

ARION BANK'S FINANCIAL RESULTS

H1 2013

Arion Bank reported net earnings of ISK 5.9 billion for the first half of 2013. Return on equity was 8.9%. The results for the first six months of the year are satisfactory, not least in light of the fact that one-off events and external factors such as the exchange rate of the ISK had a negative effect. In terms of regular operations, the Bank performed in line with expectations during the period.

Net earnings during the second quarter amounted to ISK 4.5 billion, and return on equity in the second quarter was 13.5%.

The Bank's capital ratio at the end of the period was 24.3%, the same as at the end of 2012.

Income statement				
In ISK million	6M '13	6M '12	Diff,	Diff, %
Net interest income	12,667	13,880	-1,213	-9%
Net change in valuation on loans	134	2,532	-2,398	-95%
Net interest income less val, on loans	12,801	16,412	-3,611	-22%
Net commission income	5,298	5,338	-40	-1%
Net financial income	1,544	330	1,214	368%
Net gain/-loss on foreign exchange	-1,248	-149	-1,099	738%
Other income	2,425	3,006	-581	-19%
Operating income	20,820	24,937	-4,117	-17%
Salaries and related expenses	-6,679	-6,169	-510	8%
Other operating expenses	-6,228	-5,475	-753	14%
Net earnings before taxes	7,913	13,293	-5,380	-40%
Income tax	-1,749	-2,913	1,164	-40%
Bank levy	-188	-510	322	-63%
Net earnings from continuing operation	5,976	9,870	-3,894	-39%
Net gain/-loss from discont. operation net of tax	-65	1,379	-1,444	-
Net earnings	5,911	11,249	-5,338	-47%

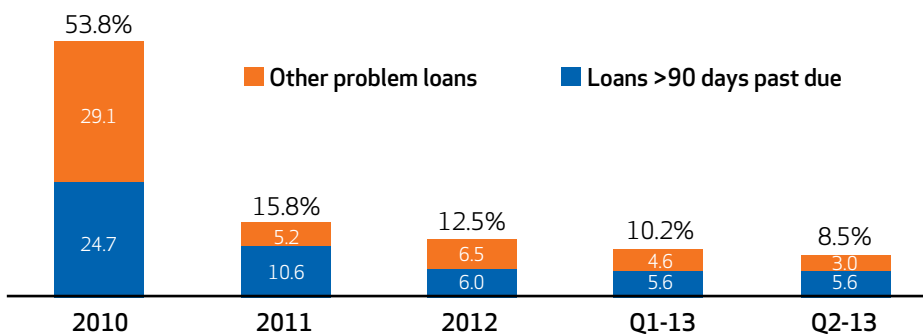
Loans to customers totalled ISK 567.3 billion at the end of the period, which is virtually unchanged from the beginning of the year. Total assets amounted to ISK 929.0 billion, compared with ISK 900.7 billion at the end of 2012.

The Bank's capital ratio at the end of the period was 24.3%

For further information on Arion Bank's results for the first six months of 2013 take a look at our [press release](#) and [investor presentation](#)

In the earnings release, Höskuldur H. Ólafsson, CEO of Arion Bank, stressed that the Bank was continuing to consolidate its position, thanks to the improved quality of the loan portfolio and greater diversity in the funding base. He said that Arion Bank had recently placed great emphasis on both areas, as well as on maintaining a strong capital ratio and robust liquidity ratios.

Development of Problem Loans



The Bank defines problem loans as book value of loans (i.e. net of impairment) that are either individually impaired or are over 90 days past due and not impaired as % of total book value of loans to customers.

ARION BANK'S PILLAR 3 RISK DISCLOSURES

Arion Bank's pillar 3 risk disclosures will be published annually and can be viewed on the [Bank's website](#)

In March this year Arion Bank published its pillar 3 risk disclosures for 2012. The aim of the disclosures is twofold: to provide information on the Bank's risk management and capital management strategies; and to meet the reporting requirements set out in the Capital Requirements Directives 2006/48 and 2006/49. The disclosures cover the main risk factors in the Bank's operations and the management of these risks, the Bank's capital structure, its capital requirements and its remuneration policy.

As stated in the disclosures, Arion Bank's capital base at the end of 2012 was ISK 159,694 million of which Tier 1 capital was ISK 125,474 million (19.1% Tier 1 ratio). Single-name concentration in the Bank's loan portfolio decreased in 2012; with large exposures totalling 60% of the capital base, net of eligible collateral, compared with 87% in 2011.

THE FIRST INTERNATIONAL BOND OFFERING

The bond offering represented a crucial first step towards gaining access to international capital markets

This year Arion Bank has made good progress in diversifying its funding profile. A very important milestone was reached in February when the Bank became the first Icelandic financial institution since 2007 to issue a public benchmark bond on the international markets. The Bank issued a 3-year bond in the amount of 500 million Norwegian kroner, approximately ISK 11 billion.

The bond issue was very well received by investors. Over 60 investors subscribed for bonds, with the average order size being approximately 9 million Norwegian kroner. The bonds were sold predominantly to investors in Sweden and Norway. This represented a crucial first step towards gaining access to international capital markets.

The plan is to issue bonds in the future in international markets and to build a stronger foundation for market access in the coming months. The Bank intends to obtain a credit rating from an international credit rating agency in the near to medium term future.

Arion Bank has also been a leading issuer of covered bonds in Iceland. The covered bonds are used to finance mortgage lending. Mortgage lending and retail banking have become an increasingly important part of Arion Bank's business mix in recent years, as loans to individuals account for 45% of the Bank's loan book, compared to 27% two years ago.



INVESTING IN INNOVATION

Arion Bank has in the last two years invested in 20 Icelandic startups in various business sectors

During the summer, Arion Bank ran the mentor driven seed accelerator Startup Reykjavik for the second time, in cooperation with Klak Innovit Entrepreneur Center. Through Startup Reykjavik, Arion Bank has invested in 20 Icelandic startups in various business sectors, ranging from IT and pharmaceuticals to design, engineering and production. Under the Startup Reykjavik program 10 companies are chosen to participate through a careful selection process. Each company receives seed capital from Arion Bank in exchange for a minor share in the company. During the intensive 10-week program, dozens of mentors from the entrepreneurial, academic and business communities meet the companies to review and improve the business ideas. The program ends with an Investor Day where all the companies pitch their ideas to investors.

The ideas that are selected to participate in Startup Reykjavik are chosen on their business merits, with a strong focus on the quality of the team behind each business idea. The 20 companies that have participated are in various stages of development, and many have received further funding to pursue their business opportunities. Bringing investors to the table also adds value to both the entrepreneurs and investors. Investors can rely on the fact that the companies have undergone intensive training during the program and have improved their business models.

The Startup Reykjavik program operates according to a similar model to the US-based accelerators Techstars and Y Combinator. The importance of a strong entrepreneurial ecosystem in any society has become evident with Startup Reykjavik since in 2012 and 2013 a total of 400 applications were received for the twenty spots available. With its initiative, Arion Bank wants to emphasize the importance of diversification in value creation in the future and show real support to entrepreneurial activity in Iceland.

www.startupreykjavik.com

NEWSLETTER



The Icelandic Geothermal project has made good progress since it was set up

Arion Bank's Capital Markets division offers a range of services relating to the capital controls

LONG-TERM VALUE CREATION IN GEOTHERMAL ENERGY

Arion Bank is one of the founding partners of Iceland Geothermal, a cluster initiative around the geothermal energy business in Iceland. The cluster was founded at a seminar held at Arion Bank in 2011, and Arion Bank continues to play an important role within the cluster. As discussed in our Newsletter, third edition 2011, the purpose of the Iceland Geothermal project is first and foremost to create a platform for cooperation within the geothermal sector in order to further drive development and growth.



The project has made good progress since it was set up, and from the outset Arion Bank has had a representative on the board of directors of the cluster and members in four of the ten projects the cluster initiated.

The strengths of the Icelandic geothermal cluster are unique: geothermal heat is used in diverse ways in Iceland, the country has highly experienced local employees, well-developed systems and infrastructure and a strong reputation in geothermal expertise.

Further cooperation between companies in the cluster with long-term value creation in mind is the key driver behind Arion Bank's participation in the Iceland Geothermal cluster initiative.

RANGE OF SERVICES RELATING TO THE CAPITAL CONTROLS

The greatest challenge facing the Icelandic economy today is the lifting of the capital controls, which have been in place since 10 October 2008. The main objective of the controls is to restrict or stop certain types of cross-border capital movements to facilitate monetary and currency stability. Today there are several routes that investors can go to invest in Iceland and the Central Bank holds special currency auctions. Arion Bank's Capital Markets division offers a range of services relating to the capital controls and can act as an intermediary on behalf of investors in the currency auctions.

The capital controls have developed since first put in place. At first all cross-border movement of foreign-denominated capital was prohibited unless the capital was used to purchase goods or services, or if especially exempted under the rules. Interest and dividends payments were exempted from the rules.

In November 2009 the country opened up for foreign direct investment (New investment route), and in March 2011 a plan was set forth by the Central Bank regarding the liberalization of the capital controls. The objectives of the first phase of the liberalization strategy are to provide liquidity for offshore ISK holdings of distressed investors and to channel long-term investments into Iceland through a series of auctions where investors can buy the ISK at a considerable discount.

NEWSLETTER



A special investment program was launched in February 2012. Through this investment program investors can invest in real estate, government bonds (RIKS 33 03021), corporate bonds, funds or equity with a discount to the official EUR/ISK rate. Applications for the investment program have to be submitted to the Central Bank through an intermediary, such as Arion Bank, 14 working days before each auction.

ICELAND INVESTMENT FORUM 2013

The Iceland Investment Forum 2013 was held on 19 September at Hotel Waldorf Hilton in London. The event was well attended and received media attention in the UK. Arion Bank was a lead strategic partner to the event.

The goal of the forum was to examine the key drivers for growth in Iceland, and new opportunities that investors seek as the economy continues its path to recovery. There was also a focus on the Icelandic government's policy approach and the incentives put in place to encourage foreign direct investment.

The speakers included Höskuldur H. Ólafsson, CEO of Arion Bank, who participated in panel discussions; Margrét Sveinsdóttir MD of Asset Management; and Ásdís Kristjánsdóttir, head of Research. The forum was opened by the Icelandic prime minister, Sigmundur Davíð Gunnlaugsson.

The presentations from the Iceland Investment forum can be viewed [here](#)

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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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