Arion Bank

Earnings Press Release, 27 July 2022

Arion Bank's Q2 2022 financial results

- Arion Bank reports net earnings of ISK 9,712m in Q2 2022, compared with ISK 7,816m in Q2 2021
- The sale of Valitor is fully accounted for in the second quarter results. The total consideration was ISK 14.6bn (USD 112.5m), resulting in a net gain of ISK 5.6bn
- Return on equity in Q2 was 21.8%, compared with 16.3% in Q2 2021
- Earnings per share in ISK of 6.47 in Q2, compared with 4.89 in Q2 2021
- Net interest margin of 3.1%, compared with 2.9% in Q2 2021
- Core income increased by 23.5%, compared with Q2 2021
- Cost-to-income ratio in Q2 was 50.1%, compared with 42.5% in Q2 2021
- The Bank's total capital ratio was 23.5% and the CET1 ratio was 19.7% on 30 June 2022, including full effect of Valitor sale

Arion Bank reported net earnings of ISK 9,712m in the second quarter and 21.8% return on equity.

Total assets amounted to ISK 1,383bn at the end of the period, compared with ISK 1,314bn at the end of 2021. Loans to customers increased by 7.9% from year-end 2021. The increase is primarily in corporate lending, or an 12.5% increase from year-end 2021. Total equity amounted to ISK 183bn at period end. Total equity decreased from year-end due to a capital release of ISK 26.8bn which was partly offset by net earnings for the period.

The Bank's total capital adequacy ratio was 23.5%, and the CET1 ratio was 19.7% at the end of June, including the full effect of the Valitor sale. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 23.1% and the CET1 ratio was 19.4%. These ratios comfortably exceed the requirements made by the Financial Supervisory Authority of the Central Bank of Iceland (FSA) and Icelandic law.

Benedikt Gíslason, CEO of Arion Bank

"Arion Bank has performed well in the first half of 2022, with the continued positive trajectory of the Bank's core activities, and the completion of the sale of our subsidiary Valitor during the period, being key factors. The Bank's core income grew by almost 24% from Q2 2021, with the main increase being in interest income. It was also an excellent quarter in terms of commission income, which reached record levels for a single quarter on the back of strong performances by corporate finance and asset management. However, challenging conditions on the financial markets have negatively impacted the Bank's financial income. The Bank's capital and liquidity positions remain robust, and the Bank's new buyback program is awaiting regulatory approval.

A key milestone was reached on 1 July when Rapyd completed the acquisition of Valitor. The deal was in fact negotiated a year ago, and it has therefore taken longer than expected to complete the transaction. The approval of the Icelandic Competition Authority on 23 May, followed by the green light from the Financial Authority of the Central Bank of Iceland on 30 June meant that all conditions for the agreement had been met. The sale of Valitor simplifies the group structure at Arion Bank and refines our focus. However, our business continues to be built on diverse and solid foundations, as the Bank and our subsidiaries, Vörður and Stefnir, offer a comprehensive range of financial services. Such diversity is good for our customers, enabling them to obtain all the financial and insurance-related services they need, while also reducing volatility in the Bank's financial results. Our role is to support our customers and help them achieve success in the tasks they undertake, and a modern and diverse service offering plays a critical part in this respect. It will be interesting to follow the journey awaiting Valitor, which is now part of the international fintech company Rapyd. I wish the company and its employees every success in their future endeavours.

Moody's recently rated Arion Bank for the first time, and we are delighted with the results: A3 long-term bank deposit rating and Baa1 long-term issuer rating. Moody's noted that the Bank had good profitability, founded on a broad revenue base from asset management, corporate finance and insurance, in addition to traditional banking services. Moody's also listed the Bank's robust capitalization, the low level of problem loans, and liquidity management as some of the Bank's strengths. The Moody's rating also has a positive outlook. Furthermore, S&P has affirmed Arion Bank's long and short-term ratings with a stable outlook.

An integral part of our business is to have a positive impact on society and the environment. We therefore place great importance on operating sustainably and responsibly. Recently Arion Bank received the results of an ESG rating by the international ESG ratings company Sustainalytics. The rating shows that Arion Bank is among the top ranking European and global banks in this area and that there is considered to be low risk of ESG factors having a material financial impact at the Bank. It indicates that we have made significant achievements in terms of sustainability, and we are determined to go even further.

In recent quarters the Bank has significantly increased its share in the vehicle financing market, with a strong emphasis on competitive rates and outstanding service. We have long offered digital vehicle loans, and anyone can apply for a car loan online at any time of the day. The whole process, from submitting an application to having the loan paid out, is now 100% digital so that our customers can arrange a loan in just a few minutes, making our services more accessible and convenient for customers than ever before."

Income Statement

In ISK millions	Q2 2022	Q2 2021	Δ	Δ %	H1 2022	H1 2021	Δ	Δ %
Net interest income	9,804	8,016	1,788	22%	19,332	15,358	3,974	26%
Net commission income	4,539	3,562	977	27%	8,091	6,839	1,252	18%
Net insurance income	1,086	914	172	19%	1,091	1,585	(494)	(31%)
Net financial income	(2,911)	2,203	(5,114)	-	(1,920)	3,703	(5,623)	(152%)
Other operating income	742	309	433	140%	1,180	616	564	92%
Operating income	**13,260**	**15,004**	**(1,744)**	**(12%)**	**27,774**	**28,101**	**(327)**	**(1%)**
Salaries and related expenses	(3,843)	(3,575)	(268)	7%	(7,383)	(6,846)	(537)	8%
Other operating expenses	(2,806)	(2,797)	(9)	0%	(5,467)	(5,574)	107	(2%)
Operating expenses	**(6,649)**	**(6,372)**	**(277)**	**4%**	**(12,850)**	**(12,420)**	**(430)**	**3%**
Bank levy	(416)	(355)	(61)	17%	(809)	(685)	(124)	18%
Net impairment	186	812	(626)	(77%)	(309)	1,892	(2,201)	-
Net earnings before income tax	**6,381**	**9,089**	**(2,708)**	**(30%)**	**13,806**	**16,888**	**(3,082)**	**(18%)**
Income tax expense	(3,488)	(1,408)	(2,080)	148%	(5,191)	(3,274)	(1,917)	59%
Net earnings from cont. operations	**2,893**	**7,681**	**(4,788)**	**(62%)**	**8,615**	**13,614**	**(4,999)**	**(37%)**
Discontinued operations, net of tax	6,819	135	6,684	-	6,915	241	6,674	-
Net earnings	**9,712**	**7,816**	**1,896**	**24%**	**15,530**	**13,855**	**1,675**	**12%**

KFI's								
Return on equity (ROE)	21.8%	16.3%			16.9%	14.3%		
Return on total assets (ROA)	2.9%	2.6%			2.3%	2.3%		
Earnings per share (in ISK)	6.47	4.89			10.34	8.47		
Cost to income ratio (C/I)	50.1%	42.5%			46.3%	44.2%		
Net interest margin (NIM)	3.1%	2.9%			3.1%	2.8%		
Operating income / REA	6.1%	8.0%			6.6%	7.5%		

Net interest income increased by 22.3%, compared with the second quarter of 2021. The net interest margin (NIM) as a percentage of average interest-bearing assets was 3.1% during the quarter, compared with 2.9% for the second quarter of 2021. Interest-bearing assets increased by 5% compared with the second quarter of 2021, mainly loans to customers but interest-bearing liabilities increased by 4% for the same period, mainly deposits.

Net commission income increased by 27.4%, compared with the second quarter of 2021. Income from lending and guarantees was strong, partly due to performance-based fees. Capital markets and corporate finance also had a strong quarter with the listings of NOVA and Alvotech.

Insurance premiums earned at the insurance company Vördur have been increasing, but volatility in *net insurance income* is mainly due to seasonal fluctuations in the claim rate. Insurance premiums for own account increased by 10.6% from the same period in the previous year, whereas claims for own account increased by 7.3%. The combined ratio for the second quarter of 2022 was 86.8%, compared with 91.5% for the same period in 2021. For the first six months the combined ratio was 101.1%, compared with 94.9% for the first six months of 2021.

Net financial income was negative by ISK 2.9bn for the quarter due to difficult market conditions, mainly driven by loss in equity holdings at the Bank and Vördur, and one-off reclassification from OCI equity reserve of ISK 1.9bn.

Other operating income during the quarter was mainly profit from the sale of real estate.

Operating expenses increased by 4.3% in the second quarter, compared with the second quarter of 2021. At the end of June, the number of full-time equivalent positions (FTEs) was 746. Salary expenses increased, compared with the second quarter of 2021, mainly due to the insourcing of IT operations and general wage increases. The average salary increase per employee was considerably less than the increase in the salary index. Other operating expenses remain relatively stable.

Net impairment was positive by ISK 186m in the second quarter of 2022, mainly due to recovery on loans previously written off. Impairments are lower than 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 unusually high for the quarter. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate.

Discontinued operations held for sale was positive by ISK 6.8bn in the quarter. The sale of the subsidiary Valitor resulted in a profit of ISK 5.6bn, post cost of sale. The operating results of Valitor amounted to ISK 0.6bn during the quarter, whereas Valitor's positive contribution to the Group, after taking into account the Group's eliminations, was ISK 0.8bn. The positive outcome from sale of assets at Sólbjarg ehf. contributed ISK 0.5bn.

Balance sheet

The balance sheet increased by 5.3% from year-end 2021. The liquidity position remains very strong despite ISK 26.8bn capital distribution through dividends and buy-backs of own shares during the first quarter and ISK 74.4bn increase in loans to customers during the first half of 2022.

Assets

In ISK millions	**30.06.2022**	**31.12.2021**	**Δ**	**Δ %**	**31.03.2022**	**Δ**	**Δ %**
Cash & balances with CB	78,011	69,057	8,954	13%	64,395	13,616	21%
Loans to credit institutions	40,195	30,272	9,923	33%	35,868	4,327	12%
Loans to customers	1,010,666	936,237	74,429	8%	976,383	34,283	4%
Financial instruments	203,741	225,657	(21,916)	(10%)	185,680	18,061	10%
Intangible assets	9,038	9,463	(425)	(4%)	9,239	(201)	(2%)
Assets and disposal groups HFS	2,126	16,047	(13,921)	(87%)	14,706	(12,580)	(86%)
Other assets	39,584	27,131	12,453	46%	54,744	(15,160)	(28%)
Total assets	**1,383,361**	**1,313,864**	**69,497**	**5%**	**1,341,015**	**42,346**	**3%**

KFI's							
REA / Total assets	62.1%	61.9%			64.9%		
Share of stage 3 loans, gross	1.4%	1.6%			1.6%		

Loans to customers increased by 7.9% from the end of 2021, with loans to corporates increasing by 12.5%, whereas loans to individuals increased by 4.4%. The medium-term growth outlook going forward is expected to be more balanced between corporates and individuals, while this will fluctuate between quarters. There is a strong pipeline, especially on the corporate side in origination and syndications. Sales of loans are progressing well as the Bank follows the strategy of increasing capital velocity. In 2022 the Bank has sold corporate loans for ISK 14bn and further syndication is in process.

The Bank's liquidity position is very strong with the total LCR ratio at 163% and the ISK LCR ratio at 156%. 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.

Assets and disposal groups held for sale comprise the subsidiaries Stakksberg ehf. and Sólbjarg ehf. On 1 July 2022 the sale of Valitor to Rapyd was settled. As all conditions were met at the end of June, the sale is fully accounted for in the second quarter results. The total consideration was USD 112.5m (ISK 14.6bn), resulting in a profit of ISK 5.6 billion, post cost of sale.

Liabilities and equity

In ISK millions	**30.06.2022**	**31.12.2021**	**Δ**	**Δ %**	**31.03.2022**	**Δ**	**Δ %**
Due to credit institutions & CB	4,604	5,000	(396)	(8%)	4,270	334	8%
Deposits from customers	726,948	655,476	71,472	11%	679,925	47,023	7%
Other liabilities	71,731	50,131	21,600	43%	64,985	6,746	10%
Borrowings	363,375	356,637	6,738	2%	370,026	(6,651)	(2%)
Subordinated liabilities	33,392	35,088	(1,696)	(5%)	33,674	(282)	(1%)
Liabilities associated w/disposal groups HFS	0	16,934	(16,934)	(100%)	15,122	(15,122)	(100%)
Total liabilities	**1,200,050**	**1,119,266**	**80,784**	**7%**	**1,168,002**	**32,048**	**3%**
Shareholders equity	182,625	193,925	(11,300)	(6%)	172,333	10,292	6%
Non-controlling interest	686	673	13	2%	680	6	1%
Total equity	**183,311**	**194,598**	**(11,287)**	**(6%)**	**173,013**	**10,298**	**6%**
Total liabilities and equity	**1,383,361**	**1,313,864**	**69,497**	**5%**	**1,341,015**	**42,346**	**3%**

KFI's							
Loans to Deposits ratio	139.0%	142.8%			143.6%		
CET1 ratio	19.7%	19.6%			19.1%		
Capital adequacy ratio	23.5%	23.8%			22.9%		

Deposits from customers remain the most important source of funding for Arion Bank, with 61% of total liabilities in deposits. The increase from year-end 2021 is mainly in SMEs but also in deposits from individuals and institutional investors. Green deposits continue to grow at a strong pace, or 169% during the first six months.

The increase in *borrowings* from year-end 2021 is mainly due to the Bank's successful EUR 200m covered bond tap in March and a total issuance of ISK 15bn in the domestic market.

Shareholders' equity decreased due to dividend payments and the purchase of own shares, in total ISK 26.8bn, which is partly offset by the net earnings for the first six months of ISK 15.5bn. The leverage ratio was 12.7% at the end of June, the same as at the end of 2021, which is very high in international comparison. At the end of June, the Group had ISK 13.0bn in surplus of the Group's current capital structure.

For further information on the accounts please visit Arion Bank's website.

Medium-term financial targets

Return on equity	Exceed 13%
Operating income / REA	Exceed 7.3%
Insurance premium growth	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3 percentage points
Loan growth	In line with nominal economic growth
Cost-to-income ratio	Below 45%
CET1 ratio	~17%
Dividend payout ratio	50%

Investor meeting / webcast in English on 28 July at 10:30 CEST (8:30 GMT)

Arion Bank will be hosting a meeting / webcast at the Bank's headquarters in Borgartún 19, Reykjavík, on Thursday 28 July at 10:30 CEST (8:30 GMT) where deputy CEO and Managing Director of Retail Banking Ida Brá Benediktsdóttir and CFO Ólafur Hrafn Höskuldsson will present the results and Chief Economist Erna Björg Sverrisdóttir will give an update on the economic environment. The meeting will take place in English and will be streamed live.

The webcast will be accessible live on financialhearings.com 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.

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.

Financial calendar

Arion Bank's financial calendar is available on the Bank's website.

This is information that Arion Bank hf. is obliged to make public pursuant to the EU Market Abuse Regulation. The information was submitted for publication through the agency of the contact persons set out above.

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.