

ARION BANK'S Q1 2015 FINANCIAL RESULTS

Arion Bank's net earnings for the first three months of 2015 were significantly affected by irregular items. The main factors were one-off events such as the Bank's sale of shares in the real estate company Reitir and the international drinks manufacturer Refresco Gerber and the subsequent stock market listing of these companies. Arion Bank reported net earnings of ISK 14.9 billion for the first three months of 2015, compared with ISK 2.9 billion for the same period of 2014. Return on equity was 35.1%, compared with 7.8% in the same period of 2014. Net earnings from regular operations amounted to ISK 4.0 billion for the first quarter of 2015, compared with ISK 1.7 billion for the same period last year. Return on equity from regular operations was 9.8%, compared with 4.6% for the first quarter of 2014. Total assets amounted to ISK 1,004.3 billion, compared with ISK 933.7 billion at the end of 2014.

The Bank's capital ratio at the end of the period was 23.9%, compared with 26.3% at the end of 2014, and Tier 1 was 21.2%, compared with 21.8% at the end of 2014.

Highlights of the Interim Financial Statements

- Net earnings of ISK 14.9 billion, compared with ISK 2.9 billion during the same period of 2014.
- Net earnings from regular operations amounted to ISK 4.0 billion, compared with ISK 1.7 billion for the same period last year.
- The capital ratio was 23.9% at the end of the period, compared with 26.3% at the end of 2014.
- Return on equity was 35.1%, compared with 7.8% in the same period of 2014. Return on equity from regular operations was 9.8% during the first quarter of 2015, compared with 4.6% during the same period last year.
- Net interest income of ISK 5.8 billion, compared with ISK 5.5 billion during the same period of 2014.
- Net commission income of ISK 3.8 billion, compared with ISK 3.1 billion during the same period of 2014.
- Operating income increased between years and amounted to ISK 21.8 billion, compared with ISK 9.0 billion during the same period of 2014. This sharp increase is related to the profit from sale and valuation change of shareholdings in the real estate company Reitir fasteignafélag hf. and the valuation change in Refresco Gerber in connection with the listing of the companies.
- Net valuation change during the period is positive, amounting to ISK 1.8 billion, compared with ISK 2.0 billion during the same period of 2014.
- Income tax and the bank levy amounted to ISK 2.5 billion, compared with ISK 1.9 billion during the same period of 2014.
- The cost-to-income ratio was 29.3%, compared with 69.0% in the same period of 2014. The cost-to-income ratio for regular operations was 53.2%, compared with 69% during the same period of 2014.
- Total equity amounted to ISK 177.1 billion, compared with ISK 162.2 billion at the end of 2014.



Höskuldur H. Ólafsson, CEO of Arion Bank:

“The financial results for the first three months of 2015 are excellent. The Bank’s performance exceeded all expectations following the successful stock market listing and sale of the Bank’s holdings in two companies, the international drinks manufacturer Refresco Gerber and the real estate company Reitir. The financial results were positively affected by these irregular items and because it is the first quarter, the effect on key indicators is significant. While it represents a strong start to the year, irregular items will clearly not have such a substantial impact during the rest of the year.

Regular operations performed well in the first quarter and generated strong earnings. Return on equity from regular operations was just under 10% for the period. We are continuing to strengthen the Bank’s underlying operations. We have placed emphasis on increasing the proportion of commission income in the Bank’s overall income and we achieved 19% growth in this area over last year. More than 80% of commission income is derived from corporate clients, while approximately 20% comes from services to retail customers.

An important milestone was achieved during the quarter when the Bank issued bonds in euros for EUR 300 million. It represented the largest bond issue by an Icelandic bank for many years. This bond issue clearly demonstrates the economic progress made in Iceland and reflects investors' confidence in the Bank and its efforts in recent years.

The number of sessions in the Arion app exceeded the number of sessions in the online bank in a single month for the first time during the quarter. This service has opened up new possibilities for customers and the pace of change has surpassed our own ambitious targets. There are now around 40,000 active users of the Arion app. This bears testament to the changing landscape in banking services and our heavy investment in technology is clearly paying off for our customers.”

Conference call in English

Arion Bank will be hosting a conference call in English tomorrow, Wednesday 13 May at 10:00 BST (11:00 CET), where Stefán Pétursson CFO, will present the 2015 first quarter results. Those who would like to participate in the conference call can send an e-mail to ir@arionbanki.is and will then receive instructions with dial in details.

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Income statement – highlights

Income statement				
<i>In ISK million</i>	Q1 2015	Q1 2014	Diff	Diff%
Net interest income	5,783	5,483	300	5%
Net commission income	3,757	3,148	609	19%
Net financial income	7,232	(96)	7,328	(7,617%)
Net foreign exchange gain (loss)	307	(476)	783	(165%)
Other income	4,702	918	3,784	412%
Operating income	21,781	8,977	12,804	143%
Salaries and related expense	(3,492)	(3,450)	(42)	1%
Other operating expenses	(2,896)	(2,746)	(150)	5%
Net change in valuation	1,782	1,967	(185)	(9%)
Net earnings before taxes	17,175	4,748	12,427	262%
Income tax	(1,720)	(1,315)	(405)	31%
Bank levy	(730)	(660)	(70)	11%
Net earnings from continuing operation	14,725	2,773	11,952	431%
Net gain (loss) from disc. operations	183	92	91	-
Net earnings	14,908	2,865	12,043	420%

Operating income

Operating income increased significantly between years, up ISK 12,804 million. Operating income amounted to ISK 21,781 million during the first three months of 2015. The increase is primarily due to an increase of ISK 7,328 million in net financial income, a shift of ISK 783 million in net gain on foreign exchange and an increase of ISK 3,784 million in other income.

Net interest income amounted to ISK 5,783 million, an increase of 5% from 2014. The net interest margin as a percentage of average interest-bearing assets was 2.6% during the period, the same as during the first three months of 2014. Despite lower inflation, affecting index-linked assets and liabilities, the net interest margin has changed little which is mainly explained by lower funding costs due to more effective liquidity management.

Net commission income increased by 19% between years to ISK 3,757 million during the first three months of 2015. The increase is largely due to higher commission income from cards and higher income generated by Investment Banking. Around 80% of the Group's Net commission income is from corporates.

Net financial income increased sharply between years to ISK 7,232 million during the first three months of 2015, compared with ISK 96 million exchange loss during the same period of 2014. The main difference is the valuation change due to the direct and indirect 9.3% shareholding in the European bottler and soft drinks manufacturer Refresco Gerber in connection with the listing of the company at the end of March. In general, the return on equities was good during the period, while the return on bonds was weaker. Dividend income was ISK 555 million lower during the first three months of 2015 than during the same period of 2014.

Net exchange rate gain amounted to ISK 307 million, compared with a loss of ISK 476 million in the first three months of 2014. The Bank's net foreign exchange imbalance was ISK 19.3 billion at the end of the period, meaning that volatility in the exchange rate has some impact on operating income. The net foreign exchange imbalance was ISK 18.9 billion at the end of 2014. The foreign exchange balance of the parent company is well within the 15% limit stipulated by the Central Bank of Iceland.



Other operating income amounted to ISK 4,702 million which is a great increase from 2014. The main types of income included in other operating income are share of profit and valuation changes of associates, valuation changes and profits from the sale of commercial property and building sites owned by Landey ehf., and income from insurance premiums at OKKAR Life Insurance hf. The increase over last year, ISK 3,784 million, is primarily a result of valuation changes and profit of the associated company Reitir fasteignafélag hf. in connection with sale and listing of the company on NASDAQ Iceland. Arion Bank's shareholding in Reitir fasteignafélag hf. was 25.3% at the beginning of the year.

Operating expenses

Operating expenses amounted to ISK 6,390 million. The cost-to-income ratio decreased to 29.3% from 69.0% during the same period in 2014. The decrease in the cost-to-income ratio is due to the major increase in operating income from valuation change and earnings from sale of assets and will not reflect the trend in the future. The cost-to-assets ratio was 2.6%, the same as for the first three months of 2014.

Salaries and related expenses amounted to ISK 3,492 million for the first three months of 2015, an increase of 1% between years. Full-time equivalent positions were on average 1,113 at the Group during the period, compared with 1,144 in the same period of 2014. Salaries per employee have increased from the same period last year, partly explained by increased activities in the international operations of Valitor.

Net valuation change

Net valuation change was positive during the first quarter of 2015, amounting to ISK 1,782 million, and is broadly divided into two types. Firstly, net valuation increases on loans to corporates totalled ISK 2,353 million and secondly, net loan impairment on retail loans amounted to ISK 549 million.

Taxes

Income tax amounted to ISK 1,720 million, compared with ISK 1,315 million in the first three months of 2014. Income tax, as reported in the interim financial statements, comprises 20% income tax on earnings and a special 6% financial tax which is levied on the earnings of financial institutions in excess of ISK 1 billion. The effective income tax rate was 10.0% during the period, compared with 27.7% in the same period of 2014. The low effective income tax rate is mainly explained by tax exempt revenue due to valuation changes and profit from equity positions.

The bank levy amounted to ISK 730 million, compared with ISK 660 million in the same period of 2014. The increase is related to the growth of the Bank's balance sheet.

Regular operations

A large proportion of net earnings during the first quarter of 2015 is related to assets that are not defined as core assets of the Bank. Those assets are in particular shares in non-banking related corporates which have been acquired through settlements of loans. The Bank has subsequently helped these companies to restructure their operations, worked on selling them and in some cases arranged their listing on the stock market. In respect of regular operations Arion Bank makes adjustments for the temporary bank levy, the effect of subsidiaries engaged in unrelated operations and valuation changes on loans.

Excluding non-core operations net earnings for the period decrease by ISK 11,167 million, or ISK 3,972 million. Return on equity from regular operations in the first quarter is 9.8%, compared with 4.6% for the same period of 2014. The cost-to-income ratio for regular operations is 53.2% during the quarter, compared with 69% for the same period of 2014.



Balance sheet – highlights

Assets					
<i>In ISK million</i>	31.03.2015	31.12.2014	Diff%	31.03.2014	Diff%
Cash & balances with CB	63,575	21,063	202%	18,744	239%
Loans to credit institutions	125,643	108,792	15%	95,158	32%
Loans to customers	649,089	647,508	0%	642,341	1%
Financial assets	106,675	101,828	5%	99,710	7%
Investment property	7,915	6,842	16%	28,503	(72%)
Investments in associates	24,965	21,966	14%	17,785	40%
Intangible assets	9,493	9,596	(1%)	5,371	77%
Non-current assets & disposal Groups HFS	3,685	3,958	(7%)	10,217	(64%)
Other assets	13,283	12,179	9%	15,317	(13%)
Total assets	1,004,324	933,732	8%	933,145	8%

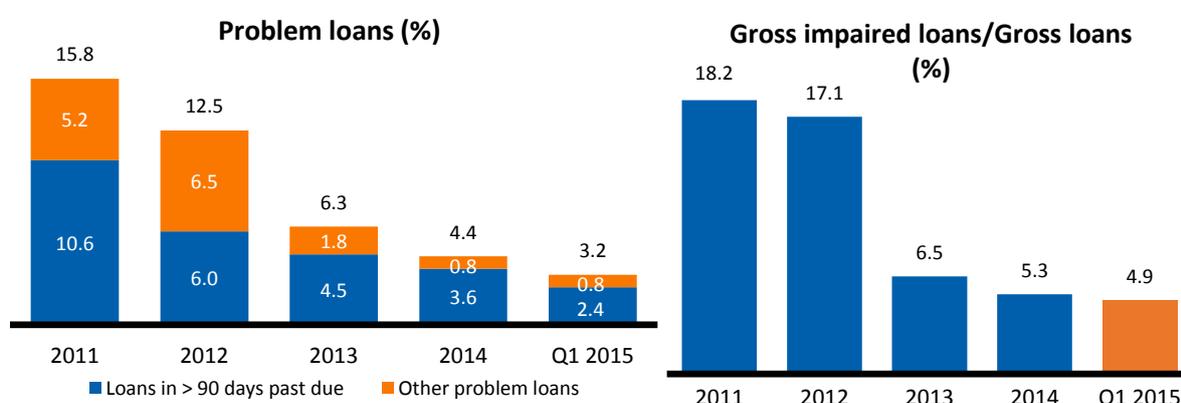
Arion Bank's *total assets* amounted to ISK 1,004.3 billion at the end of the period. Changes to individual asset classes from year end are mainly related to new funding during the period. Financial assets and investments in associates increase during the period mainly due to the increase in the value of shareholdings in Refresco Gerber and the real estate company Reitir fasteignafélag hf. in connection with the listing of the companies.

Loans to customers

Loans to customers amounted to ISK 649,089 million at the end of the period and had increased by ISK 1,581 million from year end 2014. There was a significant increase in loans to corporates during the first quarter of 2015, in line with increased activity in the Icelandic economy. These new loans are particularly in the real estate sector, transportation, tourism and the fishing industry.

Loans to individuals have increased significantly since 2010, especially with the Bank's acquisition of Arion Bank Mortgage Institutional Investor Fund at the end of 2011 and when the Bank took over retail loans from SPRON at the end of 2013. During the first quarter of 2015 loans to individuals decreased mainly because of debt relief measures implemented by the Icelandic government. Loans to individuals comprise 48% of the loan portfolio.

The quality of Arion Bank's loan portfolio has steadily improved in recent years. The Bank looks at a number of indicators in this respect, in particular the ratio of problem loans, which the Bank defines as the ratio of the book value of loans over 90 days or more in default and loans for which special provisions for losses are required. The Bank also looks at the ratio of impaired loans to total loans and monitors this. The graph shows changes in these indicators in recent years and the changes clearly demonstrate how successful efforts to improve the quality of the Bank's loan portfolio have been.





Securities

Securities holdings amounted to ISK 106,675 million at the end of the period, compared with ISK 101,828 million at the end of 2014.

Securities					
<i>In ISK million</i>	31.03.2015	31.12.2014	Diff%	31.03.2014	Diff%
Bonds	65,841	66,465	(1%)	71,858	(8%)
Shares and instruments w. variable income	29,278	25,233	16%	19,277	52%
Derivatives	2,016	1,026	96%	1,040	94%
Securities used for hedging	9,540	9,104	5%	7,535	27%
Securities total	106,675	101,828	5%	99,710	7%

The increase in shares is mainly due to an increase in the valuation of the shareholding in Refresco Gerber in connection with the listing of the company.

Liabilities and equity

Liabilities and equity					
<i>In ISK million</i>	31.03.2015	31.12.2014	Diff%	31.03.2014	Diff%
Due to credit institutions & CB	21,561	22,876	(6%)	25,915	(17%)
Deposits from customers	471,271	454,973	4%	470,665	0%
Financial liabilities at fair value	7,311	9,143	(20%)	9,145	(20%)
Other liabilities	56,821	52,313	9%	45,084	26%
Borrowings	249,751	200,580	25%	203,226	23%
Subordinated loans	20,494	31,639	(35%)	31,297	(35%)
Equity	175,570	160,711	9%	142,900	23%
Non-controlling interest	1,545	1,501	3%	4,913	(69%)
Total liabilities and equity	1,004,324	933,736	8%	933,145	8%

Total liabilities amounted to ISK 827,209 million at the end of the period, compared with ISK 771,524 million at the end of 2014.

Borrowings

Borrowings amounted to ISK 249,751 million at the end of the period. The Bank issued new senior unsecured bonds in euros during the period, amounting to EUR 300 million or ISK 45 billion, which explains the increase from year end. The bonds mature in 2018 and bear fixed 3.125% interest and were sold on terms equal to 3.1% above interbank rates. This is the first issue by an Icelandic bank in euros for several years that has been sold to broad group of investors. Offers were received from around one hundred investors and total demand exceeded EUR 675 million, or double the total bond issue. The bond issue is the largest single bond issue by a private Icelandic issuer and represents a milestone in terms of the Bank's access to foreign bonds and credit markets.

Subordinated loans

Subordinated loans amounted to ISK 20,494 million at the end of the period. Changes from year end 2014 are mainly related to payments made at the end of the quarter amounting to ISK 10 billion, where part of the newly issued bond was used to partly settle the subordinated loan with the Icelandic government. The terms of the subordinated loans worsened at the beginning of the year, from 4% to 5% on Libor, increasing the stimulus to settle the loan.

Shareholders' equity



Shareholders' equity amounted to ISK 175,570 million at the end of March 2015 compared with ISK 160,711 at the end of 2014. The change is explained by the financial results for this quarter. The Tier 1 ratio was 21.2% at the end of the period, compared with 21.8% at the end of 2014. The decrease in the ratio from year end is mainly due to approved dividend of ISK 12.8 billion which is included in the calculations.

The CAD ratio according to the FME's rules was 23.9% at period end, compared with 26.3% at the end of 2014. The reduction is mainly due to the ISK 10 billion payment of the subordinated loan from the Icelandic government and the proposed dividend to the shareholders of Arion Bank that was paid in April. Net earnings for the period increase the ratio partly against this reduction.

Key performance indicators

	Q1 2015	2014	Q1 2014
Return on equity (ROE)	35.1%	18.6%	7.8%
Return on total assets (ROA)	6.2%	3.0%	1.2%
Net interest margin (int. bearing assets)	2.6%	2.8%	2.6%
Net interest margin (total assets)	2.4%	2.6%	2.3%
Cost-to-income ratio	29.3%	50.1%	69.0%
Cost-to-Total assets ratio	2.6%	2.9%	2.6%
Effective tax rate	10.0%	16.1%	27.7%
CAD-ratio	21.9%	26.3%	22.5%
Tier 1 ratio	21.2%	21.8%	18.6%
Problem loans	3.2%	4.4%	6.1%
RWA/Total assets	72.5%	74.5%	77.3%
Loans to deposit ratio	137.7%	142.3%	136.5%
The Group's average number of employees	1,113	1,128	1,144
The Group's employees at the end of the period	1,112	1,120	1,140
The Parent's average number of employees	852	890	913
The Parent's employees at the end of the period	848	865	908

Financial calendar

The Bank's financial statements are scheduled for publication on the dates stated below.

Second quarter 2015	26 August 2015
Third quarter 2015	11 November 2015
Annual financial results	24 February 2016
Annual general meeting 2015	16 March 2016

This calendar may be subject to change.