

NEWSLETTER

Financial Institutions - September 2014

SOLID RESULTS FOR THE FIRST SIX MONTHS

Arion Bank reported net earnings of ISK 17.4 billion for the first six months of 2014, compared with ISK 5.9 billion for the same period in 2013. Return on equity was 23.4%, compared with 8.9% in the same period of 2013. Arion Bank continues to strengthen its position. The Bank's tier 1 ratio is exceptionally strong at 21.1%, the cost-to-income ratio is modest at 50.5% and asset quality continues to improve with problem loans now representing 5.4% of loans to customers. The Bank has a well-balanced business model with half of its lending to retail customers and the other half spread across various industry sectors. The Icelandic economy continues to show signs of strength with GDP growth forecast at more than 3%, falling inflation (current 2.2% YOY) and decreasing unemployment (3.3%).

In the earnings release Höskuldur H. Ólafsson, CEO of Arion Bank, said that the Bank's financial results were excellent. "Core operations remain stable and the Bank continues to build on its financial strength. We have made a focused effort to increase the contribution of commission to overall income and we are pleased to see results in this respect in the latest figures. The Bank's sale of the majority of its shareholding in HB Grandi hf. had a positive impact on the financial results."

The cost-to-income ratio was 50.5%, compared with 62.4% in the same period of 2013.

INCOME STATEMENT

Million ISK	H1 2014	H1 2013	Diff	Diff%
Net interest income	11,966	12,667	(701)	(6%)
Net commission income	6,593	5,298	1,295	24%
Net financial income	3,867	296	3,571	1,207%
Other income	3,274	2,425	849	35%
Operating income	25,700	20,686	5,014	24%
Salaries and related expenses	(7,164)	(6,679)	(485)	7%
Other operating expenses	(5,811)	(6,228)	417	(7%)
Net impairment	2,001	134	1,867	1,394%
Net earnings before taxes	14,726	7,913	6,813	86%
Income tax	(2,467)	(1,749)	(718)	41%
Bank levy	(1,375)	(188)	(1,187)	631%
Net gain from discontinued operations, net of tax	6,525	(65)	6,590	
Net earnings	17,409	5,911	11,498	195%
Shareholders of Arion Bank	17,263	6,137	11,126	181%
Minority interest	146	(226)	372	(165%)

Stable balance sheet

The Bank had total assets of ISK 949.0 billion at the end of the period, compared with ISK 938.9 billion at the end of 2013. Differences in individual asset classes during the period were mainly due to changes in the Bank's liquidity management, which resulted in lower deposits at the Central Bank of Iceland, higher loans and receivables at credit institutions and increased securities holdings.

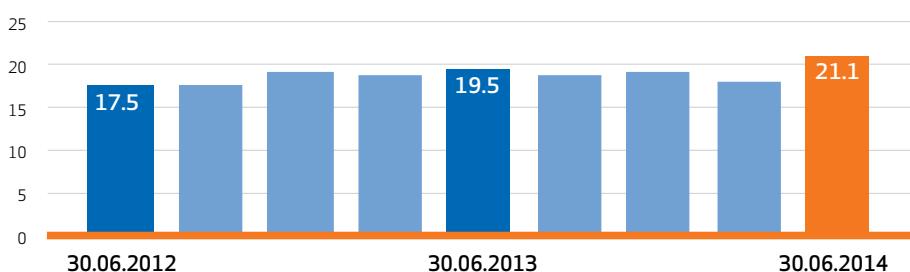
Total equity amounted to ISK 154.5 billion, compared with ISK 144.9 billion at the end of 2013. The Bank paid a dividend of ISK 7.8 billion to its shareholders during the period.

Strong financial position

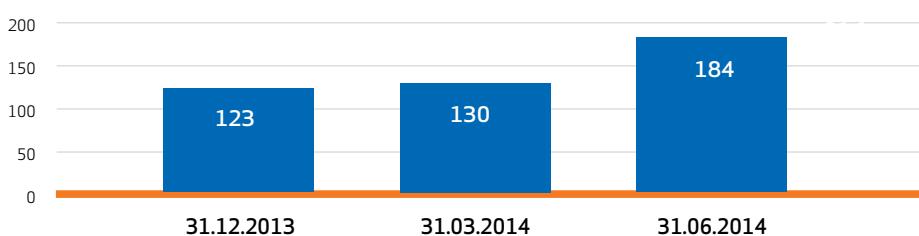
Arion Bank's strong results have reinforced the Bank's capital ratio, which now stands at 25.6%, comfortably above the requirements made of the Bank. The Bank's tier 1 ratio stands at 21.1%.

All main financial indicators are developing as expected. In addition to its very strong capital ratio the Bank's LCR now stands at 184%.

Tier 1 ratio (%)



Liquidity coverage ratio (LCR) (%)



Problem loans – good progress

Excellent progress has been made in dealing with loans over 90 days in default, which at the end of the period stood at 3.1%. Including other problem loans, total problem loans now amount to 5.4%. The focus on problem loans continues and the objective is to reduce the figure to well below 5% at the end of 2014. Problem loans as a percentage of equity are now starting to resemble levels reported by other Nordic banks.

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A MARKET LEADER IN EQUITY TRADING

Investment banking activities have picked up substantially in Iceland in recent years as a result of greater economic activity. Our Investment Banking division enjoys a very strong reputation and is one of the strongest teams in Iceland in brokerage, private placements, IPOs and listings on NASDAQ OMX Iceland. At the end of 2011 Arion Bank supervised the first new listing since 2008 and has since led the way in the all-important reconstruction of the Icelandic stock market.

In early 2014 Arion Bank managed the IPO and listing of the first Icelandic fishing company to be listed on NASDAQ OMX for several years, HB Grandi hf. Arion Bank was one of the major shareholders in the company before the listing.

The listing represented yet another milestone in the regeneration of the Icelandic stock market. Arion Bank's Investment Banking team has in recent years supervised 40% of new listings on NASDAQ OMX Iceland. Arion Bank is now the market leader in equity trading and one of the leaders in bond trading. Arion Bank's market share in the twelve months from Q2 2013 to Q1 2014 measured by the volume of shares sold and admitted to trading on NASDAQ OMX Iceland is more than 60%.

INCREASED ACTIVITY



Two major investment projects involving Arion Bank were announced this summer. They concern the companies United Silicon and Silicor Materials and represent the first major investment projects in Iceland for six years, with the exception of the construction of the Alvogen research facility in the centre of Reykjavík, which Arion Bank was also involved in. The United Silicon project is in the execution phase while Silicor Materials is still in the development phase.

In recent years the Icelandic economy has been held back by a lack of investment and limited diversity so these projects herald an important step in the right direction. Close collaboration between Arion Bank's Corporate Banking and Investment Banking divisions was key to the Bank's involvement which includes both advisory services and funding.

Another fruitful project in which Arion Bank participated during the early part of summer was a funding agreement with a major Norwegian shipping company. This project underlines our determination, now and in the future, to seek good investment opportunities overseas in those areas of business in which we possess great expertise.

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ARION APP HAS BEEN A BIG HIT



Arion Bank released the first edition of its banking app in 2011, the first Icelandic bank to do so. Since then the Bank has continued to be at the forefront of innovation in apps for smartphones. The Arion Bank app is hugely popular amongst our customers who can now do things such as check the balance on their accounts, make transfers and pay their bills with the app. Approximately 40% of our customers are now active users of the app – up by 33% in 2014.

Contacts

ECONOMIC UPDATE

Each month the Arion Research sends out an economic update with the latest economic developments in Iceland. To subscribe to mailing list or to read the latest economic updates please visit [our website](#).

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