

Press release, 26 August 2015

## ARION BANK'S H1 2015 FINANCIAL RESULTS

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Arion Bank reported net earnings of ISK 19.3 billion for the first six months of 2015, compared with ISK 17.4 billion for the same period of 2014. Arion Bank's net earnings for the first half of 2015 were significantly affected by irregular items, as in the first half of 2014. The main factors were one-off events such as the Bank's sale of shares in the real estate company Reitir and the international drinks manufacturer Refresco Gerber and the subsequent stock market listing of these companies. Return on equity was 22.8%, compared with 23.4% in the same period of 2014. Net earnings from regular operations amounted to ISK 8.7 billion for the first six months of 2015, compared with ISK 6.0 billion for the same period last year. Return on equity from regular operations was 10.8%, compared with 8.1% for the first half of 2014. Total assets amounted to ISK 974.8 billion, compared with ISK 933.7 billion at the end of 2014.

The Bank's capital ratio at the end of the period was 23.2%, compared with 26.3% at the end of 2014. The decrease is mainly related to a dividend payment of ISK 12.8 billion and the prepayment of a subordinated loan of ISK 20 billion during the period. Tier 1 was 21.8%, the same as at the end of 2014.

### Highlights of the Interim Financial Statements

- Net earnings of ISK 19.3 billion, compared with ISK 17.4 billion during the same period of 2014.
- Net earnings from regular operations amounted to ISK 8.7 billion, compared with ISK 6.0 billion for the same period last year.
- The capital ratio was 23.2% at the end of the period, compared with 26.3% at the end of 2014.
- Return on equity was 22.8%, compared with 23.4% in the same period of 2014. Return on equity from regular operations was 10.8% during the first six months of 2015, compared with 8.1% during the same period last year.
- Net interest income of ISK 13.2 billion, compared with ISK 12.2 billion during the same period of 2014.
- Net commission income of ISK 7.4 billion, compared with ISK 6.6 billion during the same period of 2014.
- Operating income increased between years and amounted to ISK 36.1 billion, compared with ISK 25.7 billion during the same period of 2014. This sharp increase is related to the profit from the sale and valuation change of shareholdings in the real estate company Reitir fasteignafélag hf. and in Refresco Gerber in connection with the listing of the companies.
- Net valuation change during the period was negative, amounting to ISK 0.1 billion, compared with a positive valuation change of ISK 2.0 billion during the same period of 2014. Net valuation change was negatively affected during the period by an additional impairment of the loan portfolio of the subsidiary AFL – sparisjóður amounting to ISK 1.7 billion. Net valuation change of other loans in the Group was positive by a similar amount.
- Income tax amounted to ISK 2.4 billion, compared with ISK 2.5 billion during the same period of 2014.
- The cost-to-income ratio was 36.5%, compared with 50.5% in the same period of 2014. The cost-to-income ratio for regular operations was 50.3%, compared with 60.2% during the same period of 2014.
- Total equity amounted to ISK 168.4 billion, compared with ISK 162.2 billion at the end of 2014.



Höskuldur H. Ólafsson, CEO of Arion Bank:

"Arion Bank's financial results for the first six months of the year were good. One-off events from the first quarter, when the Bank sold holdings in Reitir and the international soft drinks manufacturer Refresco Gerber and the companies were subsequently listed, continue to have a positive effect on the results. The strong results in the second quarter were primarily driven by the Bank's regular operations. The Bank's operations continue to gain strength and commission income, chiefly from the corporate sector, grew 13% between years. We are also seeing the effects of the improved economic situation and greater economic activity reflected in the growth in corporate loans, particularly to property developers, the transportation and tourism industries, and the fishing sector, which is very positive.

Standard & Poor's recently raised Arion Bank's credit rating and the Bank is now in an investment grade which further improves access to the international funding markets. This followed the upgrade by Standard & Poor's of the Icelandic sovereign rating after the government announced its plans to lift the capital controls. The agreement made by the authorities and the creditors will result in changes to Arion Bank's financial position, but it has long been clear that we are well positioned to deal with changes resulting from the lifting of the capital controls.

Since Arion Bank gained control of AFL – sparisjóður, it has come as a surprise to see what a serious situation the savings bank finds itself in. Independent advisors were brought in to evaluate a major segment of its loan portfolio and it has proven necessary to make additional impairments of ISK 1.7 billion in the first half of the year. However, other valuation changes in the Group's loans are positive by a similar amount and the combined effect of valuation changes has a limited effect on the financial results."

### **Conference call in English**

Arion Bank will be hosting a conference call in English on Thursday 27 August at 14:00 BST (15:00 CET), where Stefán Pétursson CFO, will present the 2015 first half results. Those who would like to participate in the conference call can send an e-mail to [ir@arionbanki.is](mailto:ir@arionbanki.is) and will then receive instructions with dial in details.

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## Income statement – highlights

Income statement					
In ISK million	H1 2015	H1 2014	Diff	Diff%	
Net interest income	13,175	11,966	1,209	10%	
Net commission income	7,434	6,593	841	13%	
Net financial income	9,102	3,714	5,388	145%	
Net foreign exchange gain	621	153	468	306%	
Other income	5,740	3,274	2,466	75%	
<b>Operating income</b>	<b>36,072</b>	<b>25,700</b>	<b>10,372</b>	<b>40%</b>	
Salaries and related expense	(7,167)	(7,164)	(3)	0%	
Other operating expenses	(6,004)	(5,811)	(193)	3%	
Bank levy	(1,389)	(1,375)	(14)	1%	
Net change in valuation	(81)	2,001	(2,082)	-	
<b>Net earnings before taxes</b>	<b>21,431</b>	<b>13,351</b>	<b>8,080</b>	<b>61%</b>	
Income tax	(2,367)	(2,467)	100	(4%)	
<b>Net earnings from continuing operation</b>	<b>19,064</b>	<b>10,884</b>	<b>8,180</b>	<b>75%</b>	
Net gain from disc. operations	262	6,525	(6,263)	-	
<b>Net earnings</b>	<b>19,326</b>	<b>17,409</b>	<b>1,917</b>	<b>11%</b>	

### Operating income

*Operating income* increased significantly between years, up ISK 10,372 million. Operating income amounted to ISK 36,072 million during the first six months of 2015. This rise is primarily due to an increase of ISK 5,388 million in net financial income and an increase of ISK 2,466 million in other income.

*Net interest income* amounted to ISK 13,175 million, an increase of 10% from 2014. The net interest margin as a percentage of average interest-bearing assets was 3.0% during the period, compared with 2.8% during the first six months of 2014. Increased interest margin is the result of higher inflation in the first half of 2015, compared with the same period in 2014, as well as lower funding costs due to more effective liquidity management.

*Net commission income* increased by 13% between years to ISK 7,434 million during the first half of 2015. The increase is largely due to higher commission income from cards and higher income generated by Investment Banking. More than 80% of the Group's Net commission income is from corporates.

*Net financial income* increased sharply between years, or by ISK 5,388 million, and amounted to ISK 9,102 million during the period. The main increase is due to a valuation change of the direct and indirect 9.3% shareholding in the European bottler and soft drinks manufacturer Refresco Gerber in connection with the company's stock market listing at the end of March. In general, the return on equities was good during the period, while the return on bonds was weaker.

*Net foreign exchange rate gain* amounted to ISK 621 million, compared with ISK 153 million in the first half of 2014. The Bank's net foreign exchange imbalance was ISK 6.3 billion at the end of the period, meaning that volatility in the exchange rate has some impact on operating income. The net foreign exchange imbalance was ISK 18.9 billion at the end of 2014. A concerted effort has been made to reduce this imbalance over the last few years. The foreign exchange balance of the parent company is well within the 15% limit stipulated by the Central Bank of Iceland.

*Other operating income* amounted to ISK 5,740 million, which is a significant increase from 2014. The main types of income included in other operating income are share of profit and valuation changes of associates, valuation changes and profits from the sale of commercial property and building sites owned by Landey ehf., and income from insurance premiums at OKKAR Life Insurance hf. The increase



over last year, ISK 4,297 million, is primarily a result of valuation changes and profit of the associated company Reitir fasteignafélag hf. in connection with the sale and listing of the company on NASDAQ Iceland. Arion Bank's shareholding in Reitir fasteignafélag hf. was 25.3% at the beginning of the year.

### **Operating expenses and bank levy**

Operating expenses amounted to ISK 14,641 million. The cost-to-income ratio decreased to 36.5% from 50.5% during the same period in 2014. The decrease in the cost-to-income ratio is due to the major increase in operating income from valuation change and earnings from sale of assets and will not fully reflect the trend in the future. The cost-to-assets ratio was 2.7%, compared with 2.8% for the first half of 2014.

*Salaries and related expenses* amounted to ISK 7,167 million for the first half of 2015, the same as for the first half of 2014. Full-time equivalent positions were on average 1,118 at the Group during the period, compared with 1,133 in the same period of 2014. Salaries per employee have increased from the same period last year, which is partly explained by increased activities in the international operations of Valitor.

*The bank levy* amounted to ISK 1,389 million, compared with ISK 1,375 million in the same period of 2014. The increase is related to the changes in the Bank's balance sheet.

### **Net valuation change**

*Net valuation change* was negative during the first half of 2015, amounting to ISK 81 million, and is broadly divided into three types. Firstly, net valuation increases on loans to corporates totalled ISK 2,543 million. Secondly, net loan impairment on loans to individuals amounted to ISK 1,299 million. And thirdly the net change in collective impairment amounted to ISK 1,300 million. The net valuation change was negatively affected during the period by an impairment of the loan portfolio of AFL - sparisjóður, a subsidiary of the Bank for which the Bank acts as a controlling party following approval by the Icelandic authorities in April. The loan portfolio of AFL - sparisjóður was subsequently revalued by external parties. Additional impairment by AFL - sparisjóður for the period amounts to ISK 1,749 million. Net valuation change of other loans in the Group was positive by ISK 1,668 million during the first half of 2015 which bears witness to the successful restructuring of the loan portfolio.

### **Taxes**

*Income tax* amounted to ISK 2,367 million, compared with ISK 2,467 million in the first half of 2014. Income tax, as reported in the interim 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 11.0% during the period, compared with 18.5% in the same period of 2014. The low effective income tax rate is mainly explained by tax exempt revenue due to valuation changes and profit from equity positions.

### **Regular operations**

A large proportion of net earnings during the first quarter of 2015 is related to assets that are not defined as core assets of the Bank. Those assets are in particular shares in non-banking related corporates which have been acquired through the settlements of loans. The Bank has subsequently helped these companies to restructure their operations, worked on selling them and in some cases arranged their listing on the stock market. In respect of regular operations Arion Bank makes adjustments for the temporary bank levy, the effect of subsidiaries engaged in unrelated operations and valuation changes on loans.

Excluding non-core operations net earnings for the period decreased by ISK 10,637 million and amounted to ISK 8,689 million. Return on equity from regular operations in the first half of 2015 was 10.8%, compared with 8.1% for the same period of 2014. The cost-to-income ratio for regular operations was 50.3% during the first half of 2015, compared with 60.2% for the same period of 2014.



## Second quarter of 2015

The financial results for the second quarter of 2014 were very good. In 2014 the financial results for the second quarter were also excellent, with the sale and listing of shares in HB Grandi hf. having a significant impact, which makes any comparison between the periods difficult. Return on equity was 10.2%, compared with 38.5% in the same period of 2014.

Income statement				
In ISK million	Q2 2015	Q2 2014	Diff	Diff%
Net interest income	7,392	6,483	909	14%
Net commission income	3,677	3,445	232	7%
Net financial income	1,870	3,810	(1,940)	(51%)
Net foreign exchange gain	314	629	(315)	(50%)
Other income	1,038	2,356	(1,318)	(56%)
<b>Operating income</b>	<b>14,291</b>	<b>16,723</b>	<b>(2,432)</b>	<b>(15%)</b>
Salaries and related expense	(3,675)	(3,714)	39	(1%)
Other operating expenses	(3,108)	(3,064)	(44)	1%
Bank Levy	(659)	(715)	56	(8%)
Net change in valuation	(1,863)	34	(1,897)	-
<b>Net earnings before taxes</b>	<b>4,986</b>	<b>9,264</b>	<b>(4,278)</b>	<b>(46%)</b>
Income tax	(647)	(1,152)	505	(44%)
<b>Net earnings from continuing operation</b>	<b>4,339</b>	<b>8,112</b>	<b>(3,773)</b>	<b>(47%)</b>
Net gain from disc. operations	79	6,433	(6,354)	(99%)
<b>Net earnings</b>	<b>4,418</b>	<b>14,545</b>	<b>(10,127)</b>	<b>(70%)</b>

*Operating income* in the second quarter decreased between years, down 15%. Net interest income and net commission income increased while net financial income decreased. Net financial income in 2014 was very high due to the listing of HB Grandi hf. Other operating income decreased as the real estate company Landfestar ehf. was sold at the end of June 2014.

*Operating expenses* were almost the same in the second quarter of 2015 and 2014. Efforts to reduce expenses are positively affecting the financial results.

*Net income from discontinued activities* was minimal during the quarter and was almost entirely related to the Bank's sale of real estates. In 2014 the sale of 18.8% shareholding in HB Grandi hf. resulted in significant gains.



## Balance sheet – highlights

Assets		30.06.2015	31.12.2014	Diff%	30.06.2014	Diff%
In ISK million						
Cash & balances with CB		33,189	21,063	58%	17,361	91%
Loans to credit institutions		103,815	108,792	(5%)	139,838	(26%)
Loans to customers		667,129	647,508	3%	637,085	5%
Financial assets		111,419	101,828	9%	99,271	12%
Investment property		7,851	6,842	15%	6,020	30%
Investments in associates		13,987	21,966	(36%)	25,128	(44%)
Intangible assets		9,353	9,596	(3%)	5,374	74%
Non-current assets & disposal Groups HFS		3,752	3,958	(5%)	4,329	(13%)
Other assets		24,316	12,183	100%	14,588	67%
<b>Total assets</b>		<b>974,811</b>	<b>933,736</b>	<b>4%</b>	<b>948,994</b>	<b>3%</b>

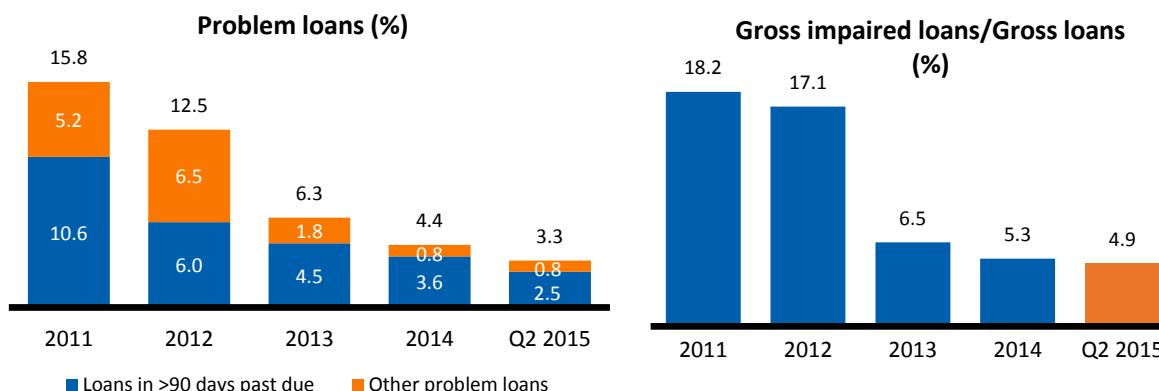
Arion Bank's *total assets* amounted to ISK 974.8 billion at the end of the period. Changes to individual asset classes from year end are mainly related to increases in loans and new funding during the period. Financial assets increased during the period mainly due to the transfer of the shareholding in the real estate company Reitir fasteignafélag hf. following the sale of the Bank's holding in the company when it was listed on the stock market.

### Loans to customers

*Loans to customers* amounted to ISK 667,129 million at the end of the period and had increased by ISK 19,621 million since the end of 2014. There was a significant increase in loans to corporates during the first half of 2015, in line with increased activity in the Icelandic economy. These new loans are particularly in the real estate sector, transportation, tourism and the fishing industry.

Loans to individuals have increased significantly since 2010, especially with the Bank's acquisition of Arion Bank Mortgage Institutional Investor Fund at the end of 2011 and when the Bank took over retail loans from SPRON at the end of 2013. During the first quarter of 2015 loans to individuals decreased mainly because of debt relief measures implemented by the Icelandic government. Loans to individuals comprise 47% of the loan portfolio.

The quality of Arion Bank's loan portfolio has steadily improved in recent years. The Bank looks at a number of indicators in this respect, in particular the ratio of problem loans, which the Bank defines as the ratio of the book value of loans over 90 days or more in default and loans for which special provisions for losses are required. The Bank also monitors the ratio of impaired loans to total loans. The graph shows changes in these indicators in recent years and the changes clearly demonstrate how successful efforts to improve the quality of the Bank's loan portfolio have been.





## Securities

*Securities holdings* amounted to ISK 111,419 million at the end of the period, compared with ISK 101,828 million at the end of 2014.

Securities					
In ISK million	30.06.2015	31.12.2014	Diff%	30.06.2014	Diff%
Bonds	68,878	66,465	4%	66,227	4%
Shares and instruments w. variable income	28,257	25,233	12%	24,000	18%
Derivatives	1,842	1,026	80%	1,298	42%
Securities used for hedging	12,442	9,104	37%	7,746	61%
<b>Securities total</b>	<b>111,419</b>	<b>101,828</b>	<b>9%</b>	<b>99,271</b>	<b>12%</b>

The increase in shares is mainly due to the transfer of the Bank's shareholding in Reitir fasteignafélag hf. from investments in associated companies to shares.

## Liabilities and equity

Liabilities and equity					
In ISK million	30.06.2015	31.12.2014	Diff%	30.06.2014	Diff%
Due to credit institutions & CB	13,961	22,876	(39%)	29,277	(52%)
Deposits from customers	472,304	454,973	4%	474,229	(0%)
Financial liabilities at fair value	4,145	9,143	(55%)	7,646	(46%)
Other liabilities	63,192	52,313	21%	52,228	21%
Borrowings	241,880	200,580	21%	199,882	21%
Subordinated loans	10,884	31,639	(66%)	31,189	(65%)
Equity	166,969	160,711	4%	149,630	12%
Non-controlling interest	1,476	1,501	(2%)	4,913	(70%)
<b>Total liabilities and equity</b>	<b>974,811</b>	<b>933,736</b>	<b>4%</b>	<b>948,994</b>	<b>3%</b>

*Total liabilities* amounted to ISK 806,366 million at the end of the period, compared with ISK 771,524 million at the end of 2014.

## Borrowings

Borrowings amounted to ISK 241,880 million at the end of the period. At the end of June Arion Bank completed a bond issue in Norwegian kroner, when it issued NOK 500 million (approximately ISK 8 billion) of 5-year instruments. The bonds bear floating NIBOR +2.95% interest. Arion Bank simultaneously entered a swap agreement, whereby part of the interest and principal are in euros. Interest in euros is floating EURIBOR +2.74%. The issue was oversubscribed and sold to investors in the Nordics and continental Europe. At the same time, Arion Bank bought back NOK 260 million of bonds from a 2013 issue and has now bought back NOK 319 million of a NOK 500 million issue.

In March Arion Bank launched its inaugural euro senior unsecured benchmark transaction, when the Bank sold EUR 300 million, approximately ISK 45 billion, 3-year fixed rate bonds to around 100 international investors. The Bank's inaugural bond is the first EUR public transaction and the single largest transaction, and the most important step taken by an Icelandic bank to re-enter the international capital markets since 2008.

## Subordinated loans

*Subordinated loans* amounted to ISK 10,884 million at the end of the period. Changes since the end of 2014 are mainly related to payments amounting to approximately ISK 20 billion, where part of the newly issued bond was used to partly settle the subordinated loan with the Icelandic government. The margin of the subordinated loans increased at the beginning of the year, from 4% to 5% on LIBOR,



increasing the stimulus to prepay the loan. The Bank aims to pay the remaining loans before the end of the year if conditions are favorable.

### Shareholders' equity

*Shareholders' equity* amounted to ISK 166,969 million at the end of June 2015, compared with ISK 160,711 million at the end of 2014. The increase is explained by the financial results for the period which is partly off-set by a dividend payment in April amounting to ISK 12.8 billion. The Tier 1 ratio was 21.8% at the end of the period, the same as at the end of 2014.

The CAD ratio according to the FME's rules was 23.2% at the end of the period, compared with 26.3% at the end of 2014. The reduction is mainly due to the ISK 20 billion payment of the subordinated loan from the Icelandic government and the dividend payment to the shareholders of Arion Bank in April. Net earnings for the period increase the ratio partly against this reduction.

Key performance indicators			
	H1 2015	2014	H1 2014
Return on equity (ROE)	22.8%	18.6%	23.4%
Return on total assets (ROA)	4.0%	3.0%	3.7%
Net interest margin (int. bearing assets)	3.0%	2.8%	2.8%
Net interest margin (total assets)	2.7%	2.6%	2.5%
Cost-to-income ratio	36.5%	50.1%	50.5%
Cost-to-Total assets ratio	2.7%	2.9%	2.8%
Effective tax rate	11.0%	16.1%	18.5%
CAD-ratio	23.3%	26.3%	25.6%
Tier 1 ratio	21.8%	21.8%	21.1%
Problem loans	3.3%	4.4%	5.4%
RWA/Total assets	74.5%	74.5%	73.9%
Loans to deposit ratio	141.2%	142.3%	134.3%
The Group's average number of employees	1,118	1,128	1,133
The Group's employees at the end of the period	1,123	1,120	1,118
The Parent's average number of employees	850	890	900
The Parent's employees at the end of the period	840	865	887

### Financial calendar

The Bank's financial statements are scheduled for publication on the dates stated below.

Third quarter 2015	11 November 2015
Annual financial results 2015	24 February 2016
Annual general meeting 2015	16 March 2016

This calendar may be subject to change.