

# Newsletter

Financial Institutions - First edition - June 2012

## Arion Bank's financial results

### Q1 2012

Arion Bank reported net earnings of ISK 4.5 billion for the first quarter of 2012, compared with ISK 3.0 billion during the same period in 2011. Return on equity was 16.5% in Q1 2012, compared with 11.3% in Q1 2011.

The Bank's capital ratio at the end of the period was 20.2%, compared with 19.2% at the end of Q1 2011. The liquidity ratio was 30.2% and the cash ratio was 13.9%.

Income statement - consolidated				
Million ISK	Q1 12	Q1 11	Diff	%
Net interest income	6,214	5,886	328	6%
Net change in valuation on loans and receivables	(76)	(413)	337	(82%)
<b>Net interest income less value on loans and receivables</b>	<b>6,138</b>	<b>5,473</b>	<b>665</b>	<b>12%</b>
Net commission income	2,336	2,492	(156)	(6%)
Net financial income	1,429	417	1,012	243%
Other operating income	952	1,099	(147)	(13%)
<b>Operating income</b>	<b>10,855</b>	<b>9,481</b>	<b>1,374</b>	<b>14%</b>
Salaries and related cost	(3,045)	(2,658)	(387)	15%
Other operating expenses	(2,757)	(2,463)	(294)	12%
<b>Net earnings before taxes</b>	<b>5,053</b>	<b>4,360</b>	<b>693</b>	<b>16%</b>
Income taxes	(1,061)	(1,045)	(16)	2%
Bank levies	(268)	(67)	(201)	300%
Net gain (loss) from discontinued oper, net of tax	727	(282)	1,009	(358%)
<b>Net earnings</b>	<b>4,451</b>	<b>2,966</b>	<b>1,485</b>	<b>50%</b>

Loans to customers totalled ISK 584.2 billion at the end of the period, compared with ISK 432.5 billion at the same time in 2011. This increase is primarily a result of the acquisition of Kaupthing Bank's mortgage portfolio which took place at the end of 2011. Total assets amounted to ISK 899.4 billion at the end the period, compared with ISK 802.7 billion at the end of Q1 2011.

### Full year 2011

Arion Bank reported net earnings of ISK 11.1 billion in 2011, compared with ISK 12.6 billion in 2010. Return on equity was 10.5%. The Bank's capital ratio was 21.2% at the end of the year, well above the minimum stipulated by the FME.

The revaluation of the Bank's corporate loan portfolio and the divestment of companies acquired in the restructuring process increased the Bank's net earnings by ISK 6.6 billion. Arion Bank's 2011 financial statement takes into account the effects of a Supreme Court ruling from 15 February 2012 on the recalculation of currency-linked loans. The cost to Arion Bank group of recalculating interest on those loans affected by the ruling is estimated at ISK 13.8 billion in the financial statements.

Earnings from regular operations amounted to ISK 12.3 billion and return on equity on regular operations was 10.8%.

During 2011 Arion Bank completed the final settlement with the bankruptcy estate of Kaupthing Bank. Arion Bank also acquired the mortgage portfolio of Kaupthing Bank's bankruptcy estate which had been managed in a separate fund and which was valued at approximately ISK 110 billion. The transaction also included the financing of loans through the acquisition of covered bonds. This strengthens the Bank's balance sheet and its long-term funding.

Income statement - consolidated				
Million ISK	2011	2010	Diff	%
Net interest income	23,388	19,785	3,603	18%
Net change in valuation on loans and receivables	(8,649)	1,878	(10,527)	(561%)
<b>Net interest income less value on loans and receivables</b>	<b>14,739</b>	<b>21,663</b>	<b>(6,924)</b>	<b>(32%)</b>
Net commission income	10,685	6,866	3,819	56%
Net financial income	2,347	1,361	986	72%
Other operating income	5,505	5,733	(228)	(4%)
<b>Operating income</b>	<b>33,276</b>	<b>35,623</b>	<b>(2,347)</b>	<b>-7%</b>
Salaries and related cost	(11,254)	(9,272)	(1,982)	21%
Other operating expenses	(10,762)	(9,020)	(1,742)	19%
<b>Net earnings before taxes</b>	<b>11,260</b>	<b>17,331</b>	<b>(6,071)</b>	<b>-35%</b>
Income taxes	(1,912)	(3,481)	1,569	(45%)
Bank levies	(1,046)	(290)	(756)	261%
Net gain (loss) from discontinued oper. net of tax	2,792	(1,003)	3,795	(378%)
<b>Net earnings</b>	<b>11,094</b>	<b>12,557</b>	<b>(1,463)</b>	<b>-12%</b>

Loans to customers totalled ISK 561.6 billion at the end of 2011, compared with ISK 451.2 billion at the end of 2010. This increase is primarily a result of the acquisition of Kaupthing Bank's mortgage portfolio. Total assets amounted to ISK 892.1 billion at the end of 2011, compared with ISK 812.6 billion at the end of 2010.

The Bank's liquidity ratio was 34.7%, which is well over the 20% minimum stipulated by the FME. The Bank's cash ratio was 15.3%, above the FME's minimum requirement of 5%.

## Latest Supreme Court ruling on currency-linked loans

On 15 February the Supreme Court ruled that the recalculations of certain currency-linked loans in a particular case previously deemed illegal by the Supreme Court had not been made in accordance with Icelandic law. Icelandic financial institutions had recalculated illegal FX loans in accordance with the provisions of Act no. 151/2010 passed by the Icelandic parliament following the Court's ruling, but the court ruled on 15 February that those provisions in fact contradicted constitutional rights in this particular case.

Arion Bank made provisions for losses in its financial accounts for 2011 of ISK 13.8 billion following the ruling. It is not clear which of the bank's loan agreements are affected by the ruling and it could take months and several more court rulings before the situation is clarified.

Despite the Supreme Court's ruling, the Bank's financial position remains robust. The strong focus on consolidating the Bank's financial strength in recent years has paid off, with the capital ratio being 20.2% at the end of Q1 2012, even after taking into account the effects of the court ruling.

## Annual General Meeting of Arion Bank 2012

The 2012 Annual General Meeting of Arion Bank was held on Thursday 22 March, at the Bank's headquarters in Borgartún, Reykjavík. The agenda contained standard AGM business.

A new Board of Directors was elected at the meeting and its full members are: Agnar Kofoed-Hansen, Freyr Thórdarson, Guðrún Johnsen, Jón G. Briem, Måns Höglund and Monica Caneman. Agnar is the representative of Icelandic State Financial Investments on the Board.

It was agreed at the meeting that no dividend would be paid out for 2011 and the salary of Board Directors would remain the same as the previous year. A new remuneration policy for the Bank was also adopted.

Monica Caneman, Chairman of the Board of Directors, read out the report of the Board of Directors. She discussed the progress that has been made in Iceland in recent years, with its falling treasury deficit, increased economic growth and the progress made in resolving corporate and household debt. Monica said that she believed the outlook for 2012 was bright. In her opinion the Bank has successfully managed to reinforce the Bank's infrastructure and foundations, creating a platform for further development.

Höskuldur H. Ólafsson, CEO of Arion Bank, discussed the annual financial statements for the last operating year. He emphasised that the 2011 financial results were satisfactory, especially in light of the current economic climate and last February's ruling by the Supreme Court. Höskuldur underlined the fact that the quality of the Bank's loan portfolio had improved during the year, primarily as a result of the progress made in corporate and personal debt recovery and also because of the acquisition of the mortgage portfolio from Kaupthing's bankruptcy estate. He also said that the acquisition of the mortgage portfolio had brought greater diversity to the Bank's long-term funding.

Höskuldur discussed the highlights of 2011, mentioning the new products introduced during the year, including indexed and non-indexed mortgages at more competitive than ever interest rates. The Bank had also made advances on numerous other markets, for example adding important new clients in asset management and corporate banking.

## Covered bonds issued by Arion Bank

Arion Bank completed its first covered bond offering in February, issuing ISK 2.5 billion worth of bonds in the series Arion CBI 34. The offering was heavily oversubscribed, with bids received for approximately ISK 8.7 billion.

The series has been listed on the Luxembourg Stock Exchange and Nasdaq OMX Iceland.

The bonds bear 3.60% inflation-indexed interest and mature in 2034 although prepayment is permitted from 2017.

Höskuldur H. Ólafsson, CEO of Arion Bank, expressed his satisfaction with the Bank's first bond offering and the positive reception it got from the market: "The level of demand reflects the faith the market has in the Bank and the work done to build the business over the last few years. It is important that we broaden the Bank's funding profile and this offering has given us a strong boost for the future."

Following the success of the first bond offering Arion Bank completed its first non-indexed fixed rate covered bond offering on Friday 11 May, issuing ISK 1.2 billion worth of bonds in the series Arion CB 15.

The series has been admitted for trading on NASDAQ OMX Iceland. The bonds bear 6.50% interest and mature in 2015.

With this bond offering Arion Bank became the first Icelandic bank to offer fixed rate covered bonds that are not inflation linked. This is a logical next step following the initiative the Bank has taken in recent months in the non-indexed mortgage market by introducing innovative new products.

## Arion Bank takes over ISK 110 billion mortgage portfolio

Arion Bank and Kaupthing Resolution Committee reached an agreement at the end of 2011 according to which Arion Bank acquired a mortgage portfolio which has been managed in a special fund owned by Kaupthing. The deal will be funded by the acquisition of covered bonds.

The mortgage portfolio is valued at ISK 110 billion, and the deal will make Arion Bank a strong participant in the mortgage market in Iceland, with a loan portfolio of ISK 200 billion. It also consolidates the Bank's position with assets of close to ISK 900 billion.

## Arion Bank manages the first listing on the Icelandic stock market for four years

Hagar, the largest retail company in Iceland, was taken over by Arion Bank in 2009 as a consequence of the financial distress experienced by its owners following the events of late 2008. Eignabjarg, a subsidiary of Arion Bank, has held the Bank's shares in Hagar.

Eignabjarg divested its shares in Hagar in three phases. The first step was in early 2011 with the sale of a 30% core stake in Hagar hf. to Búvellir, a consortium of investors and pension funds, at the price of ISK 10 a share.

The second phase was a public offering in December 2011 where Eignabjarg sold 30% for ISK 4.9 billion or ISK 13.5 a share. Hagar was subsequently listed on the Icelandic stock exchange, Nasdaq OMX Iceland. Hagar's listing was the first listing in Iceland since 2008.

It was managed by the Corporate Advisory - Investment Banking division of Arion Bank. The aim of Eignabjarg was to diversify the shareholder base with public and professional investors and to obtain a satisfactory price for its holding. The offering was successful and it attracted great interest, with investors subscribing for eight times the number of shares available.

Finally, on 1 March 2012 Eignabjarg sold 13.33% of Hagar's share capital to investors in a closed offering. The placement raised proceeds of ISK 2.8 billion. The highest accepted price offered by investors was ISK 17.2 per share.

Eignabjarg currently holds 5.98% of issued share capital in Hagar.

## Frjálsi Pension Fund named the best pension fund in Iceland for third successive year

Frjálsi Pension Fund has been named the best pension fund in Iceland for the third year in a row by the magazine Investment Pension Europe (IPE).

It was also voted second best pension fund in the nine European nations with fewer than 1 million inhabitants.

The jury noted that Frjálsi had successfully yielded good returns to fund members in a time of severe economic crisis. The jury also commended the fund for introducing an innovative new service which maximized payments to fund members.

IPE is one of the most respected professional magazines in the European pension industry. Every year the magazine hands out awards to those pension funds which its panel of experts believes have excelled in their home country and abroad. This year the Danish pension fund ATP came away with the award of Europe's best pension fund.

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### Economic update

Each month the Research department at Arion Bank 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 <http://www.arionbanki.is/?PageID=5394>

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