

## ARION BANK'S FINANCIAL RESULTS FOR 2015

Arion Bank's financial results for 2015 were influenced by the completion of several major corporate recovery cases in which significant interests were at stake for the Bank, namely the sale of the Bank's shareholdings in five companies: Reitir fasteignafélag hf., Eik fasteignafélag hf., Síminn hf., Refresco Gerber and Bakkavor Group Ltd. All these companies were listed on the stock market in Iceland or markets overseas, with the exception of the holding in Bakkavor Group, which was sold following a sale process arranged by Barclays in the UK. Arion Bank reported net earnings of ISK 49.7 billion in 2015, compared with ISK 28.7 billion in 2014. Return on equity was 28.1%, compared with 18.6% in 2014.

Earnings from regular operations amounted to ISK 16.8 billion, compared with ISK 12.7 billion in 2014. Return on equity from regular operations was 10.4%, compared with 10.7% in 2014. Total assets at the end of 2015 amounted to ISK 1,011.0 billion, compared with ISK 933.7 billion at the end of 2014. Shareholders' equity totalled ISK 192.8 billion at the end of 2015, a 20% increase from the previous year.

Net earnings in the fourth quarter amounted to ISK 24.3 billion, a substantial increase from the previous year. The main reason for this is the valuation increase in the shareholding in Bakkavor Group Ltd.

There were significant valuation changes in the Bank's loan book during the year. Impairment was primarily recognized in connection with loans to international service companies in the oil and gas industry and loans acquired from AFL Savings Bank. Valuation increases are mostly attributable to the prepayment of loans, both by retail customers and corporate clients, following government debt relief measures and corporate restructuring.

The Bank's capital ratio at the end of 2015 was 24.2%, compared with 26.3% at the end of 2014. The decrease is mainly a consequence of a dividend payment of ISK 12.8 billion and the prepayment of a subordinated loan from the government of ISK 20 billion. Tier 1 Capital increased during the year to 23.4%, compared with 21.8% at the end of 2014.

Highlights of the income statement and key performance indicators:

### Income Statement

<i>In ISK million</i>	2015	2014	Q4 2015	Q4 2014
Net interest income	26,992	24,220	6,705	5,911
Net commission income	14,484	13,309	3,758	3,190
Net financial income	12,844	7,290	2,668	1,429
Share of profit of associates	29,466	3,498	22,510	3,525
Other income	2,769	5,673	537	1,683
<b>Operating income</b>	<b>86,555</b>	<b>53,990</b>	<b>36,178</b>	<b>15,738</b>
Salaries and related expense	(14,892)	(13,979)	(4,572)	(3,953)
Other operating expenses	(13,304)	(13,063)	(4,288)	(4,465)
Bank levy	(2,818)	(2,643)	(650)	(635)
Net impairment	(3,087)	2,135	(2,973)	(742)
<b>Net earnings before taxes</b>	<b>52,454</b>	<b>26,440</b>	<b>23,695</b>	<b>5,943</b>
Income tax	(3,135)	(4,679)	504	(223)
Net gain from disc. operations	360	6,833	83	241
<b>Net earnings</b>	<b>49,679</b>	<b>28,594</b>	<b>24,282</b>	<b>5,961</b>
<b>KPI's:</b>				
Return on equity (ROE)	28.1%	18.6%	51.6%	14.8%
Net interest margin (int. bearing assets)	3.0%	2.8%	2.9%	2.8%
Cost-to-income ratio	32.6%	50.1%	24.5%	53.5%
Tier 1 ratio	23.4%	21.8%	23.4%	21.8%



## HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK:

“The full-year financial results were excellent but strongly influenced by irregular items. The year marked a certain turning point in the operations of Arion Bank as several major debt recovery cases were brought to a conclusion, cases which the Bank has been engaged in for several years. These were the sale by Arion Bank of shares in three Icelandic companies prior to flotation on the stock market; and also the sale of stakes in two international companies. The conclusion of these cases has had a highly positive effect on the annual financial results and represented a key milestone for the Bank as all the main debt recovery cases have now been completed.

The IPOs of Reitir fasteignafélag, Eik fasteignafélag and Síminn were arranged by Arion Bank and they were the only new listings on Nasdaq Iceland in 2015. It has been Arion Bank’s strategy to encourage IPOs in Iceland and thereby give the general public the opportunity to participate in the growth of the economy via an active equity market.

Core operations continued to gain strength and the Bank consolidated its position on all its key markets. Assets under management and corporate loans have both demonstrated strong growth. Arion Bank won the tender to provide financial services at Keflavík International Airport and will open for business there this spring. This is a really exciting prospect, especially given the huge growth in tourism in Iceland. It was an unusually eventful year in many ways. The Banker, which is published by The Financial Times, named Arion Bank as the bank of the year in Iceland for 2015.

We saw excellent results from startups which have participated in Startup Reykjavik and Startup Energy Reykjavik. Access to capital has improved enormously, and the 54 companies invested in by the Bank have raised a total of ISK 1.7 billion. Two thirds of this amount is in the form of risk capital, the remainder in grants. This is, in our opinion, a positive and important development in the startup environment in Iceland.

Our main task in recent years has been to create a good bank which provides its customers with quality financial services in a responsible manner; a bank which is financially robust, prepared to cope with the lifting of the capital controls and which is an attractive investment option. We have done well in all these areas. At the beginning of the year we reached a funding agreement with Kaupthing which is in fulfilment of the government's stability conditions for lifting the capital controls. We have also sensed interest from potential investors in the impending sale of the Bank. The future will certainly be interesting.”

## CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a conference call in English on Thursday 25 February at 1:00 pm GMT, where Stefán Pétursson, Chief Financial Officer, will discuss the highlights of the Bank’s financial results. People interested in participating can contact [ir@arionbanki.is](mailto:ir@arionbanki.is) to obtain dial-in information.

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## HIGHLIGHTS OF 2015

The year was characterized by corporate recovery cases and the completion of several important cases for the Bank.

- In March the drinks manufacturer Refresco Gerber was listed on the Euronext market in Amsterdam. Arion Bank Group, through direct and indirect holdings, owned a 9% stake in the company and approximately half of this interest was sold when the company was listed. Proceeds from the sale and the valuation change in the remaining holding following the listing totalled ISK 6,306 million in the first quarter.
- In March Arion Bank became the first Icelandic bank since 2008 to undertake a euro benchmark bond issue to a broad group of investors on the international markets. The Bank issued €300 million with a term of 3-years to around 100 international investors. Demand for the bonds far outstripped supply.
- At the beginning of April the real estate company Reitir fasteignafélag hf. was listed on Nasdaq Iceland. Arion Bank arranged the listing and also sold a significant proportion of its holding in a public offering. Proceeds from the sale and the valuation change in the remaining holding amounted to ISK 4,224 million in the first half of the year.
- The real estate company Eik hf. was listed on Nasdaq Iceland at the end of April. Arion Bank arranged the listing and also sold 14% of its holding in a public offering. Capital gains amounted to approximately ISK 600 million.
- In April Arion Bank paid a dividend of ISK 12.8 billion to shareholders.
- The Bank used new funding in euros to prepay subordinated loans from the government, equivalent to ISK 20 billion. Interest on the loans had increased at the beginning of 2015 and this provided the incentive to pay off the loans ahead of schedule.
- During the year Arion Bank acquired the entire capital of AFL Savings Bank and in the autumn the savings bank was merged with Arion Bank. Arion Bank opened a new branch at Siglufjörður in northern Iceland and continued to build up its operation in the region.
- In October the telecommunications company Síminn hf. was listed on Nasdaq Iceland. Arion Bank sold 10% in the company in a private placement before the company was listed and then a further 20% in a public offering. Arion Bank arranged the listing. Proceeds from the sale and the valuation change in the remaining holding amounted to ISK 4,185 million.
- In 2015 the Bank prepared the sale of a 46% holding owned by the subsidiary BG12 slhf. in Bakkavor Group Ltd in collaboration with other shareholders in the company. The shareholding was sold at the beginning of the 2016 and the value of the stake at the end of 2015 was recognized at the sale value. The valuation change in BG12's shareholding amounted to ISK 20,845 million. Arion Bank owns 62% of BG12 slhf.
- Arion Bank continued to issue covered bonds in accordance with the Covered Bonds Act No. 11/2008. The Bank issued a total of ISK 23.6 billion in covered bonds in 2015. Market making was increased under agreements with three market makers in order to improve liquidity.
- A stronger focus on liquidity management resulted in a higher net interest margin than in 2014.
- The quality of the Bank's loan portfolio continued to improve in 2015. The ratio of problem loans, which are defined as loans which have been in default for more than 90 days and loans for which special provisions for losses have been made, decreased from 4.4% at the end of 2014 to 2.5% at the end of 2015. There was a turnaround in the valuation change in loans to customers through the income statement in 2015, compared to last year. There were substantial valuation increases in connection with the prepayment of loans by retail and corporate customers. Moreover there were considerable loan impairments, both in connection with the acquisition of the AFL loan portfolio and impairments on loans to service companies in the international oil and gas industry. Loans to these companies are less than 1% of total loans to customers and have been adequately provisioned for in the Bank's accounts.
- In mid-year the government announced its plans to lift the capital controls which have been in force since 2008. The estates of the failed banks subsequently announced their plans on stability contributions, with Arion Bank playing a key role in respect of Kaupthing ehf.'s contribution. Arion Bank prepared thoroughly for these changes in 2015. It concluded agreements with Kaupthing at the beginning of 2016 which will secure the Bank's long-term interests through funding in foreign currency for the next years.
- The Bank reached an agreement on the acquisition of a majority stake in the insurance company Vördur hf. The acquisition is contingent on the approval of the competition authorities but the transaction is expected to be completed in the next few months.



## INCOME STATEMENT

### Income Statement

<i>In ISK million</i>	2015	2014	Diff	Diff%
Net interest income	26,992	24,220	2,772	11%
Net commission income	14,484	13,309	1,175	9%
Net financial income	12,844	7,290	5,554	76%
Share of profit of associates	29,466	3,498	25,968	742%
Other income	2,769	5,673	(2,904)	-51%
<b>Operating income</b>	<b>86,555</b>	<b>53,990</b>	<b>32,565</b>	<b>60%</b>
Salaries and related expense	(14,892)	(13,979)	(913)	7%
Other operating expenses	(13,304)	(13,063)	(241)	2%
Bank Levy	(2,818)	(2,643)	(175)	7%
Net change in valuation	(3,087)	2,135	(5,222)	-
<b>Net earnings before taxes</b>	<b>52,454</b>	<b>26,440</b>	<b>26,014</b>	<b>98%</b>
Income tax	(3,135)	(4,679)	1,544	-33%
<b>Net earnings from continuing operation</b>	<b>49,319</b>	<b>21,761</b>	<b>27,558</b>	<b>127%</b>
Net gain from disc. operations	360	6,833	(6,473)	-
<b>Net earnings</b>	<b>49,679</b>	<b>28,594</b>	<b>21,085</b>	<b>74%</b>

**Operating income** increased substantially between years, up 60%. The increase is largely attributable to the ISK 26 billion increase in the share of profit of associates and the ISK 5.6 billion increase in net financial income.

*Net interest income* increased by 11% from the previous year. The net interest margin as a percentage of average interest-bearing assets was 3.0% in 2015, compared with 2.8% in 2014. The increased interest margin is largely explained by higher inflation in 2015 than 2014 and also by a sharper focus on liquidity management.

*Net commission income* increased by 9% between years, primarily as a result of higher commission income from payment cards and asset management. The Bank's focus on generating higher commission income has yielded results in most divisions. Approximately 80% of net commission income originates from corporate clients.

*Net financial income* increased by ISK 5,554 million from the previous year. The main factor here was the valuation increase in the direct and indirect 9.3% holding in the European drinks manufacturer Refresco Gerber in connection with the company's IPO at the end of March. Returns on equities were generally good during the year but bond prices remained virtually unchanged. There was a net foreign exchange loss of ISK 182 million in 2015, compared with a net gain of ISK 813 million in 2014. This offsets to a small extent the positive developments on the securities market during the year.

*Share in the profit of associates* grew significantly between years. In 2015 two companies in which the Bank had a substantial shareholding were listed on the stock market. These were Reitir fasteignafélag hf. and Síminn hf. The Bank arranged the listings and divested its holdings in the companies. In 2015 the Bank prepared the sale of a 46% holding owned by the subsidiary BG12 slhf. in Bakkavor Group Ltd in collaboration with other shareholders in the company. At the beginning of 2016 the entire shareholding was sold and the sale value reflects the substantial valuation increase in the shares at the end of the year. The sale of shareholdings in these companies and valuation changes generated net earnings of ISK 29.3 billion in 2015.

*Other operating income* decreased slightly from the previous year, which can be attributed to the sale of the real estate company Landfestar hf. from the Group in 2014.

**Operating expenses** amounted to ISK 28,196 million in 2015. The Bank's cost-to-income ratio was 32.6% in 2015, compared with 50.1% in 2014. This substantial decrease is entirely attributable to high income from valuation changes in equities and asset sales and therefore does not give a realistic picture of future operations. The cost-to-assets ratio was 2.9%, the same as the previous year.

*Salaries and related expenses* amounted to ISK 14,892 million in 2015, an increase of 7% from 2014. Full-time equivalent positions were on average 1,139 at the Group, 11 more than in 2014. Salaries on average increased by approximately 6%, which is somewhat below the year-on-year increase in the salary index.

The *bank levy* amounted to ISK 2,818 million, compared with ISK 2,643 million in 2014. The increase is related to the changes in the Bank's balance sheet.



*Net valuation change* was negative by ISK 3,087 million in 2015. There were considerable valuation increases in loans to corporates following restructuring and the repayment of loans. There was also a valuation increase in mortgages to individual borrowers following the government's debt relief package at the beginning of 2015. However, there was a significant valuation decrease in loans at AFL Savings Bank, both loans to individuals and smaller companies, following the acquisition of the savings bank and the analysis of its loan portfolio. A significant impairment on loans to international companies in the oil and gas industry was recognized following difficulties in the industry.

*Income tax* amounted to ISK 3,135 million, compared with ISK 4,679 million in 2014. Income tax, as reported in the annual financial statements, comprises 20% income tax on earnings and a special 6% financial tax which is levied on the earnings of financial institutions in excess of ISK 1 billion. The effective income tax rate was only 6% in 2015, compared with 17.7% in 2014. The unusually low effective income tax rate is mainly explained by tax exemption at corporates due to valuation changes and profit from equity positions.

Arion Bank is performing well in its **regular operations**. The year was characterized by irregular income. However, income from regular banking operations such as interest and commission, developed positively. Commission income has increased across the Bank, and the focus on liquidity management is yielding solid net interest income. In respect of regular operations Arion Bank makes adjustments for capital gains and valuation changes in acquired equity positions, the temporary bank levy, the effect of subsidiaries engaged in unrelated operations and valuation changes in loans. Taking the above factors into account, net earnings for 2015 decrease by ISK 32,893 million to ISK 16,786 million. Return on equity from regular operations was 10.4%, compared with 10.7% for 2014, which is satisfactory since equity increased significantly. The cost-to-income ratio for regular operations was 53.5% in 2015, compared with 57.3% in 2014 and the decrease is primarily due to higher operating income.

**Earnings for the fourth quarter** were heavily affected by valuation changes in shareholdings in Bakkavor Group Ltd, following the sale of shares by a subsidiary of the Bank at the beginning of the year, the valuation increase in shares in Síminn in connection with the company's IPO and the impairment of loans to international oil prospecting companies. Salary expenses rose, partly because of the increase in the number of employees at subsidiaries, while other operating expenses decreased year-on-year in the fourth quarter.

<i>In ISK million</i>	<b>Q4 2015</b>	<b>Q4 2014</b>	<b>Diff</b>	<b>Diff%</b>
Net interest income	6,705	5,911	794	13%
Net commission income	3,758	3,190	568	18%
Net financial income	2,668	1,429	1,239	87%
Share of profit of associates	22,510	3,525	18,985	539%
Other income	537	1,683	(1,146)	-68%
<b>Operating income</b>	<b>36,178</b>	<b>15,738</b>	<b>20,440</b>	<b>130%</b>
Salaries and related expense	(4,572)	(3,953)	(619)	16%
Other operating expenses	(4,288)	(4,465)	177	(4%)
Bank Levy	(650)	(635)	(15)	2%
Net change in valuation	(2,973)	(742)	(2,231)	301%
<b>Net earnings before taxes</b>	<b>23,695</b>	<b>5,943</b>	<b>17,752</b>	<b>299%</b>
Income tax	504	(223)	727	-
<b>Net earnings from continuing operation</b>	<b>24,199</b>	<b>5,720</b>	<b>18,479</b>	<b>323%</b>
Net gain from disc. operations	83	241	(158)	-66%
<b>Net earnings</b>	<b>24,282</b>	<b>5,961</b>	<b>18,321</b>	<b>307%</b>



## BALANCE SHEET

Arion Bank's **total assets** increased by 8% from the previous year. The main changes result from increases in loans to customers, financial assets and investment in associates. Loans to credit institutions decreased, however.

### Assets

<i>In ISK million</i>	<b>31.12.2015</b>	<b>31.12.2014</b>	<b>Diff%</b>
Cash & balances with CB	48,102	21,063	128%
Loans to credit institutions	87,491	108,792	(20%)
Loans to customers	680,350	647,508	5%
Financial assets	133,191	101,828	31%
Investment property	7,542	6,842	10%
Investments in associates	27,299	21,966	24%
Intangible assets	9,285	9,596	(3%)
Other assets	17,784	16,142	10%
<b>Total assets</b>	<b>1,011,043</b>	<b>933,736</b>	<b>8%</b>

*Loans to customers* totalled ISK 680,350 million at the end of 2015, a 5% increase from the previous year. Loans to corporates increased significantly during 2015, reflecting increased activity in the Icelandic economy. These new loans are chiefly in the real estate sector, transportation and tourism industries. Demand for credit has grown significantly recently on the corporate side. Loans to individuals have decreased mainly because of debt relief measures implemented by the Icelandic government at the beginning of 2015. New loans to individuals increased through 2015, both loans to buy property and loans to buy vehicles and equipment, an area which has seen a strong upturn in recent years.

Several indicators are used to assess the quality of the Bank's loan portfolio. The two main indicators are the ratio of problem loans, which the Bank defines as the ratio of the book value of loans 90 days or more in default and loans for which special impairment is required from the Bank's total loans to customers. The ratio of problem loans was 2.5% at the end of 2015, compared with 4.4% at the end of 2014. The Bank also looks to the proportion of its loans which have been impaired. This ratio was 4.9% at the end of 2015, compared with 7.0% at the end of 2014.

*Financial assets* amounted to ISK 133,191 million at the end of 2015, an increase of approximately 31%. The change during the year is due to an increase in bonds, which is a result of a sharper focus on liquidity management, and also to an increase in equities, which increased following the listing and divestment of companies which were previously categorized as associates in the accounts. The Bank now has reduced holdings in these companies and categorizes the asset as financial assets.

*Shareholdings in associates* increased by 24%, despite the fact that significant holdings in Reitir fasteignafélag hf. and Síminn hf. were sold during 2015. The ISK 20.8 billion valuation change in the shareholding in Bakkavor Group Ltd before it was sold in January 2016 resulted in a significant increase in the position.

**Liabilities** increased slightly between years, which is primarily a result of new borrowing. **Equity and minority interest** increased significantly, primarily due to strong financial results.

### Liabilities and equity

<i>In ISK million</i>	<b>31.12.2015</b>	<b>31.12.2014</b>	<b>Diff%</b>
Due to credit institutions & CB	11,387	22,876	(50%)
Deposits from customers	469,347	454,973	3%
Financial liabilities at fair value	7,609	9,143	(17%)
Other liabilities	54,383	52,313	4%
Borrowings	256,058	200,580	28%
Subordinated loans	10,365	31,639	(67%)
Shareholders equity	192,786	160,711	20%
Non-controlling interest	9,108	1,501	507%
<b>Total liabilities and equity</b>	<b>1,011,043</b>	<b>933,736</b>	<b>8%</b>



*Borrowings* amounted to ISK 256,058 million at the end of 2015, an increase of 28% from 2014. Arion Bank continued to issue covered bonds which are secured in accordance with the Covered Bond Act No. 11/2008. The Bank issued a total of ISK 23.6 billion in covered bonds in 2015. During the year the Bank also issued unsecured euro-denominated bonds totalling €300 million. The bonds are 3-year instruments and were sold to around 100 international investors. The issue represented the first bond issue by an Icelandic bank in euros to a broad range of investors and the largest single bond issue since 2008, and it marked a major step towards opening up the international bond and credit markets for Icelandic banks. The Bank also issued 5-year bonds in Norwegian kroner, NOK 800 million in two tranches. Investors in these bonds came from Scandinavia and continental Europe. This issue was used to repay a more expensively priced issue in Norwegian kroner from 2013. The Bank has now bought back two thirds of this issue which matures in March 2016.

*Subordinated loans* totalled ISK 10,365 million at the end of 2015, a decrease of 67% from the previous year. This change is a result of a loan prepayment of ISK 20 billion, whereby the proceeds of a new bond issue were partly used to pay off subordinated loans to the Icelandic government. The interest on subordinated loans increased at the beginning of 2015 in accordance with the terms of the loan from LIBOR + 4% to LIBOR + 5%. This provided an even greater incentive to pay off the loan and the Bank will seek to complete repayment of the loan as conditions allow.

*Shareholders' equity* amounted to ISK 192,786 million at the end of 2015, compared with ISK 160,711 million at the end of 2014. The increase is mainly explained by the financial results for the period and is partly offset by a dividend payment in April amounting to ISK 12.8 billion. The Tier 1 ratio was 23.4% at the end of 2015, compared with 21.8% at the end of 2014.



## KEY PERFORMANCE INDICATORS

	<b>2015</b>	<b>2014</b>
Return on equity (ROE)	28.1%	18.6%
Return on total assets (ROA)	5.0%	3.0%
Net interest margin (int. bearing assets)	3.0%	2.8%
Net interest margin (total assets)	2.7%	2.6%
Cost-to-income ratio	32.6%	50.1%
Cost-to-Total assets ratio	2.9%	2.9%
Effective tax rate	5.7%	16.1%
CAD ratio	24.2%	26.3%
Tier 1 ratio	23.4%	21.8%
Problem loans	2.5%	4.4%
RWA/Total assets	79.9%	74.5%
Loans to deposit ratio	145.0%	142.3%
The Group's average number of employees	1,139	1,128
The Group's employees at the end of the period	1,147	1,120
The Parent's average number of employees	885	890
The Parent's employees at the end of the period	876	865

## FINANCIAL CALENDAR FOR 2016

The Annual General Meeting will be held 17 March 2016

The Bank's interim financial statements are scheduled for publication as stated below.

First quarter 2016	11 May 2016
Second quarter 2016	31 August 2016
Third quarter 2016	16 November 2016

This calendar may be subject to change.