

Earnings Press Release, 26 October 2023

Arion Bank's Q3 2023 financial results

- Arion Bank reports net earnings of ISK 6,131m in Q3, compared with ISK 5,008m in Q3 2022
- Return on equity in Q3 was 12.9%, compared with 10.9% in Q3 2022
- Earnings per share in ISK of 4.19 in Q3, compared with 3.35 in Q3 2022
- Net interest margin of 3.0%, compared with 3.2% in Q3 2022
- Solid quarter for the fee generating businesses, with total fees of ISK 3.8bn
- Core operating income, defined as net interest income, net commission income and insurance service results (excluding opex of the insurance operation), increased by 2%, compared with Q3 2022
- Cost-to-core income ratio in Q3 was 38.2%, compared with 37.5% in Q3 2022
- The balance sheet increased by 5.1% from year-end 2022
- The Bank's capital ratio was 24.4% and the CET1 ratio was 19.4% at the end of September and increased by 50bps in the quarter

Arion Bank reported net earnings of ISK 6,131m in the third quarter of 2023 and ISK 19,513m during the first nine months of the year. Return on equity was 12.9% for the quarter and 13.9% for the first nine months.

Total assets amounted to ISK 1,541bn at the end of September, compared with ISK 1,466bn at the end of 2022. Loans to customers increased by 5.4% in the first nine months of 2023. The increase was 7.9% in corporate lending and 3.3% in loans to individuals, mainly mortgages. Deposits from customers increased by 6.7% during the first nine months. Total equity amounted to ISK 193bn at the end of September. Total equity increased from year-end due to net earnings for the first nine months of 2023 which was partly offset by capital release of ISK 15.6bn.

The Group's capital ratio was 24.4% and the CET1 ratio 19.4% at the end of September. The ratios are determined on the basis of the unaudited net earnings in the quarter and take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank's dividend policy. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 24.1% and the CET1 ratio was 19.0%. These ratios comfortably exceed the requirements made by the FSA and Icelandic law.

Benedikt Gíslason, CEO of Arion Bank

"The Bank's third quarter financial results were in line with expectations, and we achieved all our main operating targets in the first nine months of 2023. We offer an exceptionally broad range of services which generate diverse revenue streams, and this, combined with our focus on efficiency, delivers a stable and strong business. The Bank's capital and liquidity positions continue to be robust, factors which contributed towards the Bank's recent upgrade to an A-3 rating by Moody's.

Moody's also highlighted our shift towards the bancassurance model. Indeed, it has been pleasing to see how the partnership between Arion and Vörður has gone from strength to strength. Together we are constantly seeking ways to integrate our banking and insurance businesses so that our customers can get the most out of the services we offer. We are delighted to see an increasing number of customers, both retail and corporate, recognizing the benefits of doing business with both companies.

During the third quarter loan portfolio growth slowed down, reflecting easing economic growth in Iceland. Normally, we welcome healthy economic growth, but the task at hand now is to reduce inflation and interest rates, so a dip in economic growth is actually a step in the right direction. High interest rates impact households and companies in Iceland, and consumption and economic activity in general have declined in line with the Central Bank's targets. Households who chose to fix mortgage rates when rates were low have benefited and enjoyed some level of protection. However, when the fixed mortgage rate period comes to an end, many households are likely to feel financial strain. Over the past few weeks, we have reached out to this group and discussed the options with them. We have various ways of reducing the debt service, and it is vital that people find out what's on offer so they can decide what best suits them. We look into people's circumstances on a case-by-case basis and seek to find a solution together. We encourage anyone with concerns to contact us so that we can discuss the available options.

In October we announced organizational changes at the Bank, involving the creation of a new division, Operation & Culture. The changes are designed to bring key units closer together, enhance operational efficiency, manage transformation projects more effectively, and bring a clearer focus to service and customer experience. The division will also play a pivotal role in the continued development and shaping of Arion Bank's corporate culture and the



division will be headed by Birna Hlín Káradóttir, who has served as the Bank's general counsel since 2019 and has been a member of the executive committee since 2020. Culture and risk awareness are critical to financial institutions, and it was particularly pleasing to see that when Moody's upgraded our credit rating, it also upgraded the Bank's ESG rating, explicitly stating that governance risk was low due to the Bank's financial strategy and risk management."

Income Statement

<i>In ISK millions</i>	Q3 2023	Q3 2022	Δ	Δ %	9M 2023	9M 2022	Δ	Δ %
Net interest income	10,918	10,357	561	5%	33,338	29,578	3,760	13%
Net commission income	3,848	4,057	(209)	(5%)	12,486	12,195	291	2%
Insurance service results	395	487	(92)	-	436	847	(411)	(49%)
Net financial income	(183)	(1,476)	1,293	-	(4)	(3,234)	3,230	-
Other operating income	8	98	(90)	(92%)	1,613	1,262	351	28%
Operating income	14,986	13,523	1,463	11%	47,869	40,648	7,221	18%
Operating expenses	(5,392)	(5,222)	(170)	3%	(17,871)	(16,855)	(1,016)	6%
Bank levy	(468)	(444)	(24)	5%	(1,374)	(1,253)	(121)	10%
Net impairment	(741)	42	(783)	-	(1,361)	(267)	(1,094)	410%
Net earnings before income tax	8,385	7,899	486	6%	27,263	22,273	4,990	22%
Income tax expense	(2,274)	(2,885)	611	(21%)	(7,787)	(8,189)	402	(5%)
Net earnings from cont. operations	6,111	5,014	1,097	22%	19,476	14,084	5,392	38%
Discontinued operations, net of tax	20	(6)	26	-	37	6,909	(6,872)	-
Net earnings	6,131	5,008	1,123	22%	19,513	20,993	(1,480)	(7%)
KFI's								
Return on equity (ROE)	12.9%	10.9%			13.9%	15.2%		
Return on total assets (ROA)	1.6%	1.4%			1.7%	2.1%		
Earnings per share (in ISK)	4.19	3.35			13.40	14.00		
Cost to core income ratio	38.2%	37.5%			41.4%	42.0%		
Net interest margin (NIM)	3.0%	3.2%			3.1%	3.1%		
Core income / REA	7.0%	7.2%			7.2%	6.9%		

Net interest income increased by 5.4%, compared with the third quarter of 2022. The net interest margin (NIM) as a percentage of average interest-bearing assets was 3.0% for the quarter, compared with 3.2% for the third quarter of 2022. The policy rate increased from 4.75% at the beginning of the third quarter 2022 to 9.25% at the end of the third quarter 2023. Rate sensitivity is slowing as interest expense is increasing on both deposits and wholesale funding. Average interest-bearing assets increased by 11%, compared with the third quarter of 2022, mainly loans to customers.

Net commission income was solid in the third quarter of 2023, amounting to ISK 3.8 bn. Income from asset management continues to be strong, despite challenging market conditions. A slower economy affects lending volume and capital markets fees that are generally lower in Q3.

Insurance service results of the insurance company Vödur amounted to ISK 395m during the quarter. There has been strong growth of 18.6% in premiums written, compared with the third quarter 2022, and 19.0% increase in total insurance revenues. Claims are seasonally volatile but are showing signs of normalizing after some challenging quarters. Due to the adoption of IFRS 17 Insurance Contracts, the presentation of insurance results has been changed, the largest change being a shift of insurance service expenses from operating expenses to insurance service results. The combined ratio for the third quarter of 2023 was 88.6%, compared with 81.2% for the same period in 2022.

Net financial income was negative by ISK 183m for the quarter. The quarter was challenging for bonds and equity holdings and continues to be affected by market volatility, especially in bond holdings.

Operating expenses increased by 3.3% in the third quarter, compared with the same period in 2022. When operating expenses of the insurance operation are included (post IFRS 17 cost related to insurance business is accounted for through insurance service results), the increase was 4.1%. There is an ongoing focus on operating expenses and efficiency within the Group. Cost-to-core income ratio was 38.2% in the third quarter, compared with 37.1% in the third quarter 2022, when including the operating expenses of the insurance operation. Salary expenses increased compared with the third quarter of 2022, mainly due to new labor agreements and an increase in the number of FTEs. At the end of September, the number of full-time equivalent positions (FTEs) was 800, an increase of 5% from the same period in 2022.

Net impairment was ISK 741m in the third quarter of 2023. Impairments were in line with through the cycle expectations, estimated at 20-25bps of the loan book on an annualized basis.

Income tax, as reported in the financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1bn. The effective income tax rate was 27.1% for the quarter. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate.



Balance sheet

The balance sheet increased by 5.1% from year-end 2022 and the liquidity position remains strong.

Assets

<i>In ISK millions</i>	30.09.2023	31.12.2022	Δ	Δ %	30.06.2023	Δ	Δ %
Cash & balances with CB	80,288	114,118	(33,830)	(30%)	76,499	3,789	5%
Loans to credit institutions	51,302	45,501	5,801	13%	43,428	7,874	18%
Loans to customers	1,143,473	1,084,757	58,716	5%	1,134,621	8,852	1%
Financial instruments	221,012	193,328	27,684	14%	225,828	(4,816)	(2%)
Intangible assets	8,289	8,783	(494)	(6%)	8,486	(197)	(2%)
Other assets	36,305	19,122	17,183	90%	29,364	6,941	24%
Total assets	1,540,669	1,465,609	75,060	5%	1,518,226	22,443	1%
KFI's							
REA / Total assets	58.9%	60.1%			60.1%		
Share of stage 3 loans, gross	1.5%	1.2%			1.5%		

Loans to customers increased by 5.4% or ISK 59bn from the end of 2022, with loans to corporates increasing by 7.9%, and loans to individuals growing by 3.3%. Part of this growth, or ISK 10bn, is due to inflation and changes in currencies. This growth rate has decreased from last quarter with no increase in loans to corporates and 1.5% increase in loans to individuals. The diversification of the corporate loan book continues to be good and in line with the Bank's credit strategy.

The Bank's liquidity position is strong with the total LCR ratio at 179% and the ISK LCR ratio at 104%. This is reflected in the strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments. The average duration of liquidity in the bond portfolio is less than one year and there is no HTM accounting.

Liabilities and equity

<i>In ISK millions</i>	30.09.2023	31.12.2022	Δ	Δ %	30.06.2023	Δ	Δ %
Due to credit institutions & CB	13,144	11,697	1,447	12%	21,702	(8,558)	(39%)
Deposits from customers	806,331	755,361	50,970	7%	781,202	25,129	3%
Other liabilities	73,886	70,702	3,184	5%	76,956	(3,070)	(4%)
Borrowings	407,895	392,563	15,332	4%	405,572	2,323	1%
Subordinated liabilities	46,853	47,330	(477)	(1%)	46,478	375	1%
Total liabilities	1,348,109	1,277,653	70,456	5.5%	1,331,910	16,199	1%
Shareholders equity	191,899	187,307	4,592	2%	185,651	6,248	3%
Non-controlling interest	661	649	12	2%	665	(4)	(1%)
Total equity	192,560	187,956	4,604	2%	186,316	6,244	3%
Total liabilities and equity	1,540,669	1,465,609	75,060	5%	1,518,226	22,443	1%
KFI's							
Loans to Deposits ratio	141.8%	143.6%			145.2%		
CET1 ratio	19.4%	18.8%			18.9%		
Capital adequacy ratio	24.4%	24.0%			23.9%		

Deposits from customers remain the most important source of funding for Arion Bank, with almost 60% of total liabilities in deposits. The 6.8% increase from year-end 2022 is mainly from individuals, SME's and corporates.

The maturity profile of *Borrowings* is balanced, and the Bank has broad funding options. During the second quarter Arion Bank issued EUR 300m senior preferred notes, partly used to prepay 73.5% of a EUR 300m senior bond maturing in May 2024. The Bank has no significant FX maturities until December 2024.

Shareholders' equity increased due to net earnings of ISK 19.5bn for the first nine months of 2023 which was partly offset by dividend payments and the purchase of own shares, in total ISK 15.6bn. The leverage ratio was 11.8% at the end of September, unchanged from the end of 2022, which is high by international standards. Taking into account the increase in the countercyclical buffer to 2.5%, the Bank has ISK 29bn of surplus capital over regulatory requirement. The management buffer range implies surplus capital in the range of ISK 6bn to ISK 16bn. Rating consideration may impact capital management in the near term.

For further information on the accounts please visit Arion Bank's [website](#).



Medium-term financial targets

Medium-term financial targets of Arion Bank

	Actuals Q3 2023	Actuals 9M 2023	Arion Bank's medium-term financial targets
Return on equity	12.9%	13.9%	Exceed 13%
Core operating income / REA	7.0%	7.2%	Exceed 6.7%
Insurance premium growth (YoY)	18.6%	12.9%	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3% (Premium growth in the domestic insurance market was 9.3% for Q1 2023 and 7.5% for 2022)
Cost-to-core income ratio	38.2%	41.4%	Below 48%
CET1 ratio	450 bps	450 bps	150-250 bps management buffer (~16.4 - 17.4% based on current capital requirements)
Dividend pay-out ratio	50%	50%	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both

Arion Bank will host its Capital Markets Day on 1 March 2024 to provide an update on key strategic initiatives and direction of the Group as well as revised medium-term targets.

Investor meeting / webcast in English on 27 October at 10:30 CEST / 9:30 BST / 8:30 GMT

Arion Bank will be hosting a meeting at the Bank's headquarters in Borgartún 19, Reykjavík, on Friday 27 October at 10:30 CEST (8:30 GMT) where CEO Benedikt Gíslason and CFO Ólafur Hrafn Höskuldsson will present the results and give an update on the economic environment. Additionally, COO Birna Hlín Káradóttir will introduce the Bank's recent organizational changes. The meeting will take place in English and will also be streamed live.

The webcast will be accessible live on [financialhearings](#) and a link is also available on the Bank's website under [Investor Relations](#).

Participants attending virtually will be able to ask questions during the meeting through a message board, located below the video feed. Answers will be provided by presenters at the end of the webcast.

Financial calendar

Arion Bank's financial calendar is available on the Bank's [website](#).

For any further information please contact Theodór Fridbertsson, [Head of IR](#), tel.+354 856 6760, or Haraldur Gudni Eidsson, [Head of Corporate Communications](#), tel. +354 856 7108.

Forward-looking statements

This release contains forward-looking statements that reflect management's current views with respect to certain future events and potential financial performance. The information in the release is based on company data available at the time of the release. Although Arion Bank believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Accordingly, results could differ materially from those set out in the forward-looking statements as a result of various factors. The most important factors that may cause such a difference for Arion Bank include, but are not limited to: a) the macroeconomic development, b) change in inflation, interest rate and foreign exchange rate levels, c) change in the competitive environment and d) change in the regulatory environment and other government actions. This release does not imply that Arion Bank has undertaken to revise any forward-looking statements, beyond what is required by applicable law or applicable stock exchange regulations if and when circumstances arise that will lead to changes after the date when this release was made. Arion Bank assumes no responsibility or liability for any reliance on any of the information contained herein. It is prohibited to distribute or publish any information in this release without Arion Bank's prior written consent.