

# FINANCIAL STATEMENTS 2015

INVESTOR PRESENTATION  
FEBRUARY 2016



# ARION BANK IS A UNIVERSAL RELATIONSHIP BANK

ARION BANK PROVIDES A FULL RANGE OF FINANCIAL SERVICES

## Retail Banking

- ~ 30% market share
- Largest private provider of residential mortgages
- Wide range of financial services for individuals and SMEs
- Strong focus on digital banking solutions

## Asset Management

- Leading player in the Icelandic market
- AuM equal to Arion Bank's total assets
- Services institutional investors and HNW clients

## Investment Banking

- A leading capital markets house and M&A advisor
- Full range of investment banking services
- Managed all IPOs this year

## Corporate Banking

- Leading lender to large corporates in Iceland
- Innovative and customized solutions
- International activities in seafood and related businesses

# STRATEGIC SUBSIDIARIES IN THE ARION BANK GROUP

ARION BANK PROVIDES A FULL RANGE OF FINANCIAL SERVICES

## VALITOR

- The largest online and e-commerce payment services company in Iceland
- Operations in Iceland, Denmark and the UK
- Member of VISA EU and MasterCard International

## STEFNIR

- Iceland's largest fund management company
- Retail and professional clients
- Range of mutual, investment and institutional investment funds

## okkar

- Leading life insurance company in Iceland
- Focus on modern personal insurance services
- Sales and distribution partnerships with Arion Bank

## vörður

- Vörður is the 4th largest non-life insurance company in Iceland, with a market share of more than 10%
- Arion Bank has reached a deal to acquire 51% in the company
- Acquisition is subject to approval of Icelandic regulators

# HIGHLIGHTS OF 2015

## BANK OF THE YEAR AND MILESTONE REACHED WITH END OF RECOVERY CASES

### 2015 Bank of the year in Iceland – The Banker

- The Bank consolidated its position on all key markets
- Universal bank with focus on fee and commission income, especially from asset management and investment banking activities
- More diversified funding, issued bonds both on domestic and international markets
- Emphasis on digital banking with increased popularity of the Arion app



### Major debt recovery cases concluded

- Arion Bank arranged all three IPOs on Nasdaq Iceland in 2015: Eik, Reitir and Síminn
  - The Bank sold shares in all three companies in public offerings in the run-up to the listings
- Sale and listing of shares in Refresco Gerber
  - Companies in Arion Bank Group owned 9.3% directly or indirectly, and half of this interest was sold when the company was listed
- Arion Bank prepared the sale of a 46% holding owned by the subsidiary BG12 slhf. in Bakkavor Group Ltd in collaboration with other shareholders in the company
  - Stake sold at the beginning of 2016

# HIGHLIGHTS OF 2015

---

## INVESTMENT GRADE CREDIT RATING

### Increased access to the credit markets

- Arion Bank was the first Icelandic bank to issue bonds in euros to a broad group of investors - €300 million
- More expensive loans prepaid, reducing Bank's financing costs
- The Bank issued bonds totalling NOK 800 million
- ISK 23.6 billion in covered bonds issued in 2015
- Liquidity of covered bonds increased following market making agreements with Kvika, Íslandsbanki and Landsbankinn
- Arion Bank's credit rating upgraded from BB+ to BBB- with a positive outlook



### Growth in loans to customers

- Solid growth in loans to corporate clients
  - Two pelagic vessels owned by HB Grandi funded in collaboration with DNB Bank
  - New freezer vessel owned by Rammi hf. funded in collaboration with DNB Bank
  - Arion arranged a USD 50 million bond issue for the national power company Landsvirkjun
  - Funding and advisory role to Sameinað sílíkon hf. on first silicon plant in Iceland
  - Funding agreement and advisory role on planned development of 5-star Marriott Edition hotel
- Growing share of vehicle and equipment financing market
- Special terms for first mortgage introduced
  - Loans for up to 85% of market value
  - No borrowing fee

# HIGHLIGHTS OF 2015

## FOCUS ON SERVICES TO INVESTORS AND INNOVATION

### Strong asset management

- Assets under management, excluding subsidiaries, passed the ISK 500 billion mark - good investment returns during the year
- Successful sale of real estate from investor funds SRE I and SRE II, managed by Stefnir
- Frjálsi named best pension fund in Europe in its class by IPE



### Startups – Best business accelerator in the Nordic region

- Over ISK 800 million invested in Eyrir Sprotar
- Arion Bank hosted Startup Reykjavík for fourth year. The Bank has invested in 40 startups in these four years in addition to 14 companies through Startup Energy Reykjavík
- Startup Reykjavík was recognized at the Nordic Startup Awards as the best business accelerator in the Nordic region



# HIGHLIGHTS OF 2015

## RESPONSIBLE MEMBER OF SOCIETY

### Active in the community

- Arion Bank donated 400 new medical beds to the National University Hospital
- We participated in and hosted numerous interesting and entertaining events, conferences, exhibitions, meetings and courses
  - 47,000 people attended these events
  - Arion Bank Stock Exchange Days held for the fifth year in a row
- Arion Bank was the chief sponsor of the 2015 Seafood Conference and published a special report on the industry
- Signatory to declaration on climate issues

### Equal salary certification from VR

- Arion Bank became first bank and the largest Icelandic company to receive equal salary certification from VR
- System is designed to guarantee that people doing the same or comparable jobs are not discriminated against in terms of pay



VR-15-024

### Good corporate governance

- The Center for Corporate Governance at the University of Iceland recognized Arion Bank as a company which had achieved excellence in corporate governance

# HEADLINE FIGURES FOR 2015

---

## Profitability

Net earnings  
**ISK 49,679**  
million  
2014:  
ISK 28,594 million

## Strength

Tier 1 ratio  
**23.4%**  
31.12.2014:  
21.8%

## Efficiency

Cost-to-  
income ratio  
**32.6%**  
2014:  
50.1%

## Asset quality

Problem  
loans  
**2.5%**  
31.12.2014:  
4.4%

Return on  
equity  
**28.1%**

2014:  
18.6%

Leverage  
ratio  
**16.7%**

31.12.2014:  
15.4%

Number of  
employees  
**1,147**

31.12.2014:  
1,120

Mortgages/  
Total loans  
**39.4%**

31.12.2014:  
42.8%



## INCOME STATEMENT



# INCOME STATEMENT

All amounts in ISK million

## HIGH NET EARNINGS IN Q4 MAINLY DUE TO SALE AND REVALUATIONS OF SÍMINN AND BAKKAVOR

- Increase in net interest income
- Net commission income increased in all main business areas
- Increase in net financial income due to favourable market conditions, mainly in equities
- Profit from sale and revaluation of Síminn and Bakkavor have a major impact on Q4
- Negative net impairment mainly related to foreign exposure in the oil and gas sector

	Q4 2015	Q4 2014	Diff	Diff%
Net interest income	6,705	5,911	794	13%
Net commission income	3,758	3,190	568	18%
Net financial income	2,668	1,429	1,239	87%
Share of profit of associates	22,510	3,525	18,985	539%
Other income	537	1,683	(1,146)	-68%
<b>Operating income</b>	<b>36,178</b>	<b>15,738</b>	<b>20,440</b>	<b>130%</b>
Salaries and related expense	(4,572)	(3,953)	(619)	16%
Other operating expenses	(4,288)	(4,465)	177	-4%
Bank levy	(650)	(635)	(15)	2%
Net impairment	(2,973)	(742)	(2,231)	301%
<b>Net earnings before taxes</b>	<b>23,695</b>	<b>5,943</b>	<b>17,752</b>	<b>299%</b>
Income tax	504	(223)	727	-
Net gain from disc. operations	83	241	(158)	-66%
<b>Net earnings</b>	<b>24,282</b>	<b>5,961</b>	<b>18,321</b>	<b>307%</b>

# INCOME STATEMENT

All amounts in ISK million

## HIGH NET EARNINGS MAINLY DUE TO SALE AND REVALUATIONS OF LEGACY HOLDINGS

- Strong regular operations with net earnings ISK 16,786 million and ROE 10.4%
- Solid growth in net commission income which increased in all business segments
- Share of profit of associates has a major effect on net earnings
- Slight increase in expenses between years
- Negative net impairment resulting from AFL savings bank and oil and gas exposures

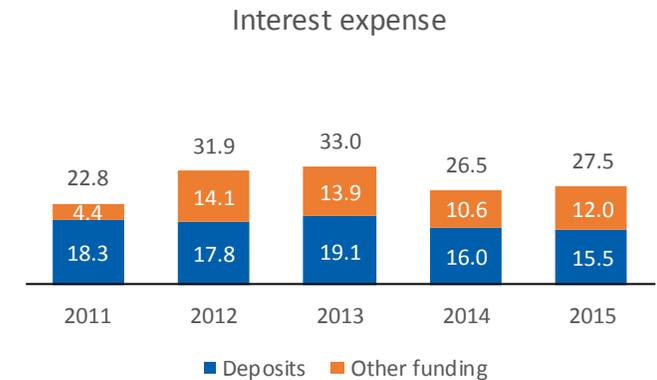
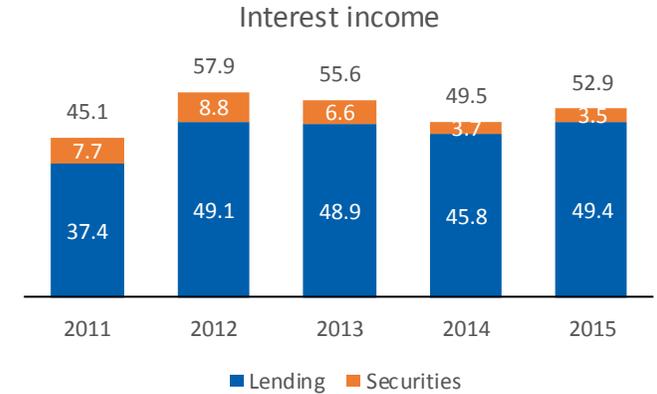
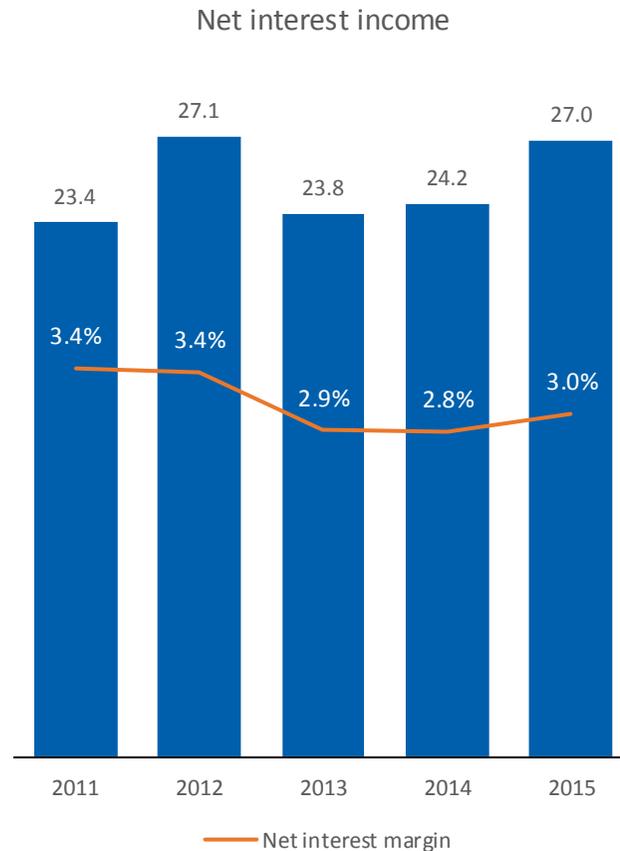
	2015	2014	Diff	Diff%
Net interest income	26,992	24,220	2,772	11%
Net commission income	14,484	13,309	1,175	9%
Net financial income	12,844	7,290	5,554	76%
Share of profit of associates	29,466	3,498	25,968	742%
Other income	2,769	5,673	(2,904)	-51%
<b>Operating income</b>	<b>86,555</b>	<b>53,990</b>	<b>32,565</b>	<b>60%</b>
Salaries and related expense	(14,892)	(13,979)	(913)	7%
Other operating expenses	(13,304)	(13,061)	(243)	2%
Bank levy	(2,818)	(2,643)	(175)	7%
Net impairment	(3,087)	2,135	(5,222)	-
<b>Net earnings before taxes</b>	<b>52,454</b>	<b>26,442</b>	<b>26,012</b>	<b>98%</b>
Income tax	(3,135)	(4,679)	1,544	-33%
Net gain from disc. operations	360	6,833	(6,473)	-
<b>Net earnings</b>	<b>49,679</b>	<b>28,596</b>	<b>21,083</b>	<b>74%</b>

# NET INTEREST INCOME

All amounts in ISK billion

## INCREASE IN NET INTEREST INCOME RESULTING FROM TREASURY ACTIVITIES AND HIGHER INFLATION

- Net interest margin increasing due to slightly higher inflation and more favourable funding
- New funding during the year mostly issued bonds while deposits remain stable
- Increased focus on funding and liquidity management has supported the development of the net interest margin



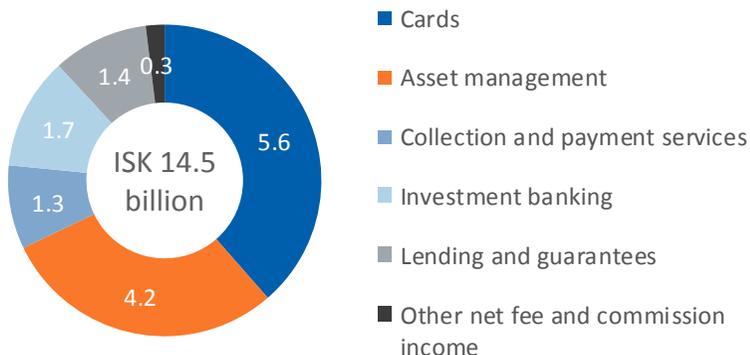
# NET COMMISSION INCOME

All amounts in ISK billion

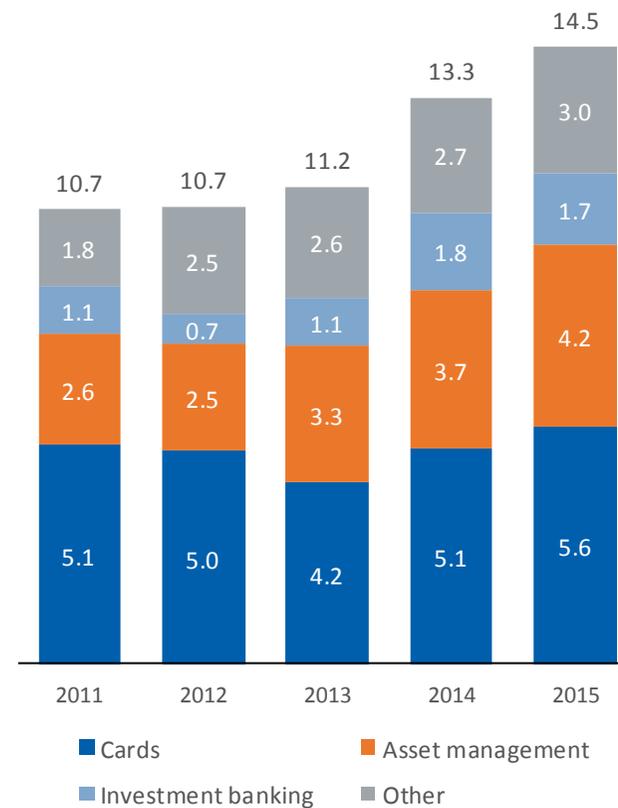
## CONTINUED GROWTH, PRIMARILY IN CARDS AND ASSET MANAGEMENT

- Good growth in net commission income from cards relating to expansion in Scandinavia and the UK
- Outstanding performance in asset management with net commission income growing almost 15% YoY
- Assets under management at year end 2015 ISK 997 billion, compared with ISK 924 billion at year end 2014 - approx. the size of Arion Bank's balance sheet
- Good progress in investment banking which has led the re-establishment of the Icelandic stock exchange

Breakdown of Net commission income 2015



Net commission income

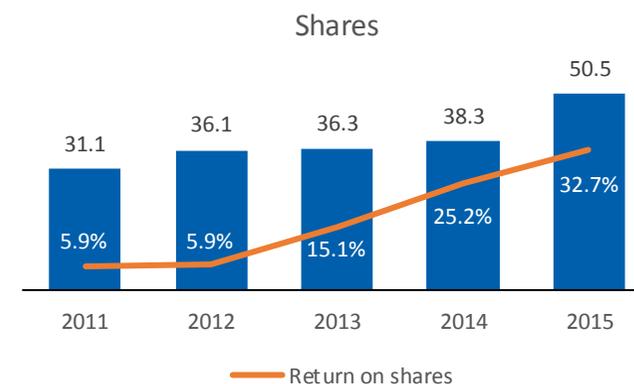
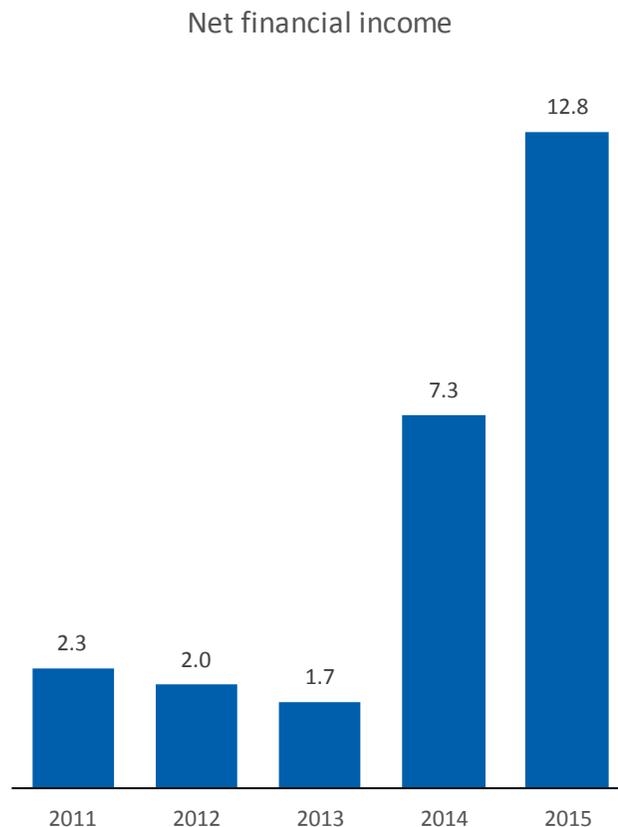


# NET FINANCIAL INCOME

All amounts in ISK billion

## MAJOR CONTRIBUTION TO NET EARNINGS

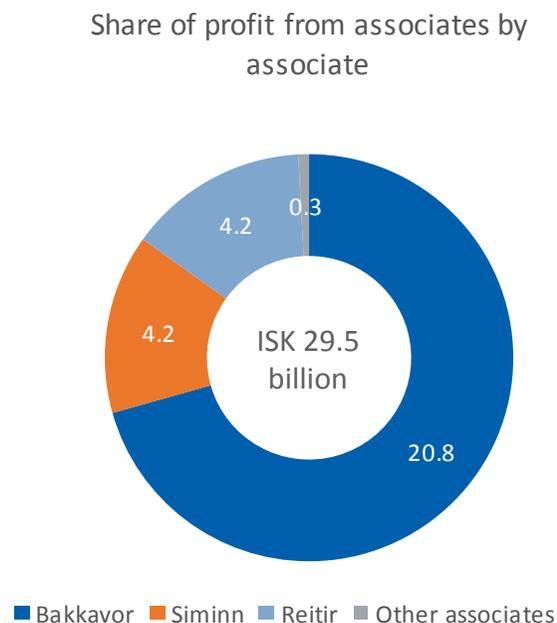
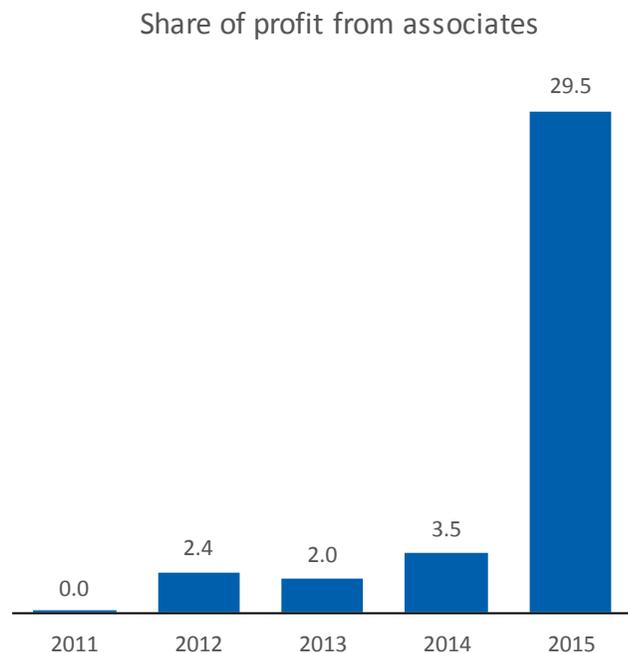
- Excellent return on equity positions, largely due to shares in Refresco Gerber in connection with the company's IPO
- The Icelandic stock index OMXI8 gained 43% during the year
- The Bank holds significant equity positions in Reitir, Síminn and HB Grandi following the listings of those company's. Those shares traded favourably during the year
- Good returns on bond holdings



# SHARE OF PROFIT FROM ASSOCIATES

All amounts in ISK billion

SALE AND FAIR VALUE CHANGES OF LEGACY HOLDINGS EXCEED NII AND HAVE A MAJOR ONE-OFF EFFECT



- Reitir fasteignafelag hf. was listed on Nasdaq Iceland in April and the Bank sold a significant part of its share in connection with listing
- Síminn hf. was listed on Nasdaq Iceland in October and the Bank sold a significant part of its share in connection with listing
- Bakkavor Group Ltd. was revalued in December 2015 and sold in January 2016

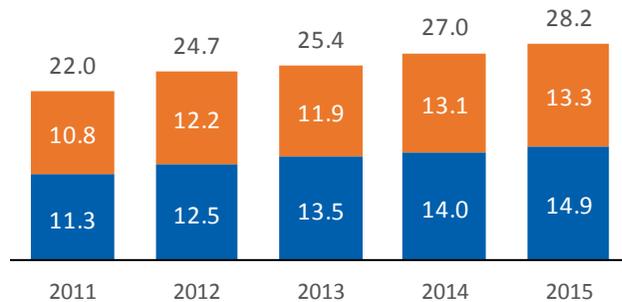
# TOTAL OPERATING EXPENSES

All amounts in ISK billion

## INCREASE IN EXPENSE RELATING TO INCREASED ACTIVITIES

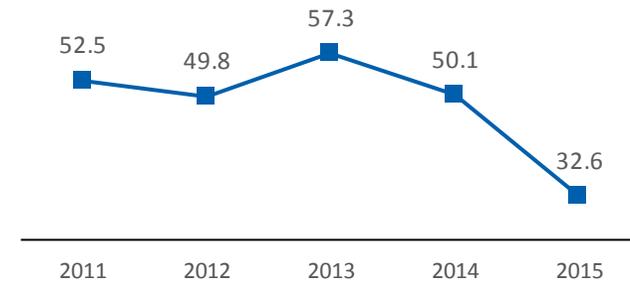
- Increase in total salaries and other operating expenses mainly related to increased activities in foreign operation of Valitor
- An increase in both IT expenditures and marketing expenses from last year
- Slight increase in number of employees at parent company due to merger with AFL savings bank
- Very low Cost-to-income ratio resulting from large one-off income items

Total operating expense



Other operating expense Salaries and related expense

Cost-to-income ratio (%)



Number of employees



Parent company Subsidiaries

# BALANCE SHEET



# BALANCE SHEET

All amounts in ISK billion

## EMPHASIS ON WELL MANAGED LOAN GROWTH, ASSET QUALITY AND FUNDING DURING THE YEAR

- Loans to customers increased during the year, mainly to corporate customers
- Deposits increased during the year and liquidity position remains strong
- The Bank increased borrowings by issuing covered bonds domestically and senior unsecured bonds internationally
- Subordinated loans partially prepaid during the year
- Strong equity position at year end

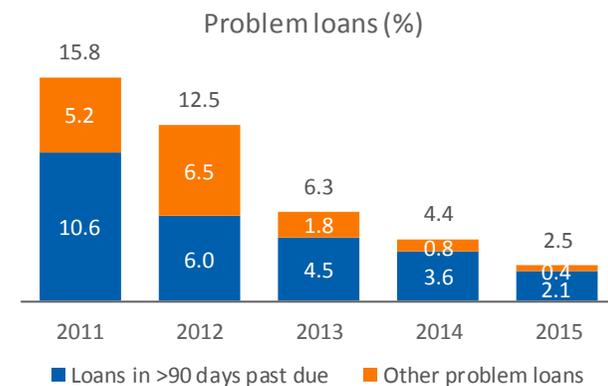
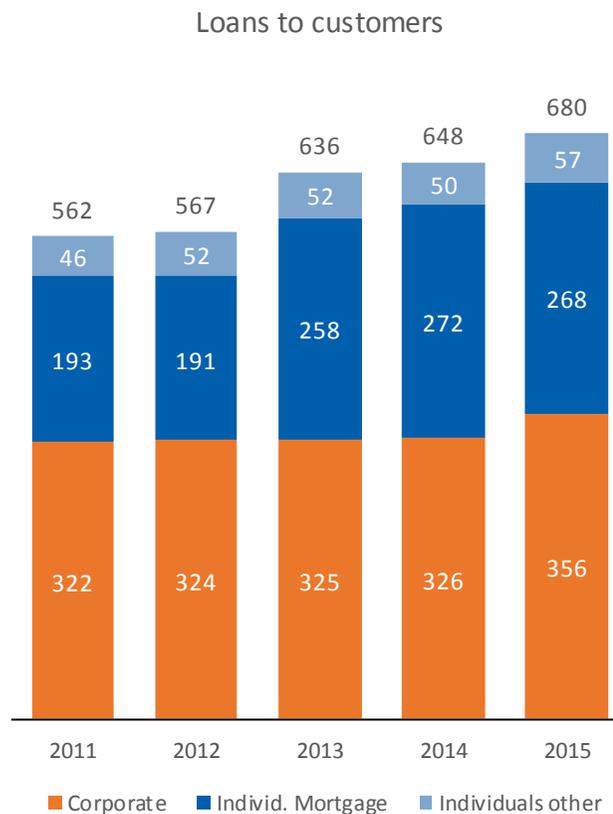
<b>Assets</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Cash & balances with CB	48	21	38	30	29
Loans to credit institutions	87	109	102	101	69
Loans to customers	680	648	636	567	562
Financial assets	133	102	87	138	158
Investment property	8	7	29	29	27
Investments in associates	27	22	18	7	3
Other assets	27	26	30	30	45
<b>Total Assets</b>	<b>1,011</b>	<b>934</b>	<b>939</b>	<b>901</b>	<b>892</b>
<b>Liabilities and Equity</b>					
Due to credit institutions & CB	11	23	28	33	16
Deposits from customers	469	455	472	449	490
Other liabilities	62	61	58	59	52
Borrowings	256	201	205	195	187
Subordinated loans	10	32	32	34	32
Share holders equity	193	161	140	127	110
Non-controlling interest	9	2	5	4	4
<b>Total Liabilities and Equity</b>	<b>1,011</b>	<b>934</b>	<b>939</b>	<b>901</b>	<b>892</b>

# LOANS TO CUSTOMERS

All amounts in ISK billion

## INCREASED DEMAND FOR NEW LENDING IN 2015

- Continued good balance in loans to corporates and individuals
- Slight decrease in mortgage loans due to the debt forgiveness of CPI indexed loans by the Icelandic state
- Good diversification in the corporate loan book
- Problem loans continue to decrease
- Solid growth in car loans whilst overdrafts are reduced in loans to individuals

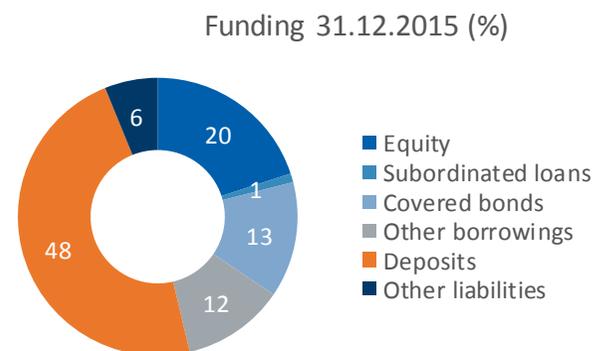
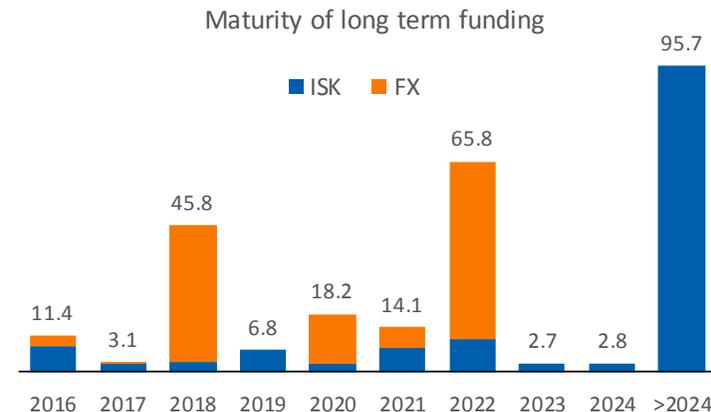
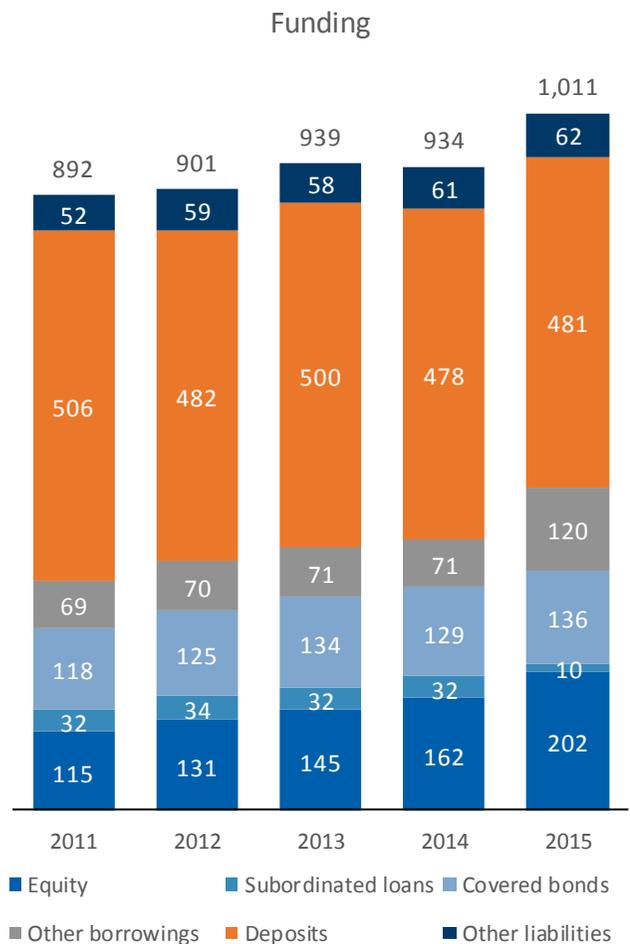


# FUNDING

All amounts in ISK billion

## THE BANK HAS BEEN LEADING THE RE-ENTRY INTO THE INTERNATIONAL MARKETS

- Bank issued 3-year EUR 300 million benchmark bond in March and a 5-year NOK 800 million bond in June and November.
- The Bank prepaid 2/3 of subordinated loans during 2015
- The Bank repurchased NOK 394 million of NOK 500 million bond issue from 2013
- The Bank continues to issue covered bonds on the Icelandic market, a total of ISK 20.7 billion during 2015

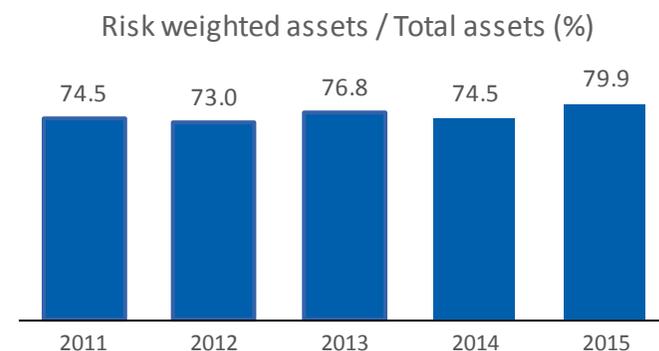
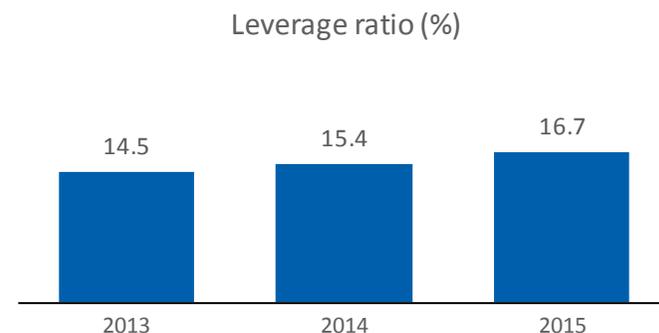
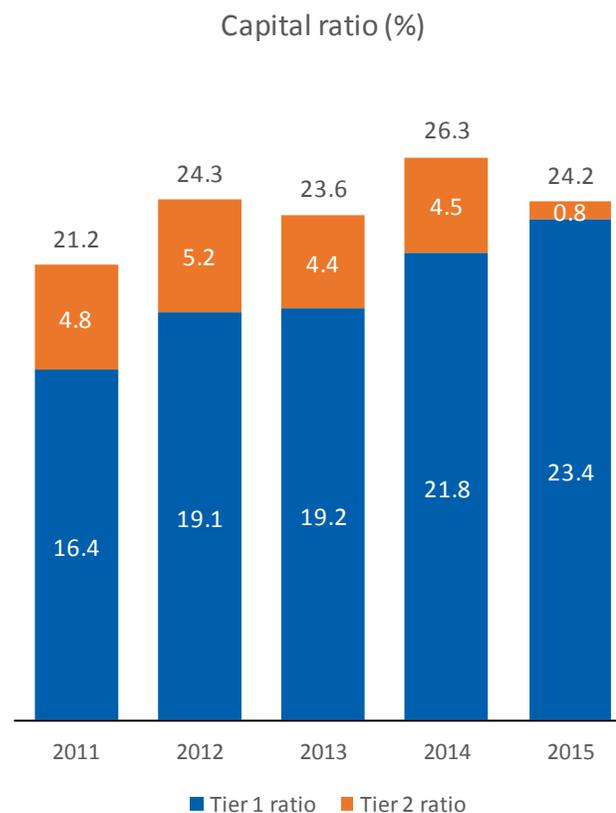


# CAPITAL BASE

All amounts in ISK billion

## VERY STRONG CAPITAL BASE DESPITE SUBSTANTIAL DIVIDEND PAYMENT

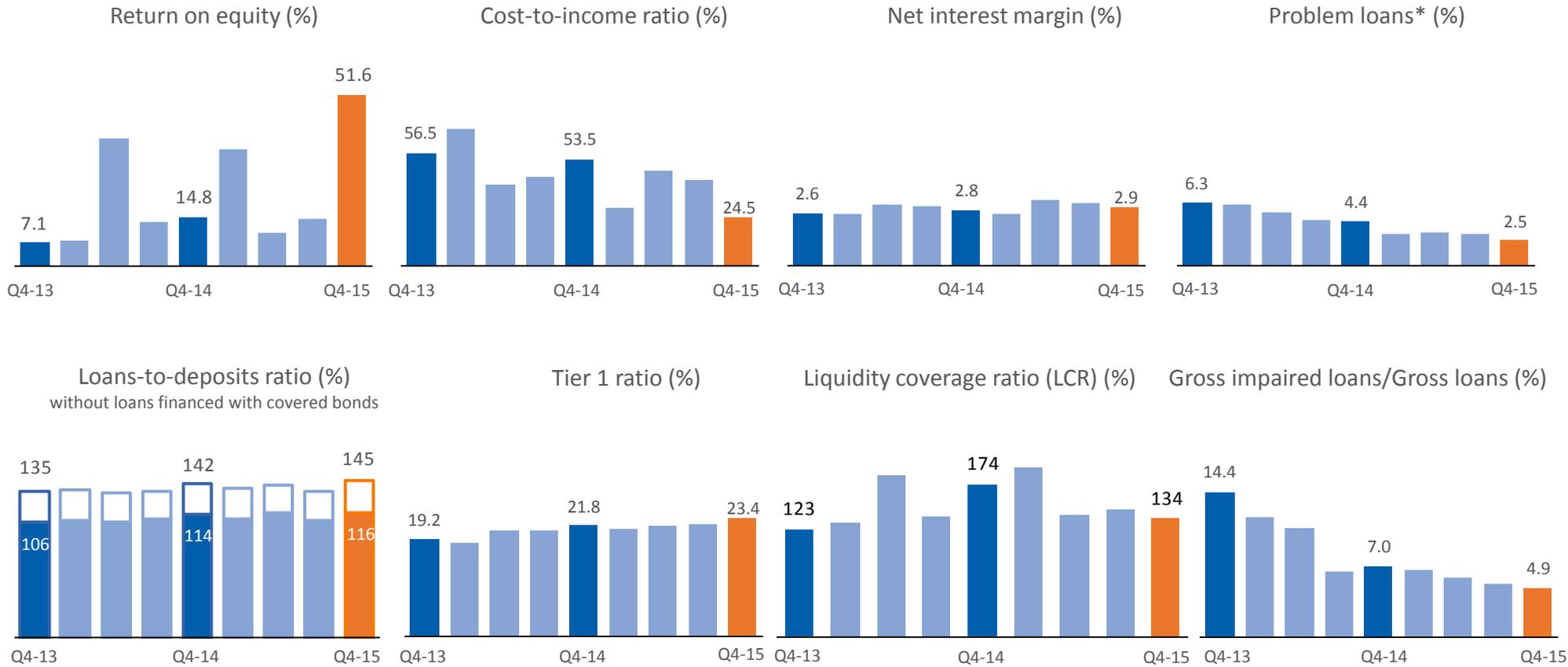
- Decrease in Tier 2 due to ISK 20 billion prepayment of subordinated liabilities
- Dividend payment of ISK 12.8 billion
- The estimated net effects of sale Visa Europe amounting to ISK 2.9 billion is accounted for through equity
- The Bank is using standardized RWA approach and RWA/Total assets are 79.9%
- Increase in risk weighted assets due to increased lending, loan commitments, increase in equity positions in banking book (Bakkavor), large FX positions at year end and increase in market risk





## KEY FINANCIAL INDICATORS AND OUTLOOK

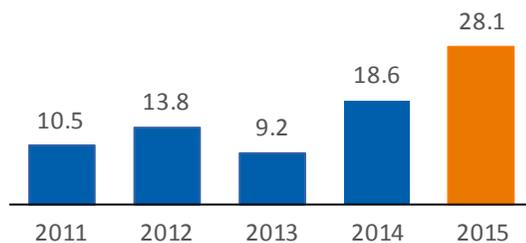
# KEY FINANCIAL INDICATORS



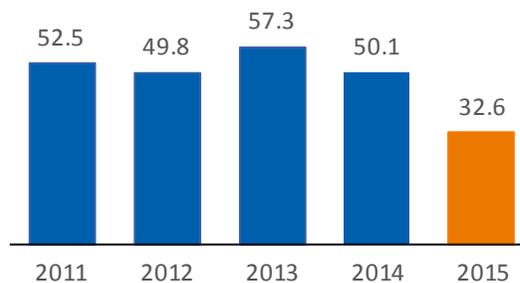
\* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

# KEY FINANCIAL INDICATORS

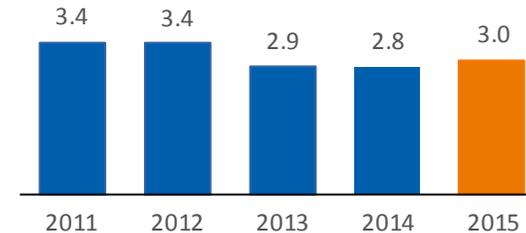
Return on equity (%)



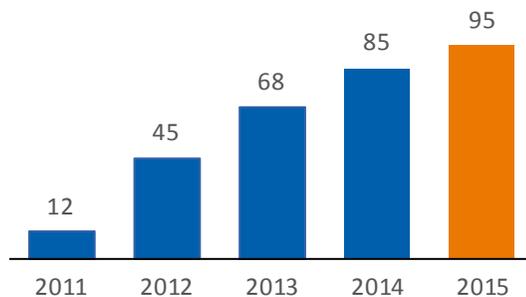
Cost-to-income ratio (%)



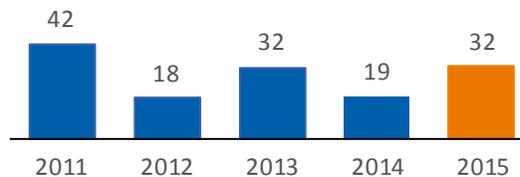
Net interest margin (%)



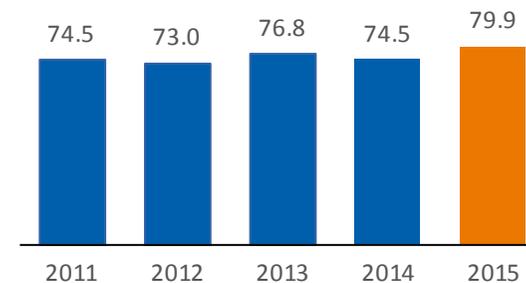
CPI Imbalance – ISK bn.



FX Imbalance – ISK bn.



Risk weighted assets/Total assets (%)



# OUTLOOK

---

## REGULAR OPERATIONS AND FUTURE OWNERSHIP ARE PRIORITIES

- Arion Bank is performing well in its regular operations and is in a strong position to grow alongside its customers, both at home and abroad
- Assignments linked to shareholdings acquired during corporate debt restructuring have mostly been concluded
- In the next few years we do not expect any significant one-off items like those which have characterized operations in recent periods
- Arion Bank is in a strong position as it has good liquidity and no immediate refunding needs for its older loans
- We expect an upgrading of the credit rating as the sovereign rating is revised upwards, and this will increase the Bank's international funding possibilities
- Arion Bank won tender to provide financial services at Keflavik International Airport and opens for business there in the spring
- Arion Bank's solid capital position makes it well placed to tackle future challenges
- The lifting of the capital controls will create new opportunities
- The Bank does not foresee any major changes to its balance sheet when the capital controls are lifted, although the structure of the balance sheet will undergo some change
- Kaupthing's foreign deposits and a loan from the Central Bank, which was sold to Kaupthing, have been converted into long-term funding in Arion Bank's EMTN programme
- Agreements between Kaupthing and the government stipulate the sale of Arion Bank to new owners
- Arion Bank will work with its owners to find high quality investors to acquire the stake of current shareholders



# DISCLAIMER

---

- This document has been prepared for information purposes only and should not be relied upon, or form the basis of any action or decision, by any person. Nothing in this document is, nor shall be relied on as, a promise or representation as to the future. In supplying this document, Arion Bank does not undertake any obligation to provide the recipient with access to any additional information or to update this document or to correct any inaccuracies herein which may become apparent.
- The information relating to Arion Bank, its subsidiaries and associates and their respective businesses and assets contained in, or used in preparing, this document has not been verified or audited. Further, this document does not purport to provide a complete description of the matters to which it relates.
- Some information may be based on assumptions or market conditions and may change without notice. Accordingly, no representation or warranty, express or implied, is made as to the fairness, accuracy, completeness or correctness of the information, forecasts, opinions and expectations contained in this document and no reliance should be placed on such information, forecasts, opinions and expectations. To the extent permitted by law, none of Arion Bank or any of their affiliates or advisers, any of their respective directors, officers or employees, or any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection with this document.
- By accepting this document you agree to be bound by the foregoing instructions and limitations.