentation with additional disclosure once the contract and the agreement is signed.

Natalia Núñez Arana: Okay. Thank you. In terms of this agreement with Banco do Brasil, will the upcoming change of structure in Brazil help you tackle the problems more efficiently and in this way will the deal be earnings accretive in 2018 and 2019?

Fernando Mata Verdejo: Well, let's say that we are optimistic with the evolution in Brazil in 2018 and 2019. What we did so far, we deployed a task group or working group of more than 25 people from the actuarial and technical areas, from different countries, the majority from Spain and they were in Brazil for over four months. They are back in Spain just a couple of weeks ago. During this time, they analyzed all the technical processes, actions for Motor, and also they designed 23 different projects, comprising over 225 initiatives to mitigate potential weaknesses in the Motor business and also they identified a lot of areas of improvement.

So, let's say that the recovery plan or the transformation plan is done, and we've got a booklet in order to put into action in Brazil as soon as we can. And I said as soon as we can because the current organizational chart is based on this managerial way, with officials from both entities, Banco do Brasil and MAPFRE. And we can't make any change in the organizational chart or in the functional responsibilities until the agreement has been signed.

So, let's say that the plan is done. The plan currently is on the table and ready to be implemented. But we have to wait a little bit longer. Overall, until now, all actuarial, technical, commercial management functions have been shared and currently they're still shared by officials from Banco do Brasil and from MAPFRE. In the future, we will be able to run Motor line business and the entities we bought 100% of the shares, on our own. So we will be able to implement these initiatives. So let's say that the bulk of the improvement will be at the end of this year or probably 2019.

Natalia Núñez Arana: Okay, good. Regarding the Brazilian Life business and the significant deterioration in local currency terms, the questions are the following: Is this a fair run rate for

2018? How do you compare the benefits of improved lending versus the headwind of lower investment income? In this way, financial income in Brazil was €20 million in 1Q, is that below normal or is this the level we should expect going forward?

Fernando Mata Verdejo: Yeah. Thank you. I personally and we don't think the first quarter 2018 Life results can be considered as a run rate for 2018. I mean, it's very important to take into account the effect of the recovery of lending activity and how it helps to improve premium volume. Also the increase in acquisition expenses is bearing fruit, but this is an expense that is variable and we can change to adapt to current volumes of premiums.

So we can see perhaps further increases, but also further reductions as well, in this ratio. There's no doubt investment income is affected, as you know, by the evolution of SELIC rate, which is currently at 6.5%. We can say that current portfolio yield has basically priced in most of the rate cuts of the last 12 months. In this way, the accounting yield is now only 90 bps above market yields.

Natalia Núñez Arana: Okay. Thank you. The next question comes from Michelle Ballatore, and is regarding the capital increase in Italy. Can you give us more color on the capital increase of €120 million in Italy?

Fernando Mata Verdejo: Yeah. Thank you, Michelle. The objective of the capital increase – well, first of all, let's say that the capital increase was in the budget, no doubt, and the objective of the capital increase is to strengthen VERTI Italy's capital position. VERTI Italy's continuously improving result is very close to breakeven, and it's something that we have to do, and that's it. So, as you know, of the capital increase of €120 million, €60 million were fully paid in the first quarter and the other is core capital and will be paid if we need to. It has been considered as Tier 2, as you know well. So, in the end the Solvency II ratio will improve dramatically. And this will allow us somehow to manage in a better way the current subordinated debt between VERTI Italy and VERTI Germany.

Natalia Núñez Arana: Okay, thank you. Now, Farquhar Murray from Autonomous would like to know if the exit from New York and New Jersey will entail a sale of the subsidiaries or a sale of the renewal rights?

Fernando Mata Verdejo: New York is a company, so the current due diligence exercise is for the New York company, and New Jersey is a portfolio, but the current due diligence comprises as well this portfolio. So we're looking at a transaction that will cover both states and both businesses. I mean the company, and also the portfolio in New Jersey.

Natalia Núñez Arana: Okay, thank you so much. We are reaching the last question I have right now, it's regarding the reinsurance program. I don't know if there are any more, but so far there are no more. Paz Ojeda asks the following, could you please explain how the catastrophic program has worked between MAPFRE USA and MAPFRE RE? You have reported gross losses of €60 million and net of reinsurance at MAPFRE USA of €13 million. If you see the development of MAPFRE's combined ratio, it is stable at 91% and no significant impact can be seen. Could you give us more details on this?

Fernando Mata Verdejo: Yeah. Thank you, Paz. The reinsurance structure we have between MAPFRE USA and MAPFRE RE is pure quota share, with retrocession of 70%. Out of this, MAPFRE is retaining 30%. So let's say that the gross and net for the U.S. operation and for MAPFRE RE before expenses is the same. Regarding the figures,– I think it's $60 million, €50 million for the gross loss and also the €13 million for MAPFRE USA is net of reinsurance and net of taxes as well. And so probably with this information you can make it up and guess both impacts. And excluding the snow storms, in general catastrophic loss experience has been more benign, let's say that as an overall conclusion.

Natalia Núñez Arana

Okay. Thank you so much. There are no more questions from the analysts. So if you want to do a wrap up to close the session.

Fernando Mata Verdejo

Thank you, Natalia, and Ramón and I want to thank everyone for joining us today, despite this being a singular first quarter, I said singular, yes, because I didn't find any better word and our long-term outlook remains quite positive with no changes. If anything, we should speed up process implementation in the U.S. and Brazil, and also it's very important to keep MAPFRE Spain and MAPFRE RE at the current efficiency levels within the profitable growth framework.

Thank you, everybody. Have a good weekend.

Natalia Núñez Arana

Thank you very much.

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