

Arion Bank's 2010 financial results

Arion Bank reported net earnings of ISK 12.6 billion in 2010, compared with ISK 12.9 billion in 2009. Return on equity was 13.4%. The Bank's capital ratio increased by 5.3 percentage points to 19% at the end of 2010, well above the FME's minimum requirement. The annual accounts have been endorsed without reservation by the Bank's auditors.

Highlights of the annual financial statement:

- Net earnings of ISK 12.6 billion in 2010, compared with ISK 12.9 billion in 2009.
- Net operating income of ISK 35.6 billion in 2010, compared with ISK 31.9 billion in 2009.
- Net interest income of ISK 19.8 billion in 2010, compared with ISK 12.2 billion in 2009.
- Net commission income of ISK 6.9 billion in 2010, compared with ISK 5.9 billion in 2009.
- Return on equity was 13.4% in 2010, compared with 16.7% in 2009.
- Interest-rate differential as a percentage of average interest-bearing assets was 2.8% in 2010, compared with 1.9% in 2009.
- Deferred income tax of ISK 3.5 billion, compared with ISK 2.6 billion in 2009. The new bank tax amounted to ISK 290 million in 2010.
- Cost-to-income ratio was 54.2% in 2010, compared with 47.7% in 2009. This increase is largely attributable to a one-off expense relating to advisory and supervisory services in 2010.
- FME's ruling on lower interest margin on bond connected to Bank's acquisition of SPRON deposits has negative effect of ISK 4.2 billion.
- The Bank's liquidity ratio was 24.8%.
- Loans to customers totalled ISK 451.2 billion at the end of 2010, compared with ISK 357.7 billion at the end of 2009. This increase is mainly related to new loans acquired by the Bank following the change in ownership on 8 January 2010.
- Deposits amounted to ISK 457.9 billion at the end of 2010, compared with ISK 495.5 billion at the end of 2009.
- Total assets amounted to ISK 812.6 billion at the end of 2010, compared with ISK 757.3 billion at the end of 2009.
- Shareholders' equity at the end of 2010 amounted to ISK 109.5 billion, compared with ISK 90.0 billion at the end of 2009.
- At the end of 2010 there were 1,260 full-time equivalent positions at the Bank, compared with 1,157 at the end of 2009. The number of employees increased by 154 as new subsidiaries joined the group.

Highlights of 2010:

At the beginning of the year, Arion Bank's ownership structure changed when Kaupthing's subsidiary Kaupskil acquired an 87% share in the Bank, with the Icelandic State Banking Agency holding the other 13%. The Bank's assets increased by ISK 80.2 billion and the capital ratio rose from 13.7% to 16.4%.

New Board of Directors was subsequently elected and it took up its duties on 18 March. The Chairwoman is Monica Caneman. Höskuldur H. Ólafsson took over as Chief Executive Officer on 1 June.

The Bank's core operations strengthened in 2010; interest income grew as interest-bearing assets increased when the Bank was recapitalized in January and also because of falling interest rates. Commission income increased between years, and Valitor's addition the group in the fourth quarter made a positive impact in this respect.

The Bank implemented a new strategy during the year and subsequently made changes to the organizational structure. Systematic efforts were made to streamline operations, including the branch network. An important milestone will be reached this month with the merger of three branches in the Reykjavík area into a single branch. The Bank currently has 24 branches and reduced by 15 from 2008.

One of the Bank's main activities during 2010 was the action taken to resolve corporate and household debt difficulties. Arion Bank has achieved considerable results in this area. More than 14,000 personal customers have taken advantage of the solutions on offer. Arion Bank opened a special advisory service at the beginning of November which has received positive responses.

Substantial progress was made in the financial restructuring of larger companies and the focus has now shifted to small and medium-sized enterprises. Today, approximately 750 companies have entered the restructuring process at the Bank and solutions have been reached in 500 cases. The Bank expects to bring financial restructuring to completion by the end of 2011.

Preparations for the sale of a core stake in Hagar began in 2010. The process was concluded in February 2011 with the sale of a 34% stake. The next stage is to list the company on the Icelandic stock market. Hekla was advertized for sale towards the end of 2010 and the sales process was completed early this year. Selling shareholdings in businesses which are unrelated to its core business is a priority for the Bank.

In 2010, the legality of Arion Bank's foreign loans to businesses was assessed by a team of experts at the Bank and the FME. They concluded that some of these foreign currency loans to companies were legal, but in the wake of recent Supreme Court judgments on similar loans, there was some doubt over the legality of other loans, depending on the type of loan agreement. It is clear that if all the Bank's corporate foreign currency loans whose legal status is uncertain were deemed illegal, the financial damage suffered by the Bank would be substantial. Nevertheless the Bank's capital ratio would remain above 16%.

Höskuldur H. Ólafsson, CEO of Arion Bank:

“The 2010 financial results are good and in line with our projections. Return on equity is satisfactory given the challenging economic climate. The year was one in which tackling

household and corporate debt played a major role in the Bank's activities. We achieved excellent results in this respect and we expect to have completed the majority of corporate recovery cases by the end of 2011. The good progress we made in this area helps eliminate uncertainties and improve the quality of the balance sheet. The Bank's core operations strengthened and I am convinced that the Bank is well placed to handle the challenges ahead. If 2009 was a year of staying afloat, 2010 was the year when the Bank regained stability and made successful advances in recovery cases. The Bank also laid down its strategic lines for the future and modified its organization accordingly. In 2011, recovery cases will come to end and traditional banking activities will come to the fore again. We are confident that in 2012 the economy will have regained its impetus.”