9 August 2022

AKSIGORTA GWP REACHED 3,027m TL WITH 113% YoY GROWTH IN THE SECOND QUARTER OF 2022

2022 SECOND QUARTER PERFORMANCE SUMMARY

Aksigorta reported gross written premiums (GWP) of 3,027m TL and net loss of 192m TL in the second quarter of 2022 compared to gross written premiums of 1,422m TL and net profit of 95m TL in second quarter of 2021. These figures represent 113% growth in gross written premiums and 303% YoY decline in net profit in the second quarter of 2022.

- Highlights of the second quarter of 2022 GWP growth:
    - strong growth of 89% in non-motor – engineering, marine, business, and liability main drivers
    - new pricing model and new technologies in MTPL such as AI and machine learning
    - focus on non-motor products especially in bank and corporate channels
    - Aksigorta market share decreased by 0.7pp YoY and reached 7.5% as of Jun.22

GWP (m TL)	2021 Q1	2022 Q1	YoY	2021 Q2	2022 Q2	YoY	2021 H1	2022 H1	YoY
MTPL	488	625	28%	426	850	100%	914	1.475	61%
MOD	369	508	37%	274	780	184%	644	1.287	100%
Non-Motor	582	1.129	94%	616	1.166	89%	1.197	2.295	92%
Health	138	220	59%	106	231	118%	245	451	84%
Total	**1.578**	**2.482**	**57%**	**1.422**	**3.027**	**113%**	**3.000**	**5.509**	**84%**

- Major regulatory changes announced in the second quarter of 2022:
    - With the Circular No 2022/22, the official discount interest rate used in discounting the net cash flows arising from the outstanding claims provision has been revised as 22% instead of 17% as of 30 June 2022
- Net profit impact of the change in the official discount rate is 208m TL in the second quarter of 2022
- Outstanding indemnity discount calculation has started to be applied in all branches in the last quarter of 2021, instead of the three compulsory branches. As a result of this decision, which is considered as an accounting policy change, the financial statements have been restated retrospectively
- Decreased mobility due to Covid-19 has ended in 2021, which had a negative impact on the loss ratios in Motor branches in 2022
- As a result of TL depreciation and increase in minimum wage, already priced (in force) MOD portfolio resulted in technical loss (because of increase in spare parts and labor cost)
- Increase in large and medium size claims in non-motor products
- Pre-tax negative impact of the June flood claims in Ankara and the Western Black Sea Region on Aksigorta financials in June is 15 million TL
- 30% increase in the minimum wage in June caused an additional reserve requirement of approximately TL 100 million in Aksigorta financials and negatively affected technical profit

- In the actuarial valuation report on the MTPL risky drivers' insurance pool as of the first quarter of 2022 published by PwC in June, the ultimate loss ratio estimate of the MTPL pool was revised upwards for all accident years
- Total underwriting result (UWR) decreased by TL 577 million to -498 million TL YoY in the second quarter of 2022
- The combined ratio increased by 55pp in the second quarter of 2022 compared to the second quarter of 2021 and reached 156%. The increase in the combined ratio comes entirely from the loss ratio which increased to 136% in the first half of 2022
- Net financial income, including FX gain/loss and financial expenses, increased by 139% compared to the second quarter of 2021 and amounted to TL 323 million TL

Financial Highlights (m TL)	(Restated) 2021 Q1	2022 Q1	YoY	(Restated) 2021 Q2	2022 Q1	YoY	(Restated) 2021 H1	2022 H1	YoY
GWP	1.578	2.482	57%	1.422	3.027	113%	3.000	5.509	84%
UWR	22	-490	-2360%	62	-498	-908%	83	-988	-1286%
Expenses	-66	-101	52%	-68	-103	52%	-134	-204	52%
Net Financial Income	147	273	86%	135	323	139%	282	596	111%
Net Profit	**92**	**-254**	**-377%**	**95**	**-192**	**-303%**	**186**	**-446**	**-339%**
Combined Ratio	*106%*	*164%*	*58pp*	*101%*	*156%*	*55pp*	*102%*	*160%*	*58pp*

- In the second quarter 2022, Aksigorta AuM increased by 23% compared to the previous year and reached TL 4.5 billion. Thanks to successful fund management, the financial annualized return yield increased to 29% in the second quarter of 2022. (Return yield in first quarter of 2022 was 27%)
- As a result of the TL depreciation in the last quarter of 2021, the foreign currency policy was reviewed, and it was decided to increase the net balance sheet foreign currency position to hedge from the FX effect on the MOD spare part claim cost. The net balance sheet FX position, which was 68m USD at the end of 2021, reached to 86m USD at the end of June 2022

THE UNDERLYING REASONS FOR 1 BILLION TL CAPITAL INCREASE DECISION

• Cost and price dynamics of the non-life insurance sector (insurance sector) operate differently from other sectors. In other sectors, first the cost of goods sold is calculated and then the price is determined. However, in the insurance sector, the price is determined first and then the cost is realized. While determining the price, historical claim statistics and future period forecasts are used. Therefore, the actual cost in the insurance sector may be different from the projected cost. For this reason, the forecasts for the future period used when determining the price in the insurance sector are very important. Estimated cost elements are claim frequency and average claim cost. Unless a significant change is made in the risk selection criteria of the insurance portfolio or a catastrophic event occurs, the frequency of claim is not expected to change in the coming period. However, for the average cost of claim, the risks are higher and the effect on the cost is higher. Inflation, increase in exchange rate, labor cost, minimum wage, auto spare part prices and automobile prices, changes in legislation and distribution of claim types etc. many factors have an impact on claim costs. Under the relatively stable economic conditions in 2021, Aksigorta generated a total of 2.8 billion TL in auto insurance premiums, namely 1.6 billion TL in MTPL and 1.2 billion TL in MOD. The underlying cost assumptions in premiums of 2.8 billion TL included inflation and minimum wage increase forecast in the range of 15%-20%. However, annual inflation realized at the end of 2021 was 36% in CPI and 80% in PPI. Annual inflation realized at the end of July 2022 rose to 80% in CPI and 145% in PPI. On the other hand, the increase in auto spare parts prices was around 90%. While automobile prices have increased by up to 200%, the increase in the minimum wage has reached 95% in the last 12 months. Let us explain the reason for the big loss in auto insurance with a simple example. As an example of the reasoning for technical loss in motor insurance products, let us assume that we have motor insurance for a car with a market value of 200 thousand TL in August 2021. While determining the motor insurance price, we predicted that there would be a 20% increase in the vehicle price in the next 12 months due to inflation and exchange rates. Anticipating that the market value of the vehicle will increase to 240 thousand TL, we determined the premium of the motor insurance policy as 4,800 TL with a 2% insurance premium rate and issued the motor own damage (MOD) policy. Until August 2022, when the motor insurance policy will expire, the market value of the vehicle increased by 200% to 600 thousand TL. This increase reflects market realities. In case of complete loss damage of the car, the insured will not be paid 200 thousand TL or 240 thousand TL, but rather the insured is paid the market value of the vehicle, i.e.,600 thousand TL. The same is true for MTPL insurance. We can reproduce this example for spare parts costs, loss of value claims and bodily injury claims.

- As we mentioned before, while premiums of 2.8 billion TL were written in auto insurances in 2021, the inflation and minimum wage increase prediction used in pricing was in the range of 15%-20%. However, since October 2021, inflation realizations have steadily increased and finally, at the end of July, the CPI increased to 80% and PPI to 145%. The expected loss from the premium written as 2.8 billion TL was 2.1 billion TL. If we accept that the claim cost inflation is roughly at 100%, we can easily say that 1.4 billion TL additional claim cost occurred than we had anticipated. Moreover, while the average life of motor insurance claims is 7-8 months, the average lifespan of MTPL claims is around 30 months. In some cases, it takes up to 10 years for traffic insurance claims to result. For the 1.4 billion TL additional claim cost, MOD claims do not pose a risk of further increase, whereas MTPL claims continue to increase with risks such as inflation, minimum wage, and legislative changes. For this reason, there is a risk that the 1.4 billion TL additional claim cost could increase further in the future. Let's explain how the minimum wage increase influences the MTPL claim cost. There are three types of claims in MTPL insurance: material damage, loss of value and bodily injury claims. Material claims in MTPL insurance and claims in motor insurance are of the same character. The reality, extent and cost of the claims are determined in a short time; repair and payment will also result in a short time. Loss of value claims, like material claims, is a fast-flow process and there are rules that will not create conflict between the parties

• Bodily injuries in MTPL insurance are both multidimensional and may take a long time to resolve, since there are dynamics that will cause conflict between the parties. The MTPL claim charge filing period can extend up to 15 years. In a traffic accident, the traffic insurance of the faulty driver covers the claims that will occur in the body and mind integrity of the driver and passengers in the non-defective vehicle. Death and disability are the most common bodily injuries. For example, let us assume that the motor insurance of the defective driver is from ABC company and the non-faulty driver died in the accident. ABC company is obliged to pay “indemnity for lack of support” to the dependents of the driver who lost his life in the accident. This compensation is also known as blood money. The compensation for loss of support is roughly calculated as follows: “How many more years would the driver have lived if he had not died in the accident, and how much income would he have earned in his remaining life?” Suppose that the driver was 40 years old when he died in the accident, and according to the mortality (death statistics) table, this driver would have lived up to 70 years if he had not died in the accident. In this case, the remaining life of the driver is 30 years. The official income of the driver is used to calculate how much income the driver would have received in the remaining 30 years of his life. The net present value is calculated by discounting the total income calculated and to be paid as a compensation. According to the statistics of the bodily injury files in the Turkish insurance sector, the share of those whose official income is at or below the minimum wage constitute 85% in the total. In the calculation of bodily injury, the income of persons whose official wage is below the minimum wage (housewife, student, etc.) is considered at the minimum wage level. According to the financial statements of the first quarter of 2022, the insurance sector has net claim reserves of 43.4 billion TL. Out of that amount 27.8 billion TL is only the net claim reserves of MTPL. While 20% of the claim provisions in traffic insurance are material claims, 80% is bodily injuries. 85% of bodily injuries are completely sensitive to the minimum wage increase.

- Non-life insurance companies have two sources of income: insurance income and financial income. When we look at the past figures of Aksigorta, we see that while one income item decreased, the other income item increased compensating the other, the total income did not decrease, but increased in parallel with the premium growth. The income item that will compensate for the additional 1.4 billion TL loss from the 2.8 billion TL auto insurance portfolio written in 2021 is financial income under normal conditions. However, in the last 10 months, while the inflation has been increasing continuously, there has been no change in the market interest rates. If we consider the nominal market interest rate as 20% as of July, we can say that the negative real interest rate is -60%. If there was a real interest rate environment in the -2% / +2% band in our country, as in other emerging economies, we would have been able to generate 2.7 billion TL more annual financial income as Aksigorta. In this case, we could have offset the impact of additional loss (-1.4 billion TL) in auto insurance with the increase in financial income (2.7 billion TL).

• In the current economic conditions, the non-life insurance sector is experiencing low insurance profits and low financial income at the same time, which we can call “the double dip”. As a result, in our company's balance sheet:

(1) our liabilities, mainly consisting of premium and loss provisions, grew by 44%

(2) with the effect of premium growth and market interest rates, our assets grew by only 32%

(3) since our liabilities have overgrown our assets, both balance sheet loss occurs, and our equity is decreasing

• The insurance industry has its own “capital adequacy legislation”. If the capital adequacy result calculated with these legislation rules is below 100%, it is considered that the available capital is insufficient. Our company's 2021 year-end capital adequacy result was 82%, below the minimum threshold of 100%. We shared our organic action plans (such as reducing, transferring, or eliminating balance sheet risks) to improve our capital adequacy result with SEDDK (Insurance and Private Pension Regulation and Supervision Agency). Considering our gap in capital adequacy at the end of 2021 and our balance sheet loss in the first quarter of 2022; SEDDK directed us towards a paid capital increase.

• In summary capital increase was required

(1) since insurance loss caused by inflation and minimum wage increase was higher than anticipated,

(2) since balance sheet loss occurred due to the negative real interest rate in the market,

(3) in order to guarantee the continuity of the company, and

(4) in order to improve our capital adequacy result

For this reason, our Board of Directors has decided to increase the paid-in capital of the company by 1 billion TL.

Prospects

Topline growth will be maintained via:

- contribution of new agencies; in the last 3 years 1.027 new agencies are added to our agency network which make 29% of total agency GWP in 2022
- # of agencies exceeded 3.600 in the first half of 2022
- increase in bank channel penetration
- following corporate business potential closely
- Telcosurance partnership with Vodafone to sell insurance products
- IOT partnership with Fiat Connect to sell insurance products bundled with auto sales
- Mercedes-Benz branded MOD launched in October 2021

Combined ratio will be kept below 100% via:

- enhanced risk management policy and profitable insurance portfolio
- data analytics capabilities used in pricing and underwriting
- usage of robotic process automation (currently 144 processes are automated corresponding to 3,4m transactions and 150+ FTE equivalents in Jan.22-Jul.22 period) leading to operational efficiency & saving
- new technologies applied in customers' claim experiences
- new technologies such as AI, ML used in pricing of motor products

Earnings Call Q&A Session Summary:

Q: Do you have any estimate for the timing of the right and sort of decision of capital market about your right issue application? Can you give some information about the financial situation or financial health company?

CFO: The process could take 1 or 1,5 months so I can say that we can start the exercise of using the preemptive rights in the middle September and we can complete the process at the end of September that's our expectation now. We are releasing some management commentary with the results and in that management commentary we explained the reasons for 1,0 billion capital injection you know the reasons, but we shared clearly and in detail that as I said the actual inflation is far higher than expected which is the first reason and second reason for net loss is negative real interest rates. Our Desires or our ambition is to keep the sustainable of the company and then recover the profitability of the company, so these are the main drivers and the reasons of the capital injection and then after 1,0 billion capital injection at the end of third quarter at latest according to our expectation, so we have good investment opportunities in front of us. One option is getting longer in fx position via Eurobond side with 11% to 12% returns in dollars in the government issued Eurobonds. Second option could be the offshore market where we can find 50%-55% return for TL supranational bonds and in the domestic market with investment fund in the CPI linker we can find 40% return and together with the 25% tax shield the return rises up to 50%; so capital injection will contribute to the company's profitability; this is very clear. On the other hand, there is a capital adequacy issue and we reported that at the end of 2021 our capital adequacy result was below the legal threshold of 100%. And then at the end of the 1st half of 2022 we are still below the legal threshold so that 1 billion capital injection will improve our capital adequacy result, but still with one billion capital injection our capital adequacy ratio will not immediately reach to 100% legal threshold. We will focus on profit generation to reach 100% capital adequacy level.

CEO: Regarding capital injection, the Company has a strong liquidity position in the market but on the other hand, our capital base is less than our competitors. The major reason of this is that; in the last 5-6 years Aksigorta was one of highest dividend payers in the market. We were always moving around minimum threshold level of capital adequacy in the past. Capital increase aims mainly to improve capital adequacy ratio, since the company doesn't have any liquidity issue this injection will provide additional financial income source for the company so it will improve the profitability of the company. On the coming days the capital adequacy would be an issue not only for Aksigorta but for the whole industry.

Q: The capital adequacy ratio or the solvency may not be reaching a 100% level following the capital increase issue and do you expect 2nd half earnings to be offsetting some losses so that you may be in safe zone for the full year of 2022?

CFO: There is an unexpected risk reserve standard (“Devam Eden Riskler Karşılığı”) this is a regulated provision, and it says that if your insurance portfolio is loss-making, you should set aside unexpected risk reserve over the unearned premium, assuming that in the remaining life of the portfolio you will continue to make losses. Regulations is like that it is clear it's reasonable but in MTPL side you know we have MTPL portfolio which is not only underwritten in the last 12 months which is issued in the last 10 years, so we have outstanding claims portfolio coming from the last 10 years period. So, with the increase in the minimum wages there will be additional costs on our claims and our loss ratio is increasing. Then the rule says that the financial loss ratio is to be calculated and you know our financial loss ratio in MTPL is around 160% and it says that the exceeding part over 100% loss ratio is 60% and it says that you have to book URR reserve in order to be on the conservative side for the future losses. But from the rational of that provision it is the financial loss ratio represents the total 10 years portfolios result. But in the new business in the last 12 months there was a 25% one time increase in the price kept in favor there was a game 30% price kept a price kept increase in June and we expect a new price gap within a few months. So all these price kept increases and there is still 2.25% monthly increase. All the price cap increases are improving the loss ratio MTPL so the loss ratio of the portfolio which I issued in the last 12 months. It's not that much high. So the losses in the future over unearned premium reserve I can say the remaining life of our portfolio will be not that much. so the computation rules of URR is not appropriate from our point of view. We are discussing with regulator there is no change at the end of 1st half. we know that all the companies are suffering from that URR so we hope and the insist to make a rule change in that URR. 394 million URR in our financials. If there is a rule change in that URR provisioning it will contribute one reason is that and 2nd we are increasing our return and third we have positive margins of the new business in MOD.

CEO: Aksigorta established a new company under Aksigorta application is the health company. Sabancı Holding and Ageas decided to enter the health insurance market next to the nonlife pension and life operation. So this is a new and a good news from Aksigorta perspective now the company established under Aksigorta but on the coming days the company will play maybe in independence one similar to Aksigorta and AgeSA.

Q: Policies expire, and the new policies are issued at higher prices, will there be a reversal on URR as well on those unearned reserve or whatever has been done will be done?

CFO: That's explained in the logic of the URR, so we started to provision that URR at the end of 2021. Prior to 2021 the level of URR was at immaterial level so till the year end it will continue but one option is that at the year-end, there could be a release if the MTPL price increases continue and with improvement in our MTPL portfolio there could be a URR release. Second option could be a rule change of URR computation, again there could be a release. But from MOD perspective we have a 124 million URR provision in MOD product from now I can say there will be no URR in MOD because we already improved our new business loss ratio to 75% so far better than 95%. MOD is not a long tail business this is a short tail business 1- and 1,5-years business. In MTPL you know that's a long tail business so the minimum wage increases will continue, and you know there is a possibility of general election in the next year so you know all, we can make an estimation on how much the minimum wage increase will be at the year-end but it can from 30% to a 100% posing a risk on MTPL product. Price cap increases is vitally necessary for MTPL product.

Q: If the minimum wage increase by the end of this year over 40%, what could we see for the year end financials? Because as far as I know you reflect the impact of minimum wage increase immediately in your full year earnings at the end of the year.

CEO: For new business we are pricing with an expectation of year end minimum wage increase impact, we accelerated our bodily injury final closing rates that almost quadrupled in the last 4 months, so we are trying to pay and close bodily injury files before an announcement of a new minimum wage. On the other hand, the minimum wage may have a sizeable impact but there could be change in URR computation at the end of the year which may compensate that minimum wage effect.

Q: Regarding this discount rates upgrading from 17 to 22% so should we expect another 5% points or what maybe your expectation?

CFO: The most proper solution would be linking the discount rate to the rate curve because we will shift to IFRS17 reporting in the next year and in IFRS17 reporting from today dry run we are using the rate curve is the best solution, so we do not expect more discount rate for the 2nd half of the year.

Q: What about the inflation accounting under IFRS17, what maybe the impact on the overall financials. I think book value will be inflated, I guess.

CFO: Tax authority announced that the inflation adjustment will be implied in the next year and the reporting authority is not clear about the timing. When the inflation adjustment will be applied from insurance reporting perspective, it is not the main issue now, but the critical issue is there is a unclarity of IFRS17 reporting under the high inflationary conditions. So IAS29 and IFRS17 is not aligned. IFRS17 is more critical compared to inflation because you know IFRS17 is taking into consideration of the cash flows on the issued business cash flow; and not the accrual basis, it is the cash flow basis reporting. IFRS17 rules already contains some inflation effects. IFRS17 reporting is more critical and insurance regulator didn't explain or announce any exit from IFRS17 reporting.