

ARION BANK'S 9M 2015 FINANCIAL RESULTS

Arion Bank reported net earnings of ISK 25.4 billion for the first nine months of 2015, compared with ISK 22.6 billion for the same period of 2014. Arion Bank's net earnings for the first nine months of 2015 were affected by irregular items, as in the first nine months of 2014. The main factors were one-off events such as the Bank's sale of shares in the real estate company Reitir, the international drinks manufacturer Refresco Gerber and the telecommunications company Síminn in connection with stock market listing of these companies. Return on equity was 19.8%, compared with 19.9% in the same period of 2014. Net earnings from regular operations amounted to ISK 13.5 billion for the first nine months of 2015, compared with ISK 11.4 billion for the same period last year. Return on equity from regular operations was 11.2%, compared with 10.1% for the first nine months of 2014. Total assets amounted to ISK 1,009.5 billion, compared with ISK 933.7 billion at the end of 2014.

The Bank's capital ratio at the end of the period was 23.5%, compared with 26.3% at the end of 2014. The decrease is mainly related to a dividend payment of ISK 12.8 billion and the prepayment of a subordinated loan of ISK 20 billion during the period. Tier 1 was 22.2%, compared with 21.8% at the end of 2014.

Highlights of the Interim Financial Statements

- Net earnings of ISK 25.4 billion, compared with ISK 22.6 billion during the same period of 2014.
- Net earnings from regular operations amounted to ISK 13.5 billion, compared with ISK 11.4 billion for the same period last year.
- The capital ratio was 23.5% at the end of the period, compared with 26.3% at the end of 2014.
- Return on equity was 19.8%, compared with 19.9% in the same period of 2014. Return on equity from regular operations was 11.2% during the first nine months of 2015, compared with 10.1% during the same period last year.
- Net interest income of ISK 20.3 billion, compared with ISK 18.3 billion during the same period of 2014.
- Net commission income of ISK 10.7 billion, compared with ISK 10.1 billion during the same period of 2014.
- Operating income increased considerably between years and amounted to ISK 50.4 billion, compared with ISK 38.3 billion during the same period of 2014. This sharp increase is related to the profit from the sale and valuation change of shareholdings in the real estate company Reitir fasteignafélag hf., Refresco Gerber and the telecommunications company Síminn hf. in connection with the listing of the companies in 2015.
- Net valuation change during the period was negative, amounting to ISK 0.1 billion, compared with a positive valuation change of ISK 2.9 billion during the same period of 2014. Net valuation change was negatively affected during the period by an additional impairment of the loan portfolio of the subsidiary AFL – sparisjóður amounting to ISK 1.7 billion, as reported in the Financial Statements for the first six months of 2015. Net valuation change of other loans in the Group was positive by a similar amount.
- Income tax amounted to ISK 3.6 billion, compared with ISK 4.4 billion during the same period of 2014.
- The cost-to-income ratio was 38.4%, compared with 48.7% in the same period of 2014. The cost-to-income ratio for regular operations was 49.7%, compared with 54.6% during the same period of 2014.
- Total equity amounted to ISK 174.8 billion, compared with ISK 162.2 billion at the end of 2014.



Höskuldur H. Ólafsson, CEO of Arion Bank:

“Arion Bank’s financial results for the first nine months of 2015 were most satisfactory. The Bank’s sale of legacy holdings prior to their IPOs had a significant impact on the financial results. One-off events such as this will have less of an effect on earnings in the future and the Bank’s financial results will be increasingly driven by regular banking activities. The strong recent focus on reinforcing its core business makes the Bank well prepared to do this.

Many exciting projects have been completed during the first nine months of the year. The Bank has arranged all three IPOs on the Icelandic stock market this year, thereby helping to strengthen the market and bring a diverse group of investors on board as shareholders of the restructured companies. There has been considerable public interest in recent share offerings. We take note of constructive debate on this subject and will adjust our procedures where appropriate. The Bank has been involved in plans to construct a 5 star hotel in central Reykjavík, and in October we signed an agreement to acquire the insurance company Vörður, subject to approval from the regulators.

The Bank has successfully managed to diversify its sources of funding over the last couple of years. The Bank’s public bonds have been performing well in the secondary market and the upgrading of the credit rating by S&P to investment grade will further improve access to the international credit markets.”

Conference call in English

Arion Bank will be hosting a conference call in English on Thursday 12 November at 13:00 GMT (14:00 CET), where Stefán Pétursson CFO, will present the 9M 2015 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.

For further information please contact Haraldur Gudni Eidsson of Arion Bank’s Communications division at haraldur.eidsson@arionbanki.is, or tel. +354 444 7108.



Income statement – highlights

Income statement				
<i>In ISK million</i>	9M 2015	9M 2014	Diff	Diff%
Net interest income	20,287	18,309	1,978	11%
Net commission income	10,727	10,119	608	6%
Net financial income	10,570	5,295	5,275	100%
Net foreign exchange (loss) gain	(395)	565	(960)	(170%)
Other income	9,188	3,961	5,227	132%
Operating income	50,377	38,249	12,128	32%
Salaries and related expense	(10,320)	(10,026)	(294)	3%
Other operating expenses	(9,015)	(8,597)	(418)	5%
Bank Levy	(2,168)	(2,008)	(160)	8%
Net change in valuation	(114)	2,877	(2,991)	(104%)
Net earnings before taxes	28,760	20,495	8,265	40%
Income tax	(3,639)	(4,456)	817	(18%)
Net earnings from continuing operation	25,121	16,039	9,082	57%
Net gain (loss) from disc. operations	277	6,592	(6,315)	-
Net earnings	25,398	22,631	2,767	12%

Operating income

Operating income increased significantly between years, up ISK 12,128 million. Operating income amounted to ISK 50,377 million during the first nine months of 2015. This rise is primarily due to an increase of ISK 5,275 million in net financial income and an increase of ISK 5,227 million in other income.

Net interest income amounted to ISK 20,287 million, an increase of 11% from 2014. The net interest margin as a percentage of average interest-bearing assets was 3.0% during the period, compared with 2.9% during the first nine months of 2014. Increased interest margin is the result of higher inflation in the first nine months of 2015, compared with the same period in 2014, as well as lower funding costs due to more effective liquidity management.

Net commission income increased by 6% between years to ISK 10,727 million during the first nine months of 2015. The increase is largely due to higher commission income from cards and higher income generated by Investment Banking. More than 80% of the Group's Net commission income is from corporates.

Net financial income increased sharply between years, or by ISK 5,275 million, and amounted to ISK 10,570 million during the period. The main increase is due to a valuation change of the direct and indirect 9.3% shareholding in the European bottler and soft drinks manufacturer Refresco Gerber in connection with the company's stock market listing at the end of March. In general, the return on equities was good during the period, while the return on bonds was weaker.

Net foreign exchange rate loss amounted to ISK 395 million, compared with ISK 565 million profit in the first nine months of 2014. The Bank's net foreign exchange imbalance was ISK 5.1 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. A concerted effort has been made to reduce this imbalance over the last few years. 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 9,188 million, which is a significant increase from 2014 or by ISK 5,227 million. 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 6,983 million, is a result of valuation changes and profit of the associated company Reitir fasteignafélag hf. in connection with the 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. Positive effects of sale of a 10.5% share in Síminn hf. and consequent valuation changes of the Bank's remaining shareholdings in the company also resulted in higher other operating income.

Operating expenses and bank levy

Operating expenses amounted to ISK 19,335 million. The cost-to-income ratio decreased to 38.4% from 48.7% 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 the sale of assets and will not fully reflect the trend in the future. The cost-to-assets ratio was 2.6%, the same as for the first nine months of 2014.

Salaries and related expenses amounted to ISK 10,320 million for the first nine months of 2015 and have increased by 3% compared with the same period in 2014. Full-time equivalent positions were on average 1,131 at the Group during the period, similar to the first nine months of 2014. The increase in average salaries is close to 3% which is well below the increase in the salary index between periods.

The bank levy amounted to ISK 2,168 million, compared with ISK 2,008 million in the same period of 2014. The increase is related to the changes in the Bank's balance sheet.

Net valuation change

Net valuation change was negative during the first nine months of 2015, amounting to ISK 114 million, and is broadly divided into three types. Firstly, net valuation increases on loans to corporates totalled ISK 2,878 million. Secondly, net loan impairment on loans to individuals amounted to ISK 1,481 million. And thirdly the net change in collective impairment amounted to ISK 1,486 million. The net valuation change was negatively affected during the period by an impairment of the loan portfolio of AFL - sparisjóður, a subsidiary of the Bank for which the Bank acts as a controlling party following approval by the Icelandic authorities in April. The loan portfolio of AFL - sparisjóður was revalued and additional impairment by AFL - sparisjóður for the period amounts to ISK 1,749 million. Net valuation change of other loans in the Group was positive by ISK 1,660 million during the first nine months of 2015 which bears witness to the successful restructuring of the loan portfolio.

Taxes

Income tax amounted to ISK 3,639 million, compared with ISK 4,456 million in the first nine 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 12.7% during the period, compared with 21.7% 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.

Regular operations

A large proportion of net earnings during the first nine months 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 the 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 decreased by ISK 11,752 million and amounted to ISK 11,499 million. Return on equity from regular operations was 11.2%, compared with 10.1% for the first nine months of 2014. The cost-to-income ratio for regular operations was 49.7% during the first nine months of 2015, compared with 54.6% for the same period of 2014.

Third quarter of 2015

The financial results for the third quarter of 2015 were good. Return on equity was 14.2%, compared with 13.3% in the same period of 2014.

Income statement				
<i>In ISK million</i>	Q3 2015	Q3 2014	Diff	Diff%
Net interest income	7,112	6,343	769	12%
Net commission income	3,292	3,526	(234)	(7%)
Net financial income	1,469	1,582	(113)	(7%)
Net foreign exchange (loss) gain	(1,016)	412	(1,428)	(347%)
Other income	3,448	689	2,759	400%
Operating income	14,305	12,552	1,753	14%
Salaries and related expense	(3,153)	(2,862)	(291)	10%
Other operating expenses	(3,012)	(2,787)	(225)	8%
Bank Levy	(779)	(633)	(146)	23%
Net change in valuation	(33)	876	(909)	(104%)
Net earnings before taxes	7,328	7,146	182	3%
Income tax	(1,272)	(1,989)	717	(36%)
Net earnings from continuing operation	6,056	5,157	899	17%
Net gain from disc. Operations	15	67	(52)	(78%)
Net earnings	6,071	5,224	847	16%

Operating income in the third quarter increased between years by 14%. Other operating income increased considerably between years mainly due to the sale of a 10% shareholding in the associated company Síminn hf., prior to the listing of the company on NASDAQ Iceland at the beginning of October, and valuation changes on the remaining 27.8% shareholding. Net foreign exchange gain decreased considerably between years.

Operating expenses increased between years, mainly related to increased activities abroad within Valitor.

Net change in valuation decreased between years. Net change in valuation was positive by ISK 876 million in the third quarter of 2014.



Balance sheet – highlights

Assets					
<i>In ISK million</i>	30.09.2015	31.12.2014	Diff%	30.09.2014	Diff%
Cash & balances with CB	73,289	21,063	248%	33,335	120%
Loans to credit institutions	93,326	108,792	(14%)	108,621	(14%)
Loans to customers	678,807	647,508	5%	652,598	4%
Financial assets	111,191	101,828	9%	99,223	12%
Investment property	7,817	6,842	14%	2,901	170%
Investments in associates	13,847	21,966	(37%)	22,025	(37%)
Intangible assets	9,194	9,596	(4%)	5,337	72%
Non-current assets & disposal Groups HFS	4,040	3,958	2%	4,210	(4%)
Other assets	17,963	12,183	47%	13,921	29%
Total assets	1,009,476	933,736	8%	942,172	7%

Arion Bank's *total assets* amounted to ISK 1,009.5 billion at the end of the period. Changes to individual asset classes from year end are mainly related to increases in loans and new funding during the period. Financial assets increased during the period mainly due to the transfer of the shareholding in the real estate company Reitir fasteignafélag hf. following the sale of the Bank's holding in the company when it was listed on the stock market.

Loans to customers

Loans to customers amounted to ISK 678,807 million at the end of the period and had increased by ISK 31,299 million since the end of 2014.

Loans to corporates have increased significantly from year end 2014, in line with increased activity in the Icelandic economy. These new loans are chiefly in the real estate sector, transportation, tourism and the fishing industry. Demand for loans has increased significantly recently and loans to companies are likely to increase even further.

Loans to individuals have decreased mainly because of debt relief measures implemented by the Icelandic government in 2015. Demand has gradually increased throughout the year for new loans to individuals, both loans to buy property and other types of loans.

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 over the Bank's total loans to customers. The ratio of problem loans was 3.2% at end of September, compared with 4.4% at the end of 2014. Additionally, the Bank looks to the proportion of its loans which have been impaired. This figure was 4.9% at the end of September, compared with 5.3% at the end of 2014.



Securities

Securities holdings amounted to ISK 111,191 million at the end of the period, compared with ISK 101,828 million at the end of 2014.

Securities					
<i>In ISK million</i>	30.09.2015	31.12.2014	Diff%	30.09.2014	Diff%
Bonds	69,471	66,465	5%	65,699	6%
Shares and instruments w. variable income	26,834	25,233	6%	25,276	6%
Derivatives	2,285	1,026	123%	1,306	75%
Securities used for hedging	12,601	9,104	38%	6,942	82%
Securities total	111,191	101,828	9%	99,223	12%

The increase in shares is mainly due to the transfer of the Bank's shareholding in Reitir fasteignafélag hf. from investments in associated companies to shares.

Liabilities and equity

Liabilities and equity					
<i>In ISK million</i>	30.09.2015	31.12.2014	Diff%	30.09.2014	Diff%
Due to credit institutions & CB	11,470	22,876	(50%)	21,131	(46%)
Deposits from customers	503,155	454,973	11%	482,518	4%
Financial liabilities at fair value	5,511	9,143	(40%)	6,038	(9%)
Other liabilities	55,996	52,313	7%	49,568	13%
Borrowings	248,172	200,580	24%	191,947	29%
Subordinated loans	10,378	31,639	(67%)	31,205	(67%)
Equity	173,507	160,711	8%	154,643	12%
Non-controlling interest	1,287	1,501	(14%)	5,122	(75%)
Total liabilities and equity	1,009,476	933,736	8%	942,172	7%

Total liabilities amounted to ISK 834,681 million at the end of the period, compared with ISK 771,524 million at the end of 2014.

Borrowings

Borrowings amounted to ISK 248,172 million at the end of the period. Arion Bank continued to issue covered bonds which are secured in accordance with the Covered Bond Act No. 11/2008. In August a new series of non-indexed covered bonds was issued, amounting to ISK 4.3 billion. The new series bears 6.5% fixed interest rate, with settlement date in September 2022.

At the end of June Arion Bank completed a bond issue in Norwegian kroner, when it issued NOK 500 million (approximately ISK 8 billion) of 5-year instruments. The bonds bear floating NIBOR +2.95% interest. Arion Bank simultaneously entered a swap agreement, whereby part of the interest and principal are in euros. Interest in euros is floating EURIBOR +2.74%. The issue was oversubscribed and sold to investors in the Nordics and continental Europe. At the same time, Arion Bank bought back NOK 260 million of bonds from a 2013 issue and has now bought back NOK 319 million of a NOK 500 million issue.

In March Arion Bank launched its inaugural euro senior unsecured benchmark transaction, when the Bank sold EUR 300 million, approximately ISK 45 billion, 3-year fixed rate bonds to around 100 international investors. The Bank's inaugural bond is the first EUR public transaction and the single largest transaction since 2008, and the most important step taken by an Icelandic bank to re-enter the international capital markets.



Subordinated loans

Subordinated loans amounted to ISK 10,378 million at the end of the period. Changes since the end of 2014 are mainly related to payments amounting to approximately ISK 20 billion, where part of the newly issued bond was used to partly settle the subordinated loan with the Icelandic government. The margin of the subordinated loans increased at the beginning of the year, from 4% to 5% on LIBOR, increasing the stimulus to prepay the loan. The Bank aims to pay the remaining loans when conditions are favorable.

Equity

Equity amounted to ISK 174,795 million at the end of September 2015, compared with ISK 162,212 million at the end of 2014. The increase is mainly explained by the financial results for the period and is partly off-set by a dividend payment in April amounting to ISK 12.8 billion. The Tier 1 ratio was 22.2% at the end of the period, compared with 21.8% at the end of 2014.

According to the FME's rules on calculating capital ratios, it is not permitted to take into account financial results unless they are endorsed by an auditor. The capital ratio according to the FME's rules was 22.7% at the end of September, compared with 26.3% at the end of 2014. The reduction is mainly due to the ISK 20 billion payment of the subordinated loan from the Icelandic government and the dividend payment to the shareholders of Arion Bank in April. Taking into account the net earnings from the third quarter the capital ratio is 23.5%.

Key performance indicators

	9M 2015	2014	9M 2014
Return on equity (ROE)	19.8%	18.6%	19.9%
Return on total assets (ROA)	3.5%	3.0%	3.2%
Net interest margin (int. bearing assets)	3.0%	2.8%	2.9%
Net interest margin (total assets)	2.8%	2.6%	2.6%
Cost-to-income ratio	38.4%	50.1%	48.7%
Cost-to-Total assets ratio	2.6%	2.9%	2.6%
Effective tax rate	11.8%	16.1%	19.8%
CAD ratio	23.5%	26.3%	25.3%
Tier 1 ratio	22.2%	21.8%	21.1%
Problem loans	3.2%	4.4%	4.6%
RWA/Total assets	73.3%	74.5%	77.4%
Loans to deposit ratio	134.9%	142.3%	135.2%
The Group's average number of employees	1,131	1,128	1,130
The Group's employees at the end of the period	1,151	1,120	1,135
The Parent's average number of employees	849	890	898
The Parent's employees at the end of the period	850	865	899



Financial calendar

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

Annual financial results 2015	24 February 2016
Annual general meeting 2015	17 March 2016
First quarter 2016	11 May 2016
Second quarter 2016	31 August 2016
Third quarter 2016	16 November 2016

This calendar may be subject to change.