

A low-angle photograph of a modern glass skyscraper against a clear blue sky. The building's glass facade reflects the sky and surrounding environment. A large, dark blue geometric shape, resembling a stylized star or a large 'X', is overlaid on the right side of the image, partially obscuring the building and the text.

FINANCIAL STATEMENTS 30.06.2013

INVESTOR PRESENTATION

HIGHLIGHTS IN H1 2013

1 Good performance in Q2
but H1 is affected by Q1

2 Further improvement
in asset quality

3 Minor changes in Balance
from 2011



FINANCIAL HIGHLIGHTS

STRONG PERFORMANCE IN Q2 2013

Stable second quarter after difficult first quarter of 2013

Stable Net interest margin but is under pressure going forward

No changes in the loan book since year-end 2011, when mortgage loan portfolio was bought from Kaupthing

Good progress in asset quality, which has been focus for some time

Financial- and liquidity strength is good and will be focus

Income statement

	H1 2013	H1 2012	Q2 2013	Q1 2013
Operating income (ISK bn)	20.8	24.9	12.1	8.8
Net earnings (ISK bn)	5.9	11.2	4.5	1.4

Profitability

Return on equity	8.9%	18.8%	13.5%	4.3%
Net interest margin	3.1%	3.4%	3.1%	3.1%

Efficiency

Cost-to-income ratio	62.4%	52.0%	54.4%	72.6%
Total employees	1,153	1,179	1,153	1,187

Balance sheet

	30.06.13	31.03.13	31.12.12	31.12.11
Loans to customers (ISK bn)	567.3	565.5	566.6	561.6
Total assets (ISK bn)	929.0	907.5	900.7	899.4
Deposits from customers (ISK bn)	466.8	462.3	448.7	490.0
Total equity (ISK bn)	136.8	132.3	130.9	114.6

Liquidity

Loans-to-deposits ratio	121.5%	122.3%	126.3%	114.6%
Liquidity ratio	38.0%	35.3%	32.9%	30.2%

Asset quality

Problem loans	8.5%	10.2%	12.5%	15.8%
Loans in >90 days default	5.6%	5.6%	6.0%	10.6%

Financial strength

Tier 1 ratio	19.5%	19.1%	19.1%	16.4%
CAD ratio	24.3%	23.9%	24.3%	21.2%

INCOME STATEMENT



INCOME STATEMENT

GOOD PERFORMANCE IN SECOND QUARTER 2013

Financial income
affected by fluctuation
in the krona

Positive net valuation
change

Higher commission
income primarily driven
by cards and investment
banking

Lower other operating
expense due to the fine
on Valitor in Q1

Million ISK	Q2 2013	Q1 2013	%
Net interest income	6,379	6,288	1%
Net change in valuation	456	(322)	-
Net commission income	2,849	2,449	16%
Net financial income	1,123	(827)	-
Other income	1,249	1,176	6%
Operating income	12,056	8,764	38%
Salaries and related cost	(3,357)	(3,322)	1%
Other operating expenses	(2,951)	(3,277)	(10%)
Net earnings before taxes	5,748	2,165	166%
Income tax	(1,163)	(586)	98%
Bank Levy	(97)	(91)	7%
Net gain from discontinued operations, net of tax	14	(79)	(118%)
Net earnings	4,502	1,409	220%
Shareholders of Arion Bank	4,440	1,697	162%
Minority interest	62	(288)	(122%)

INCOME STATEMENT

LESS EFFECT FROM VALUATION CHANGES AND DISCONTINUED OPERATION

Lower net interest income is mainly due to lower inflation and one off interest income in H1 2012

Net change in valuation affected by higher impairment

Higher net gain from discontinued operation in H1 2012 from sale of share in Hagar and N1

Million ISK	H1 2013	H1 2012	%
Net interest income	12,667	13,880	(9%)
Net change in valuation	134	2,532	(95%)
Net commission income	5,298	5,338	(1%)
Net financial income	296	181	64%
Other income	2,425	3,006	(19%)
Operating income	20,820	24,937	(17%)
Salaries and related cost	(6,679)	(6,169)	8%
Other operating expenses	(6,228)	(5,475)	14%
Net earnings before taxes	7,913	13,293	(40%)
Income tax	(1,749)	(2,913)	(40%)
Bank Levy	(188)	(510)	(63%)
Net gain from discontinued operations, net of tax	(65)	1,379	(105%)
Net earnings	5,911	11,249	(47%)
Shareholders of Arion Bank	6,137	11,052	(44%)
Minority interest	(226)	197	(215%)

CORE INCOME STATEMENT

CHALLENGING TO MAINTAIN ACCEPTABLE PROFITABILITY DUE TO INCREASED EQUITY

FX loss included in core operating income

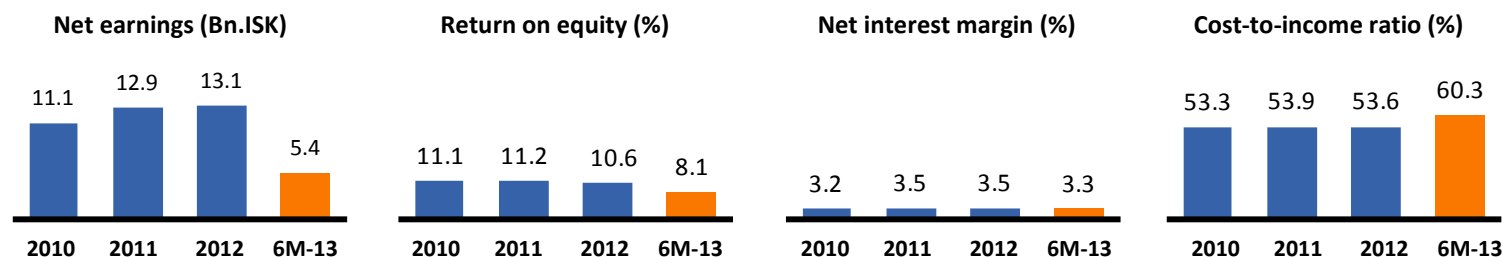
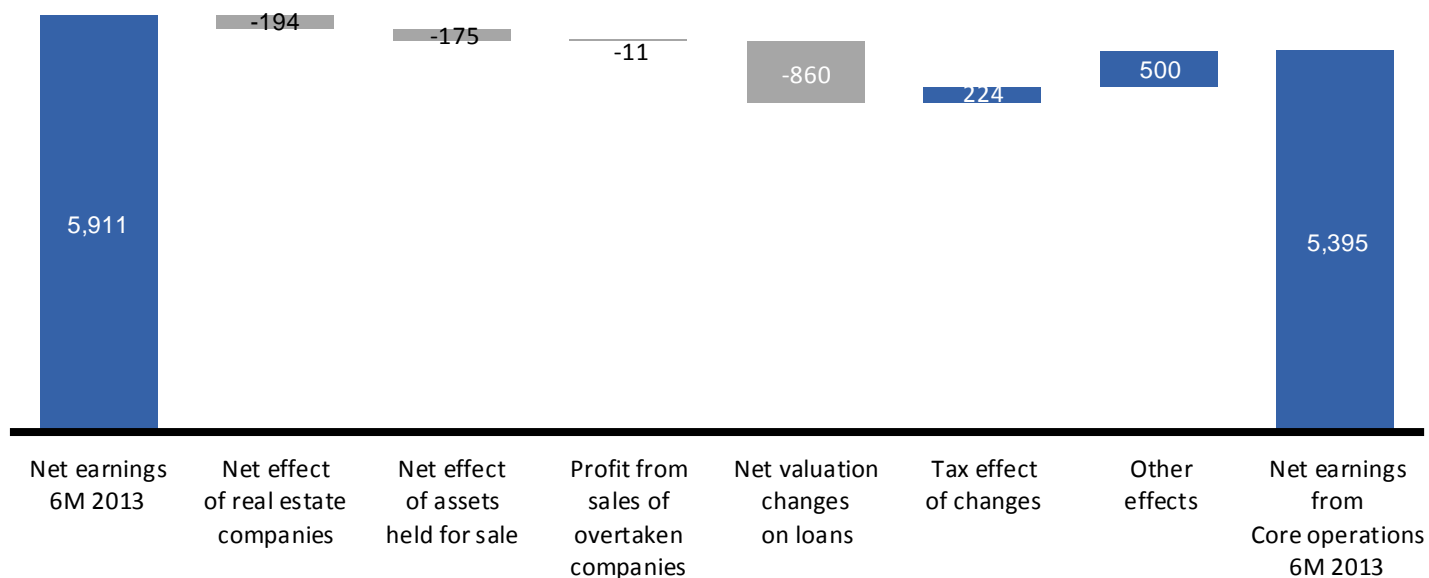
- Has a negative effect on performance

Challenging to maintain Core ROE due to high capitalization

- Core ROE was 9.8% in Q2 2013

Core C/I ratio improving from Q1-13

- Core C/I was 55.2% in Q2 2013 compared with 66.7% in Q1 2013



NET INTEREST INCOME

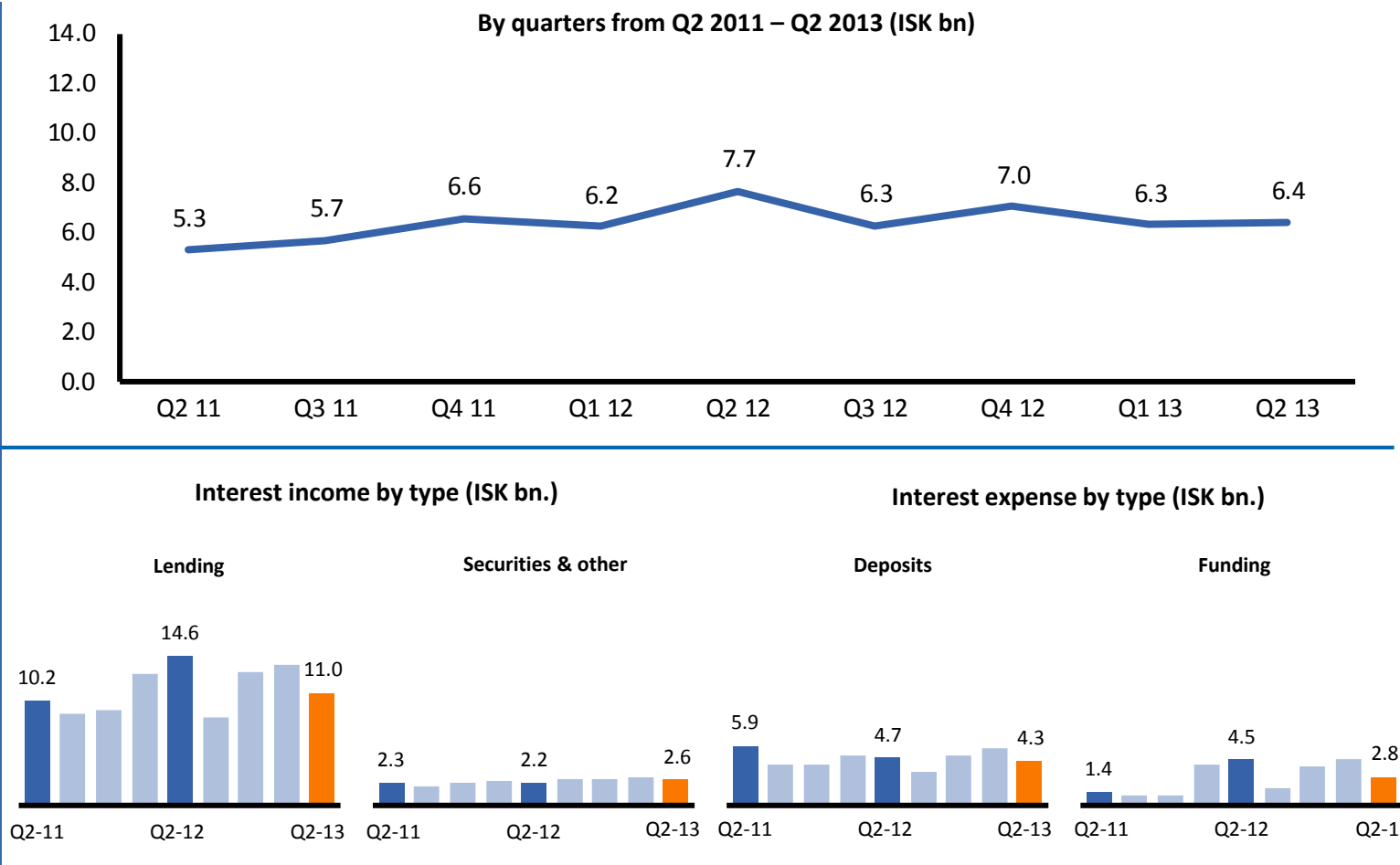
GROWING TREND IN NET INTEREST INCOME

Pressure on interest margin due to more competition in lending

Focus on cost and maturity of funding

Net interest income further affected by fluctuation in inflation

High net interest income in Q2 2012 due to one-off irregular interest income



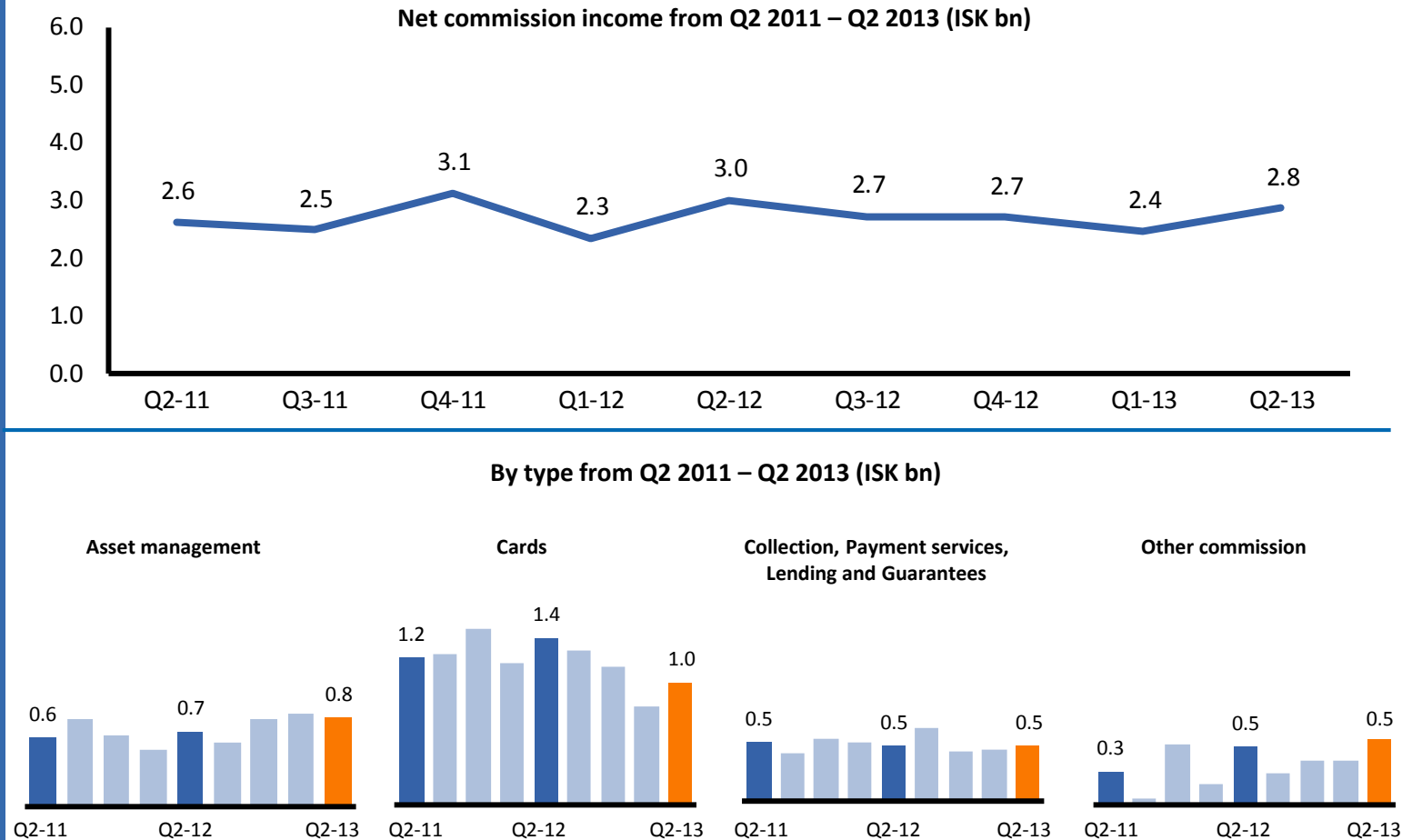
NET COMMISSION INCOME

STRONG COMMISSION INCOME DRIVEN BY RETAIL BANKING AND ASSET MANAGEMENT

Commission income from cards coming back after changes in revenue model at Valitor

Increasing commission income from asset management is driven by increasing asset under management

Other commission mainly from investment banking activities



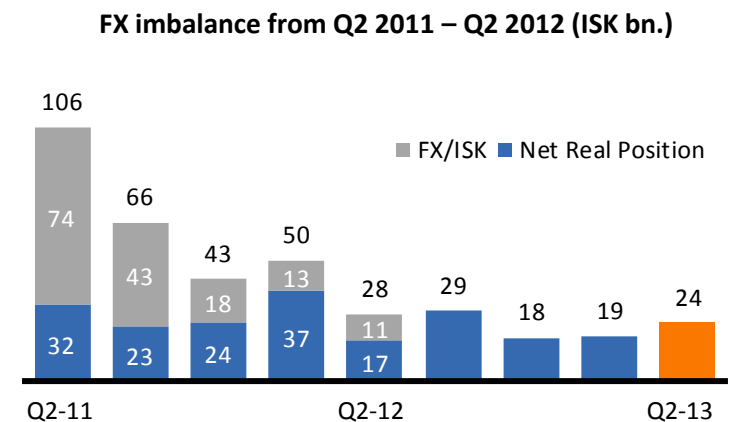
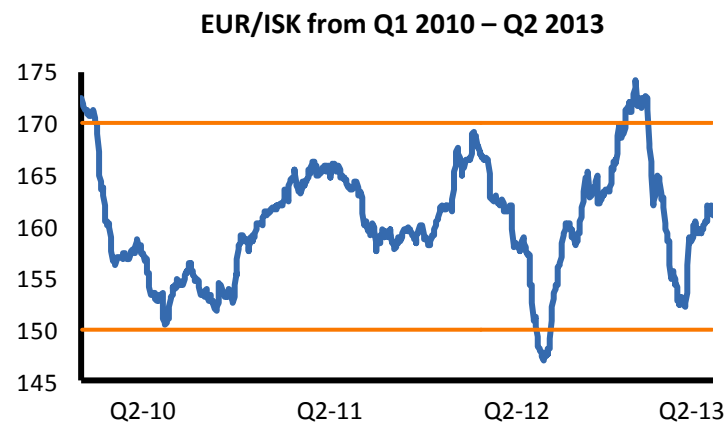
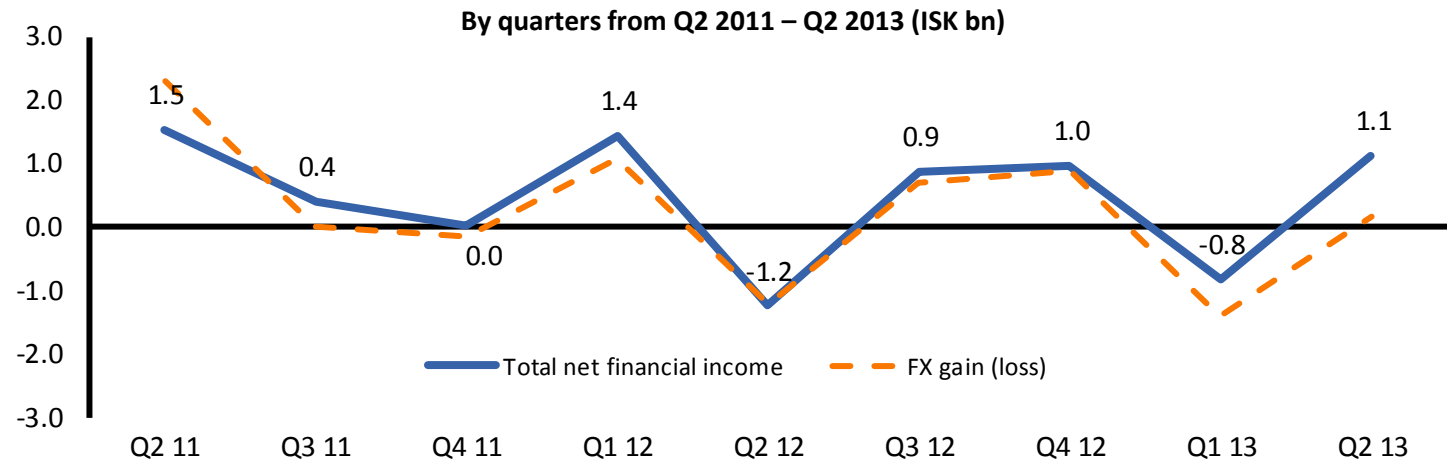
NET FINANCIAL INCOME

FX IMBALANCE HAS A FUNDAMENTAL EFFECT ON NET FINANCIAL INCOME

Net financial income driven by FX gain / loss which is affected by fluctuation in the Icelandic krona

Good progress in bond and equity markets

Increasing FX imbalance resulting from revaluation of FX loans



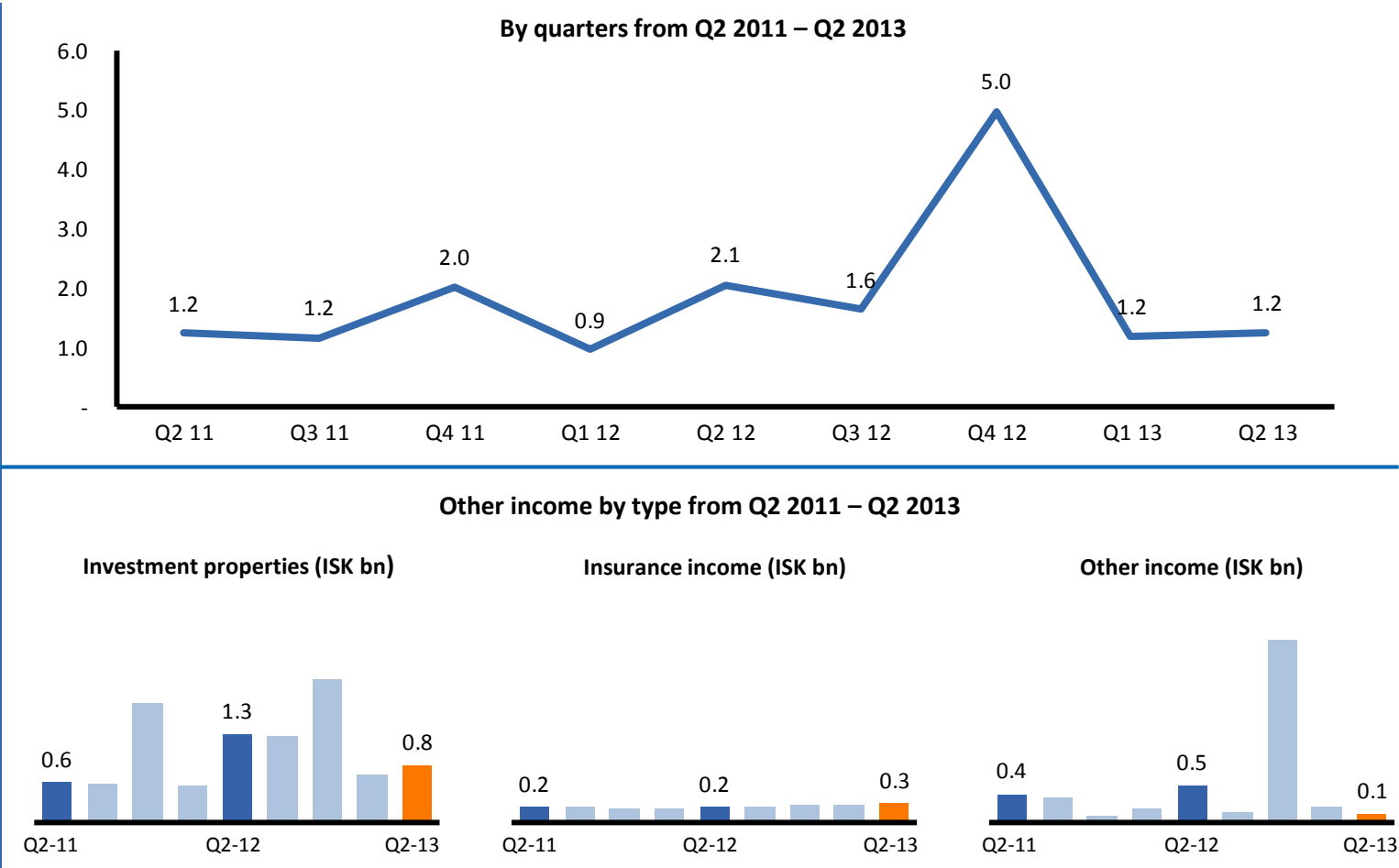
OTHER INCOME

VALUATION CHANGES HAVE A STRONG IMPACT

The increase in Q4-12 is mainly due to valuation changes in investment properties and fair value changes in associated companies

Income from investment properties are from real estate subsidiaries Landfestar and Landey

Stable insurance income from Okkar liftryggingar which is a core life insurance subsidiary



TOTAL OPERATING EXPENSE

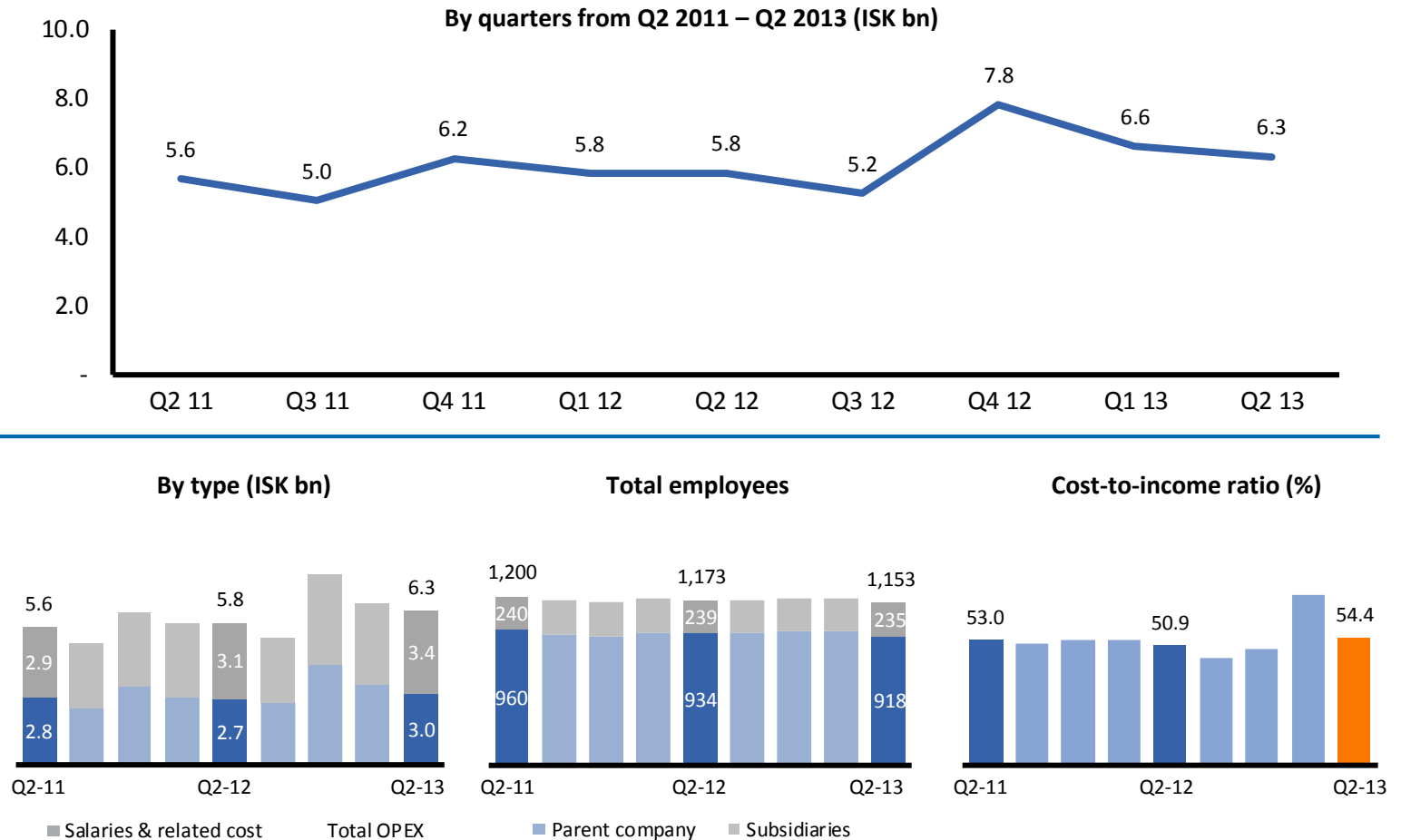
RELATIVELY STABLE COST BASE

Relatively steady cost-to-income ratio excluding Q1 2013

Large one-off costs in Q4 2012 and Q1 2013

Special tax on salaries and stipulated pay rise are the main factors for increasing salaries & related cost

Focus on increased efficiency with overall cost reduction



BALANCE SHEET



BALANCE SHEET

MODERATE GROWTH OF TOTAL ASSETS

No major change in the balance sheet from Q1 2013

No significant changes in loans to customers since year-end 2011

Financial assets are mainly bonds

Changes in Liabilities are mainly related to new borrowings

Assets				
Billion ISK	30.06.13	31.03.13	2012	2011
Cash & balances with CB	26	28	30	29
Loans to credit institutions	110	103	101	69
Loans to customers	567	566	567	562
Financial assets	154	146	138	158
Investments properties	29	28	29	27
Non current assets & disp.groups HFS	10	11	12	24
Other assets	34	26	25	24
Total assets	929	907	901	892

Liabilities and Equity				
Billion ISK	30.06.13	31.03.13	2012	2011
Due to credit institutions & CB	26	22	33	16
Deposits from customers	467	462	449	490
Non current liab. & disp.groups HFS	1	1	2	5
Other liabilities	63	54	57	47
Borrowings	203	204	195	187
Subordinated loans	33	32	34	32
Equity	137	132	131	115
Total liabilities and equity	929	907	901	892

LOANS TO CUSTOMERS ARE WELL DIVERSIFIED

WITH LOANS TO INDIVIDUALS REPRESENTING 45% OF TOTAL LOANS TO CUSTOMERS

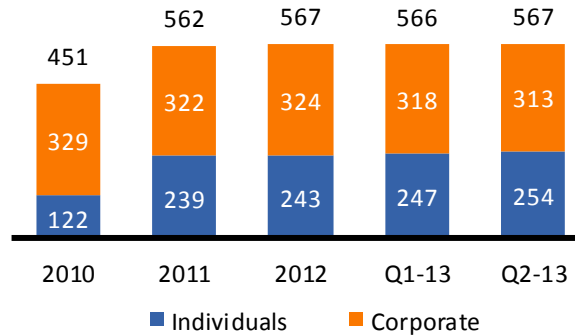
No growth in loans to customers is in line with moderate economic growth and hard competition from pension funds

Arion has a strong position on the mortgage loan market

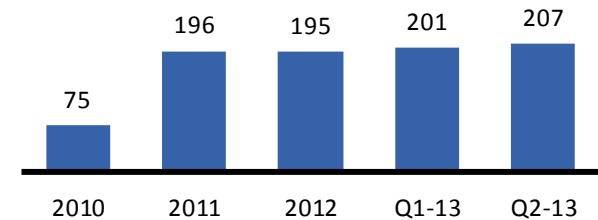
Good progress in redenomination of FX loans representing 22% of total loans to customers in ISK

It is the strategic objective of the bank to maintain and build further on this diversity rather than concentration in particular sectors

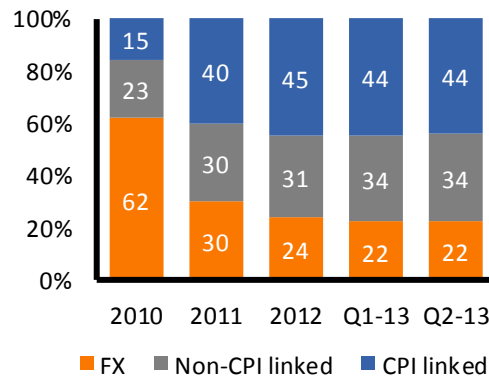
Development (ISK bn)



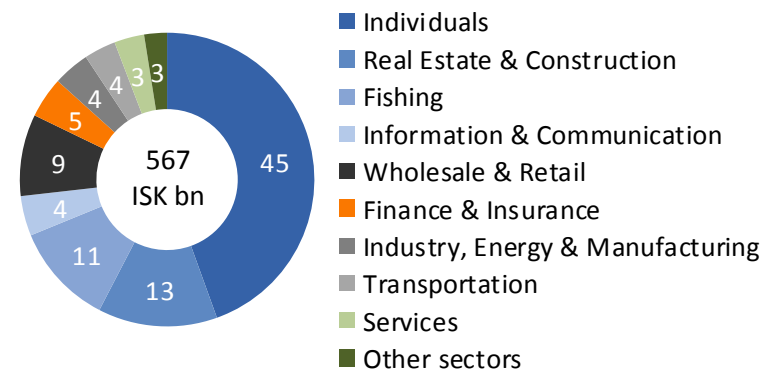
Mortgage loans (ISK bn)



By currencies 30.06.2013 (%)



By sectors 30.06.2013 (%)



IMPROVING ASSET QUALITY

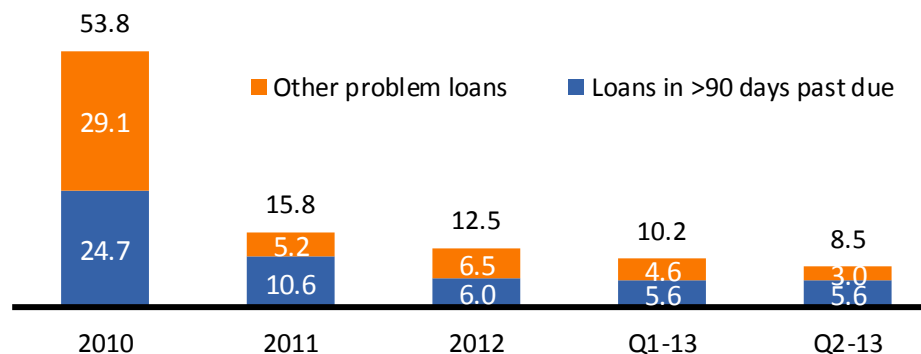
THE BANK AIMS TO GET PROBLEM LOANS DOWN TO 5% BY THE END OF THE YEAR

Good progress in recovery

Problem loans have continued to decreased since their peak in 2010

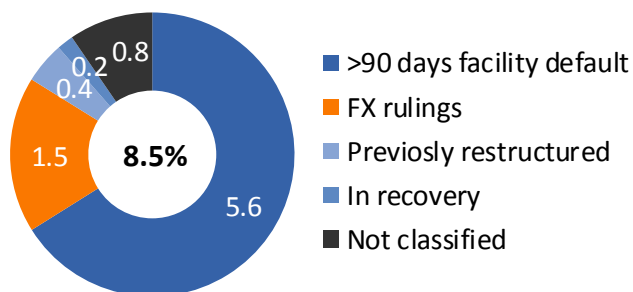
Loans in over 90 days default have also been decreasing

Development of problem loans (%)

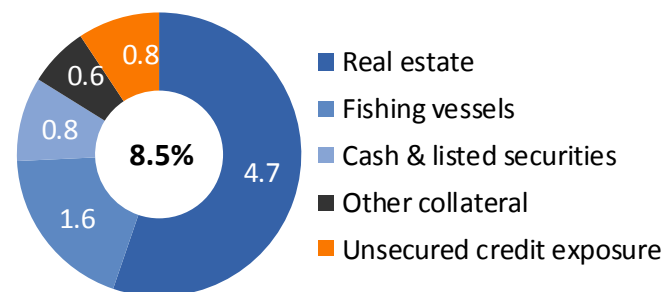


The bank define problem loans as book value of loans (i.e. net of impairment) that are either individually impaired or are in over 90 days past due and not impaired as % of total book value of loans to customers

Problem loans by status (%)



Collateral behind problem loans (%)



STRONG FUNDING PROFILE

NO SIGNIFICANT REDEMPTION OF LONG-TERM FUNDING DURING COMING YEARS

Limited refinancing needs in years to come for current loan portfolio

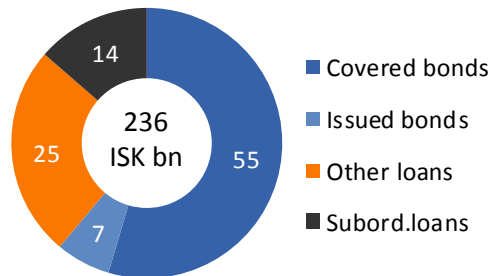
- Low uncertainty in funding cost

First Icelandic bank to access international funding markets in February 2013

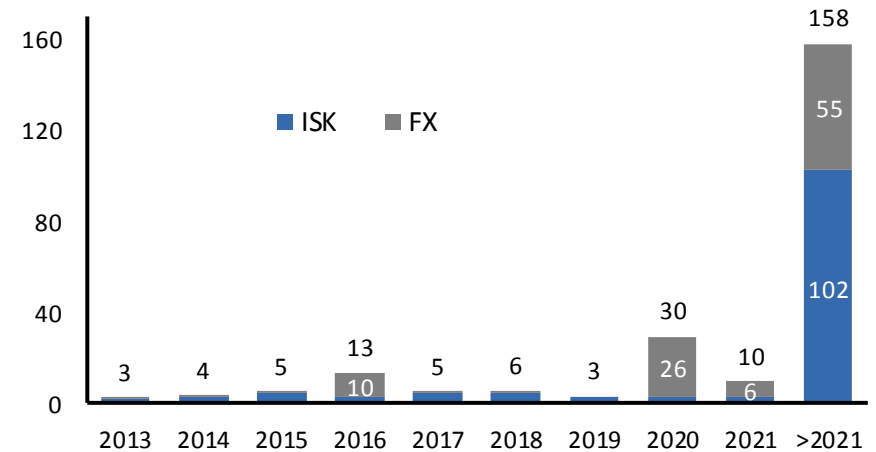
- New bond with maturity in 2016

Successfully increased term deposits

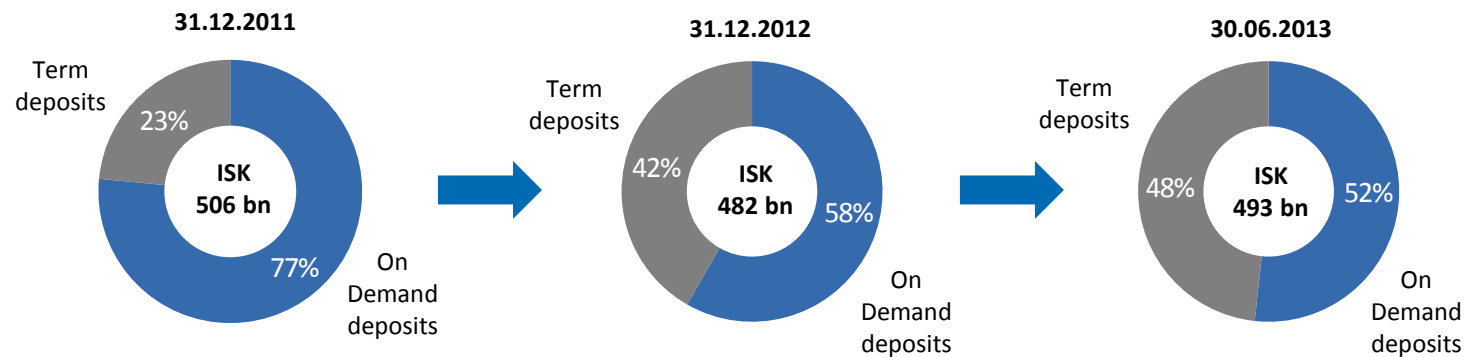
Funding mix (%)



Maturity of long-term funding 30.6.2013 (ISK bn)



Development of total deposits by maturity



SOUND MANAGEMENT OF LIQUIDITY

THE BANK HOLDS GREAT LIQUIDITY RESERVE IN FOREIGN CURRENCY

Arion's liquidity position is strong, based on limited refinancing needs in coming years and solid deposit base

Focus on maintaining strong liquidity in FX

Liquidity ratios well above regulatory minimum

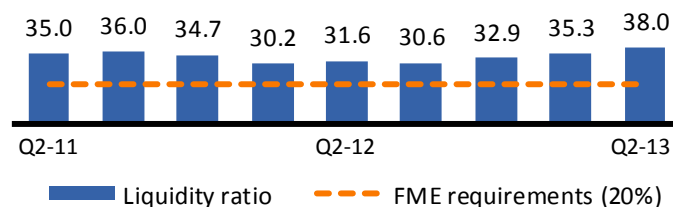
Legal entities and retail individuals deposits are categorized as the most sticky and are the Bank's core deposits

Deposits from investors are in ISK and mainly from Icelandic pensions funds

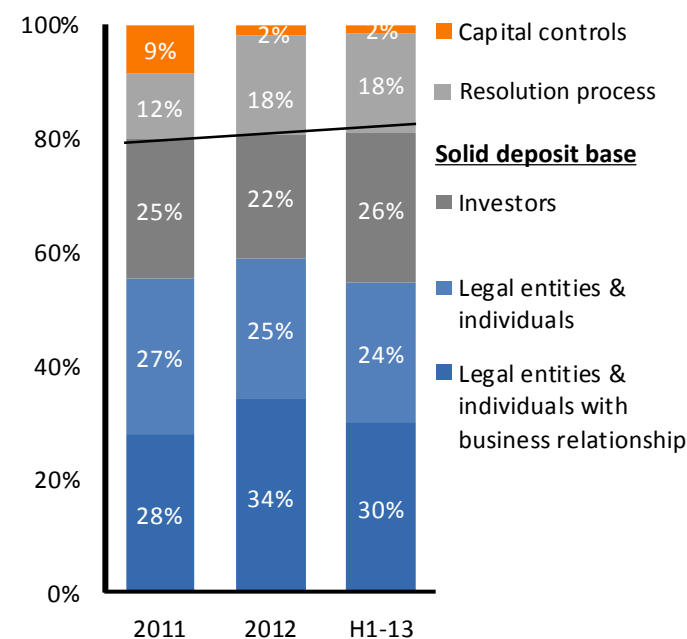
Deposits coverage ratio 30.6.2013 (ISK bn)

Asset type	ISK	FX	Total
Cash and balances with Central Bank	15	9	24
Balances with Credit institutions	-	70	70
Repo eligible bonds and Liquid Facility	112	-	112
Total liquid assets	127	79	206
Liquid assets to total deposits	28%	98%	38%
Cash to total on demand deposits	6%	195%	32%

Development of liquidity ratio (%)



Deposits from customers by stickiness rating



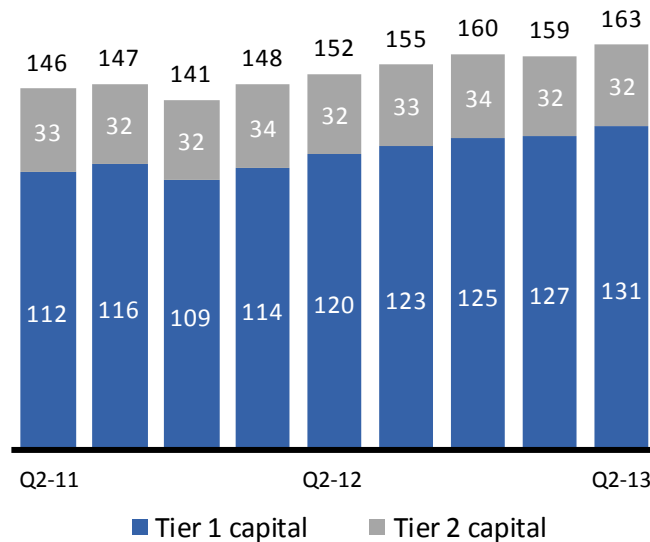
VERY SOLID CAPITAL BASE

WITH HIGH QUALITY CAPITAL WITH NO RELIANCE ON HYBRID INSTRUMENTS

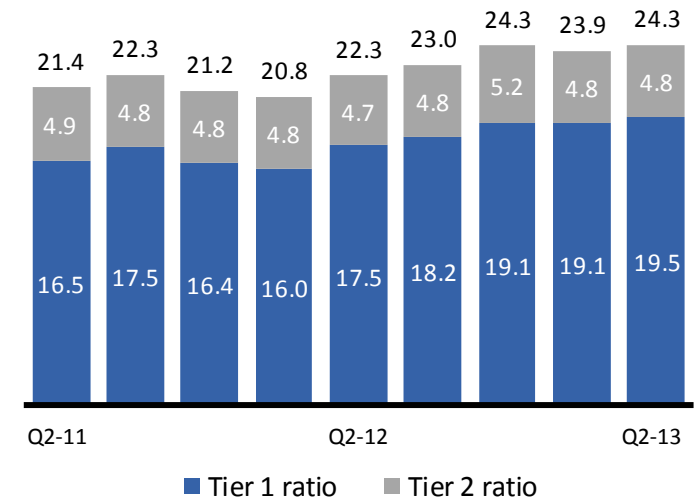
Arion has maintained very solid levels of capitalization due to strong profit generation and dividend payment restrictions

The Bank's capital base is composed of core Tier 1 and Tier 2 capital

Total capital base (ISK bn)



Total capital ratio (%)



KEY FINANCIAL INDICATORS



KEY FINANCIAL INDICATORS

VOLATILITY IN PROFITABILITY DUE TO IRREGULAR ITEMS

Strong profitability in Q2 2013 but the aim is to reduce volatility

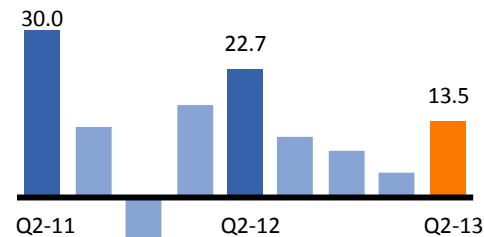
Competitive C/I ratio but the aim is to improve further

Improving asset quality and further improvements expected this year

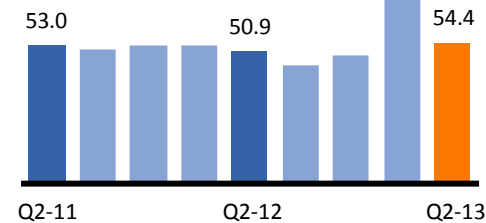
Loans-to-deposits ratio increasing due to acquisition of mortgage loan portfolio in 2011

Increasing total capital ratio due to good profitability

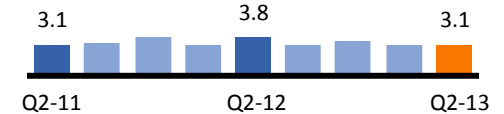
Return on equity (%)



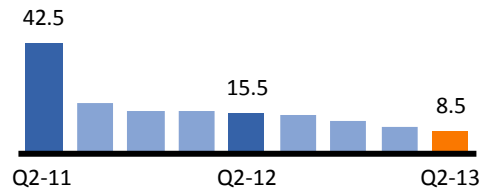
Cost-to-income ratio (%)
without net valuation change



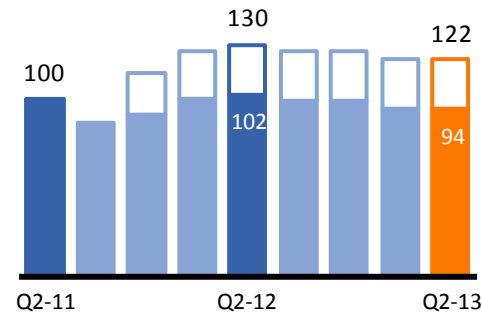
Net interest margin (%)



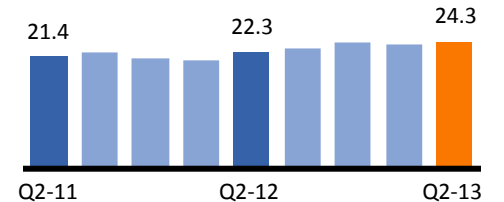
Problem loans * (%)



Loans-to-deposits ratio (%)
without loans financed with covered bonds



Total capital ratio (%)



* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

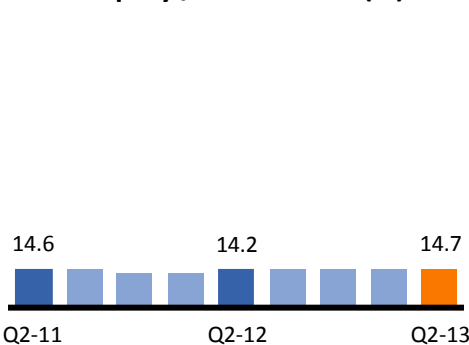
KEY FINANCIAL INDICATORS

Return from core operation close to target

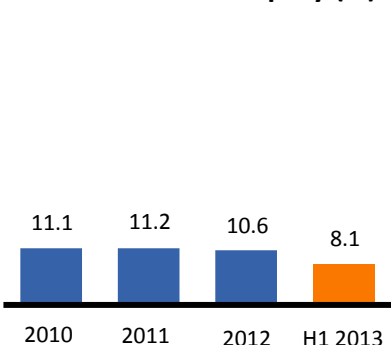
Difficult to decrease Cost to total average assets ratio without increase in assets

Extremely strong liquidity and cash position

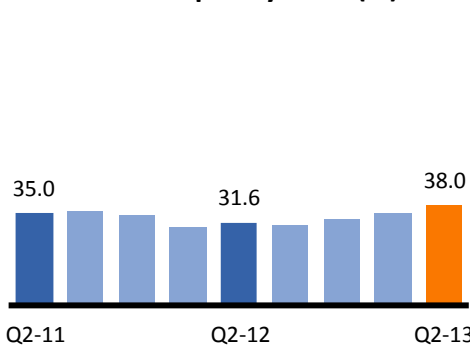
Equity / Total assets (%)



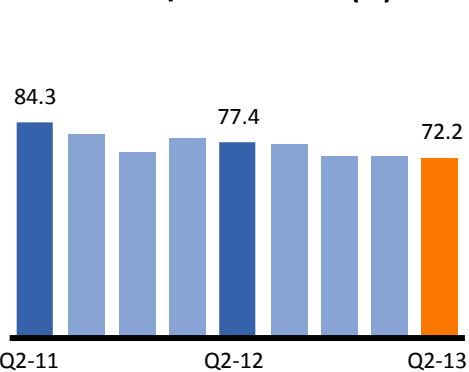
Core return on equity (%)



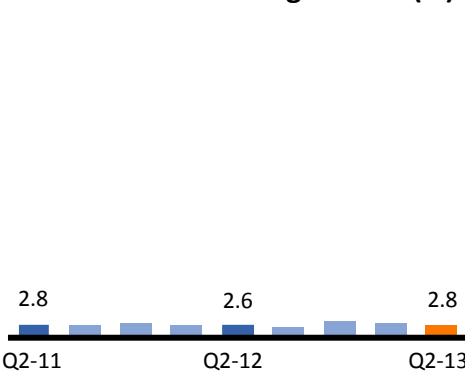
Secured liquidity ratio (%)



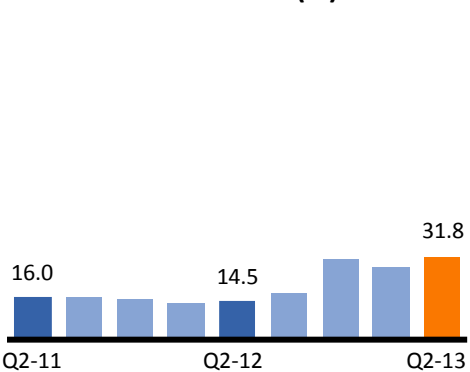
RWA / Total assets (%)



Cost-to-total average assets (%)



Cash ratio (%)



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