

FINANCIAL STATEMENTS 30 JUNE 2016

INVESTOR PRESENTATION
31 AUGUST 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

- Full range of investment banking services
- A leading capital markets house and M&A advisor
- Managed all IPOs in Iceland during 2015

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

STEFNIR

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

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

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 the whole company
- Acquisition is subject to approval of Icelandic regulators

okkar

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

HIGHLIGHTS OF H1 2016

FINANCIAL RESULTS INFLUENCED BY CONDITIONS ON MARKET

Increased corporate lending

- Significant rise in interest income due to higher interest rates and increase in interest-bearing assets
- Lending to companies up 8% and there is strong demand for loans
- Valitor's sale of its share in Visa Europe Ltd. to Visa Inc. has positive impact on the Bank's results
- Earnings negatively affected by sub performance of securities markets
- Decrease in commission income, particularly due to fewer stock market listings
- Higher salary expenses due to renewed wage agreements and rise in number of employees, both at subsidiaries and the Bank
- Arion Bank named best investment bank in Iceland in 2016 by Euromoney

Second major bond issue in euros

- In April the Bank held its second major bond issue in euros to a broad group of investors, issuing €300 million (ISK 42 billion)
- ISK 31 billion paid off ahead of schedule of Arion-issued bond owned by Kaupthing issued in January. The January issue was in USD approx. ISK 97 billion and was part of the capital controls liberalization process
- Covered bond issues during period amounted to ISK 15.3 billion
- In January Standard & Poor's changed the outlook on Arion Bank's BBB- rating from stable to positive



HIGHLIGHTS OF H1 2016

NEW BRANCH AT KEFLAVÍK INTERNATIONAL AIRPORT – FIRST CLASS SERVICES FOR TRAVELLERS

New branch at Keflavík International Airport

- Branch opened at Keflavík International Airport with a focus on currency exchange and VAT refund services
- Three service points and 13 ATMs are located at the airport

Managerial and organizational changes

- Rakeł Óttarsdóttir is managing director of a new division, Information Technology, which previously formed part of Operations
- Ida Brá Benediksdóttir took over as managing director of Investment Banking in February



Products and services

- Customers of Arion Bank have been issued with a new contactless debit card – Visa Debit
- Launch of a new currency card for foreign tourists – a prepaid international VISA card
- Introduction of a convenient new way of becoming a new customer of Arion Bank via Internet



HIGHLIGHTS OF H1 2016

SUPPORTING INNOVATION EVERY STEP OF THE WAY

Startup Reykjavík best business accelerator

- Startup Reykjavík held for the 5th time during the summer
- Ten companies selected to take part from almost 250 applicants
- Startup Reykjavík was named as the best business accelerator in Iceland in 2016 at the Nordic Startup Awards
- Companies which have passed through Startup Reykjavík and Startup Energy Reykjavík have raised ISK 2.4 billion in grants and equity



Supporting young innovators

- Partnership agreement reached with Junior Achievement (JA)
- JA promotes innovation at secondary school level. Selection of best student company was made at Arion Bank
- Special finance day was held at Arion Bank in conjunction with the NKG innovation competition for which Arion Bank was the chief sponsor

Fin Tech Party

- Arion Bank hosted a Fintech party in which 11 teams participated. The teams worked for 30 hours straight, programming financial solutions

HEADLINE FIGURES FOR H1 2016

Profitability

Net earnings
ISK 9,759
million
H1 2015:
ISK 19,326 million

Strength

Tier 1 ratio
26.8%
31.12.2015:
23.4%

Operations

Cost-to-
income ratio
56.1%
H1 2015:
36.5%

Asset quality

Problem
loans
1.9%
31.12.2015:
2.5%

Return on
equity
9.5%

H1 2015:
22.8%

Leverage
ratio
18.1%

31.12.2015:
16.7%

Number of
Employees
1,199

31.12.2015:
1,147

Mortgages/
Total loans
38.1%

31.12.2015:
39.4%



INCOME STATEMENT

INCOME STATEMENT

All amounts in ISK million

POSITIVE NET CHANGE IN VALUATION ON LOANS TO CUSTOMERS

- Increase in net interest income due to larger loan portfolio and increase in other interest bearing assets
- Decrease in net commission income, mainly due to lower IPO activity in investment banking compared to last year
- Net financial income higher than previous periods due to profit from the sale of Visa Europe in Valitor. Other equity and bond holdings have sub performed during the period
- Salaries and related expense and other operating expense increase by 17% compared to H1 2015 due to new wage agreements and increased number of FTE's

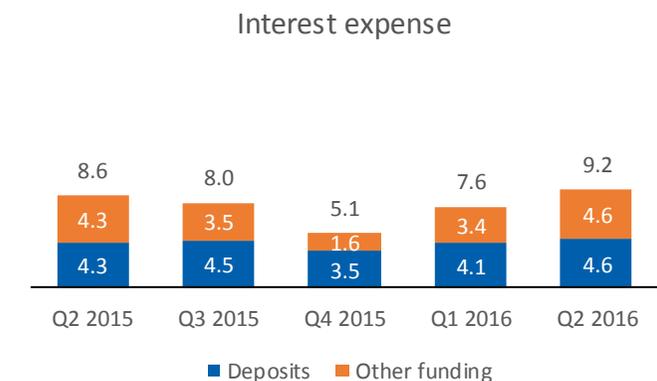
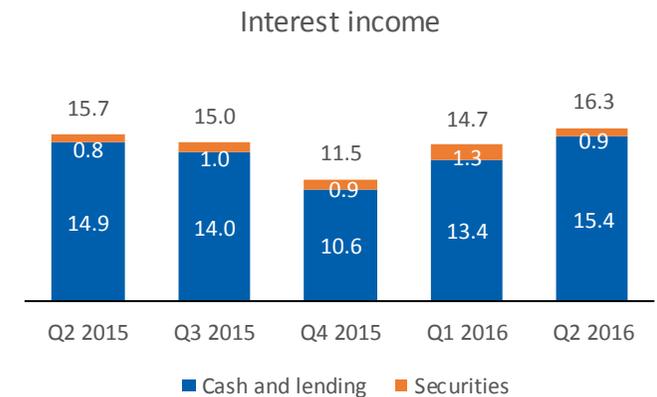
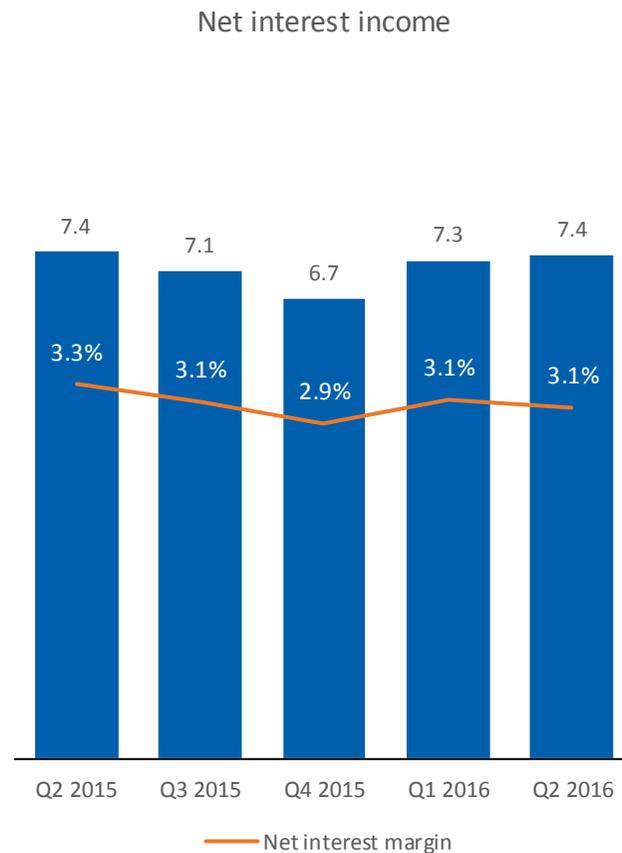
| | H1 2016 | H1 2015 | Diff | Q2 2016 | Q1 2016 | Diff |
|----------------------------------|---------------|---------------|--------------|---------------|---------------|-------------|
| Net interest income | 14.626 | 13.175 | 11% | 7.353 | 7.273 | 1% |
| Net commission income | 6.747 | 7.434 | (9%) | 3.528 | 3.219 | 10% |
| Net financial income | 3.495 | 9.723 | (64%) | 3.796 | (301) | - |
| Share of profit of associates | 694 | 4.217 | (84%) | 17 | 677 | (97%) |
| Other income | 1.861 | 1.523 | 22% | 626 | 1.235 | (49%) |
| Operating income | 27.423 | 36.072 | (24%) | 15.320 | 12.103 | 27% |
| Salaries and related expense | (8.426) | (7.167) | 18% | (4.318) | (4.108) | 5% |
| Other operating expenses | (6.970) | (6.004) | 16% | (3.736) | (3.234) | 16% |
| Bank levy | (1.485) | (1.389) | 7% | (743) | (742) | 0% |
| Net impairment | 945 | (81) | - | 1.448 | (503) | - |
| Net earnings before taxes | 11.487 | 21.431 | (46%) | 7.971 | 3.516 | 127% |
| Income tax expense | (2.091) | (2.367) | (12%) | (1.354) | (737) | 84% |
| Net gain from disc. operations | 363 | 262 | 39% | 259 | 104 | 149% |
| Net earnings | 9.759 | 19.326 | (50%) | 6.876 | 2.883 | 139% |

NET INTEREST INCOME

All amounts in ISK billion

INCREASE IN INTEREST BEARING ASSETS

- Increase in both interest income and expenses from Q1 due to increased inflation in Q2
- Increase in interest bearing assets from year end 2015 of ISK 41 billion, or 4% of total assets
- Sharp increase in interest expense from other funding due to new bonds issued both domestically and internationally



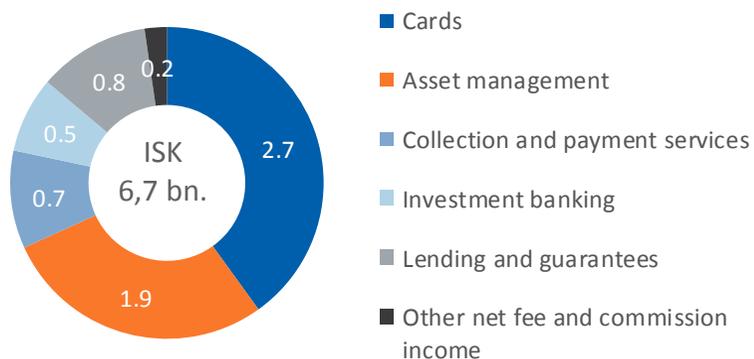
NET COMMISSION INCOME

All amounts in ISK billion

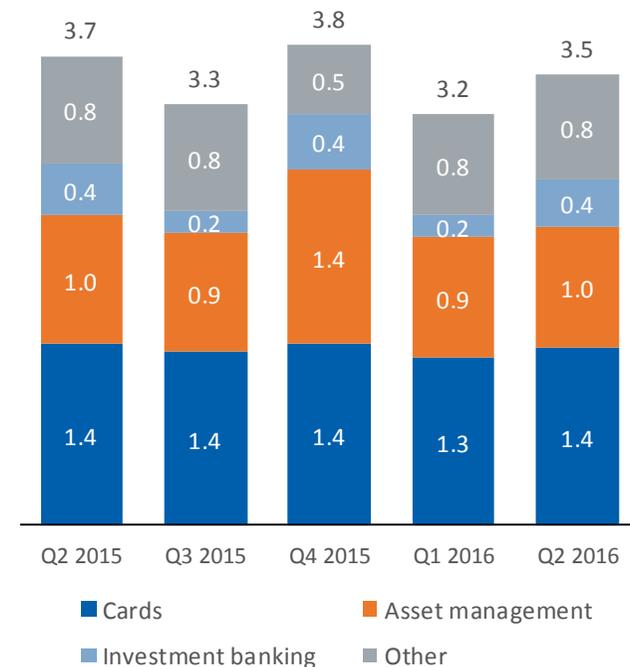
STRONG BASE FOR COMMISSION INCOME

- Net commission increases in Q2 mainly due to increased activity in investment banking
- The Group is investing in the international growth model of Valitor
- Net commission income from cards expected to grow as these plans materialize

Breakdown of Net commission income H1 2016



Net commission income

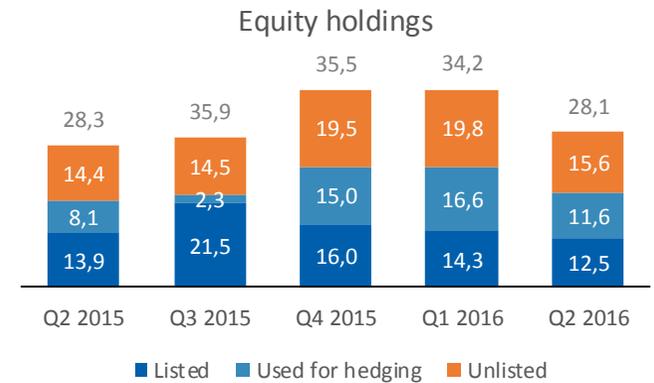
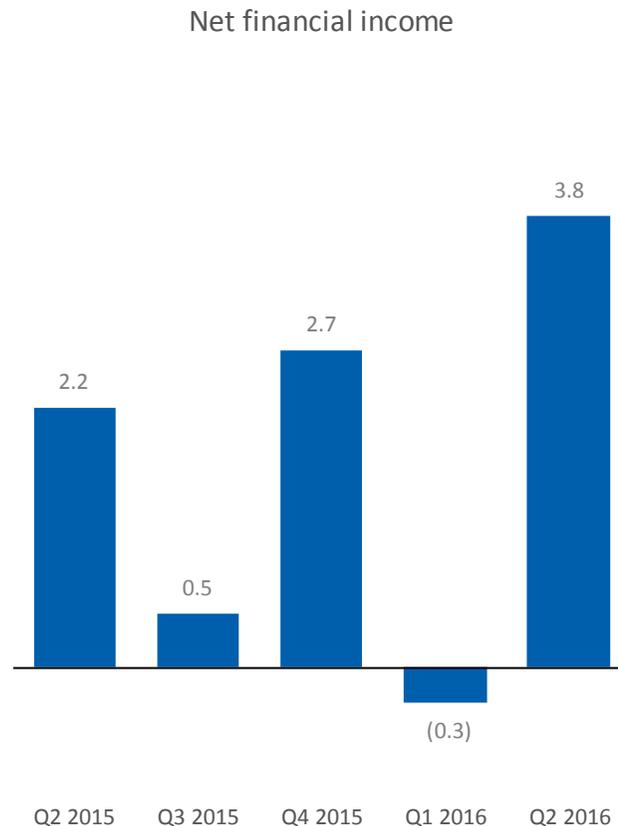


NET FINANCIAL INCOME

All amounts in ISK billion

PROFIT FROM THE SALE OF VISA EUROPE HAS MAJOR EFFECT ON Q2

- The sale of Visa Europe to Visa Inc. was finalised in June with net effect of ISK 5.3 billion profit for the group
- The Icelandic stock market sub performed during H1 2016 with OMXI8 decreasing 5.5% during the period
- Listed equity positions of the Bank continued to decrease during the period
- Loss from listed bond and equity holdings offset by profit from the sale of Visa Europe
- FX development was unfavourable for the Bank during Q2

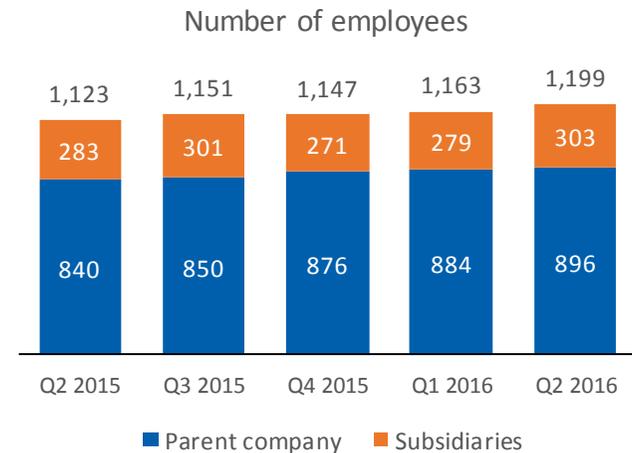
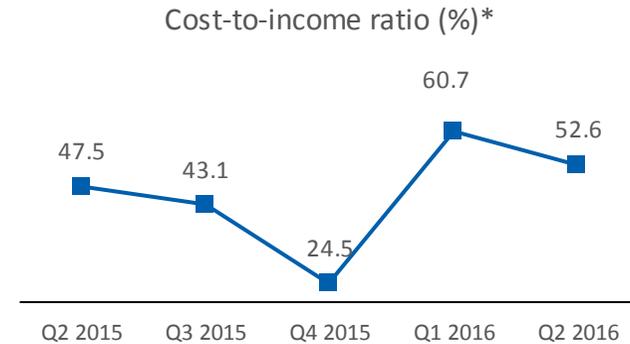
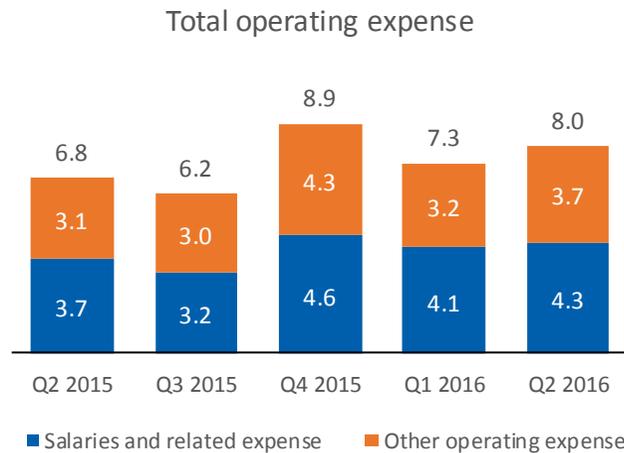


TOTAL OPERATING EXPENSE

All amounts in ISK billion

NEW WAGE AGREEMENTS AFFECT COST BOTH DIRECTLY AND INDIRECTLY

- Increase in salaries greatly affected by new wage agreements and increase in full time employees
- Increase in professional services, marketing expenses and IT expenditures compared with prior year
- Cost-to-income ratio volatile mainly due to large one-off income items
- Number of employees continues to grow in Valitor and at the Bank, mainly in relation to the new branch at the Keflavik Airport



BALANCE SHEET



BALANCE SHEET

All amounts in ISK billion

LOANS TO CUSTOMERS CONTINUE TO GROW

- Strong liquidity position
- Loans to customers increased by ISK 33 billion or 4.9% during the period
- Decrease in investment in associates due to sale of Bakkavor Group Ltd.
- Decrease in deposits due to funding agreement with Kaupthing
- Increase in borrowings due to funding agreement with Kaupthing and new issues during the period
- Strong equity position

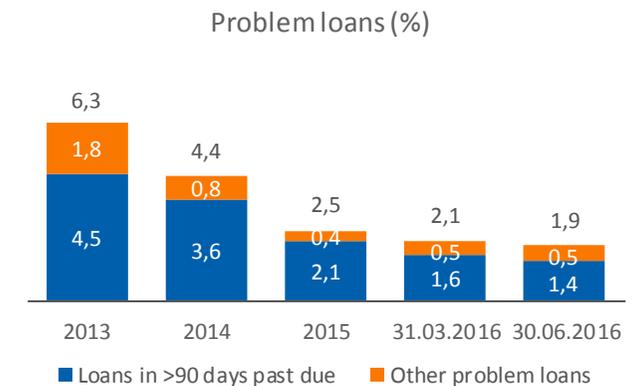
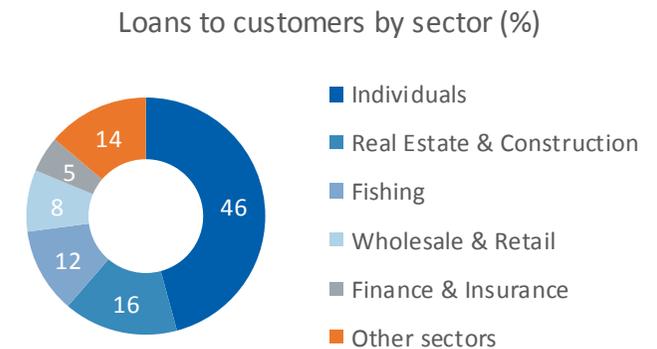
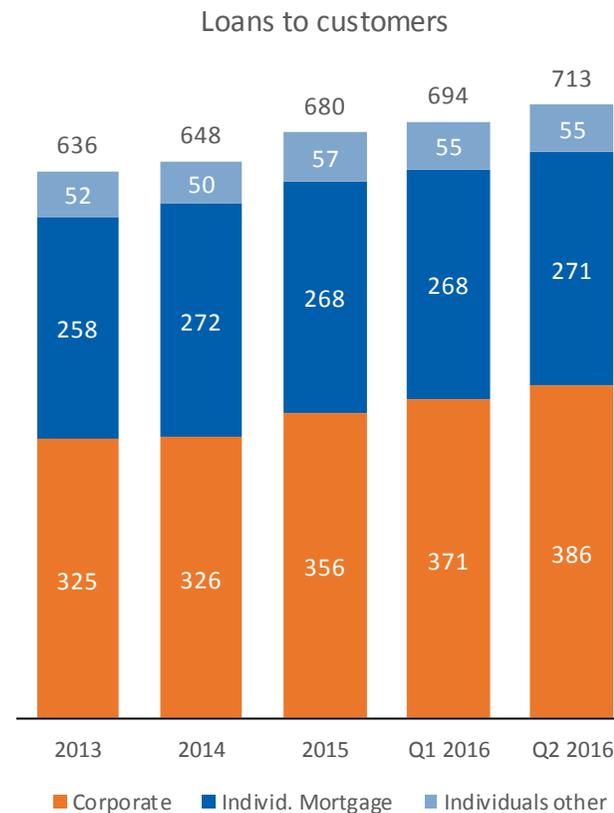
| Assets | 30.06.2016 | 31.03.2016 | 2015 | 2014 | 2013 |
|-------------------------------------|-------------------|-------------------|--------------|-------------|-------------|
| Cash & balances with CB | 77 | 70 | 48 | 21 | 38 |
| Loans to credit institutions | 86 | 92 | 87 | 109 | 102 |
| Loans to customers | 713 | 694 | 680 | 648 | 636 |
| Financial assets | 121 | 133 | 133 | 102 | 87 |
| Investment property | 6 | 6 | 8 | 7 | 29 |
| Investments in associates | 1 | 1 | 27 | 22 | 18 |
| Other assets | 31 | 33 | 27 | 26 | 30 |
| Total Assets | 1,035 | 1,029 | 1,011 | 934 | 939 |
| Liabilities and Equity | | | | | |
| Due to credit institutions & CB | 8 | 11 | 11 | 23 | 28 |
| Deposits from customers | 423 | 433 | 469 | 455 | 472 |
| Other liabilities | 56 | 59 | 62 | 61 | 58 |
| Borrowings | 330 | 311 | 256 | 201 | 205 |
| Subordinated loans | 10 | 10 | 10 | 32 | 32 |
| Shareholders Equity | 199 | 195 | 193 | 161 | 140 |
| Non-controlling interest | 10 | 10 | 9 | 2 | 5 |
| Total Liabilities and Equity | 1,035 | 1,029 | 1,011 | 934 | 939 |

LOANS TO CUSTOMERS

All amounts in ISK billion

WELL DIVERSIFIED LOAN PORTFOLIO – PROBLEM LOANS CONTINUE TO DECREASE

- Continued good balance in loans to corporates and individuals
- Increase in loans to customers during the period, mostly to corporate customers in industry, energy and manufacturing and wholesale and retail
- Strong pipeline for corporate loans. Competition on the mortgage loan market has increased after pension funds entered the market
- Good diversification in the corporate loan book
- Problem loans continue to decrease, now below 2%

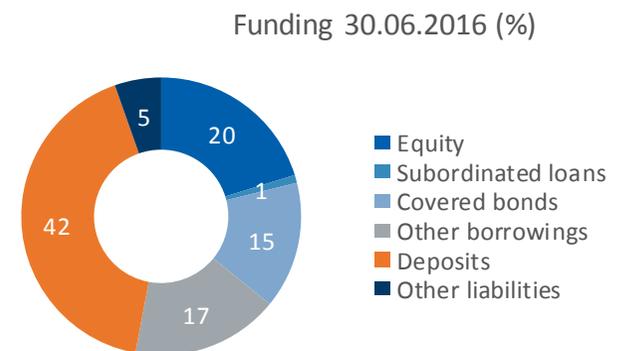
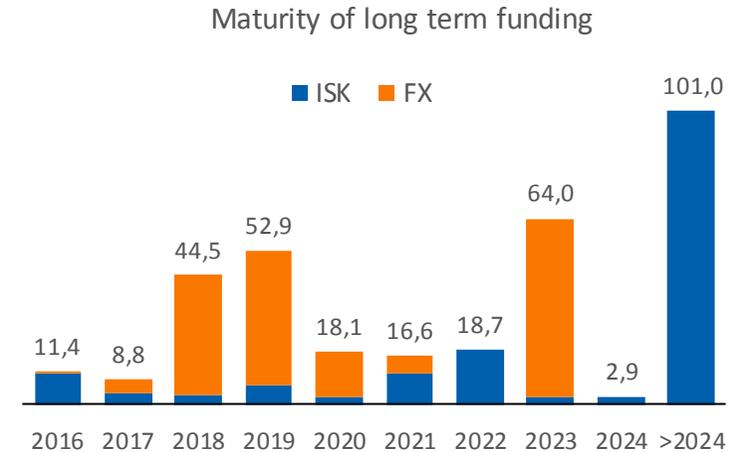
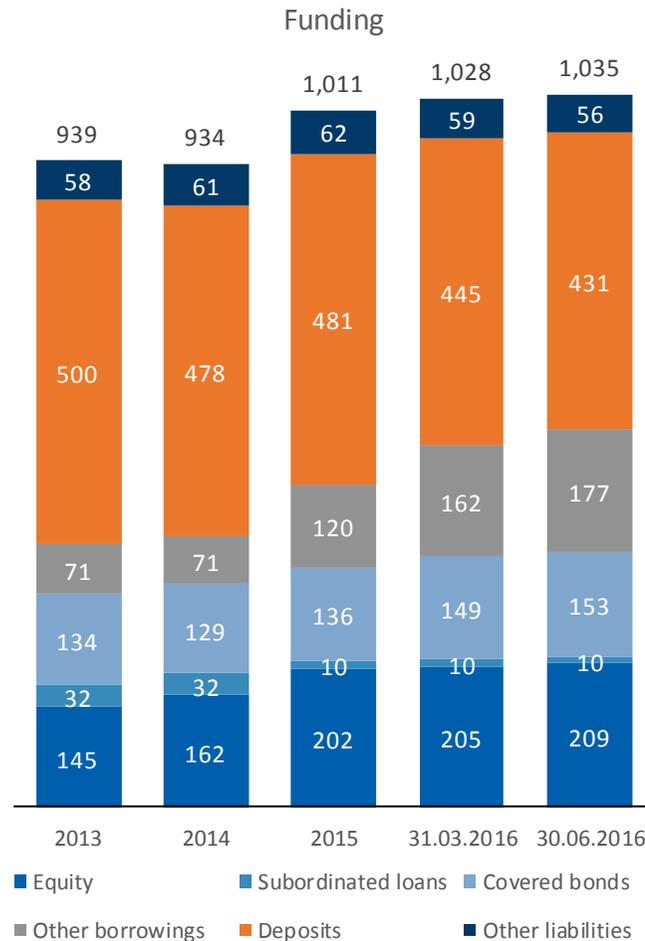


FUNDING

All amounts in ISK billion

GOOD BALANCE IN FUNDING

- In January the Bank and Kaupthing reached a funding agreement with deposits in foreign currency at Arion Bank and foreign currency loan at Central Bank changed to EMTN 7 year USD bonds. The total amount was USD 748 million but USD 252 million was prepaid in April
- In April the Bank issued a new 3 year EUR 300 million bond, which are trading favourably on the market as other bonds issued by Arion Bank
- The Bank continues to issue Covered Bonds in the Icelandic market, total of ISK 15.3 billion during H1 2016

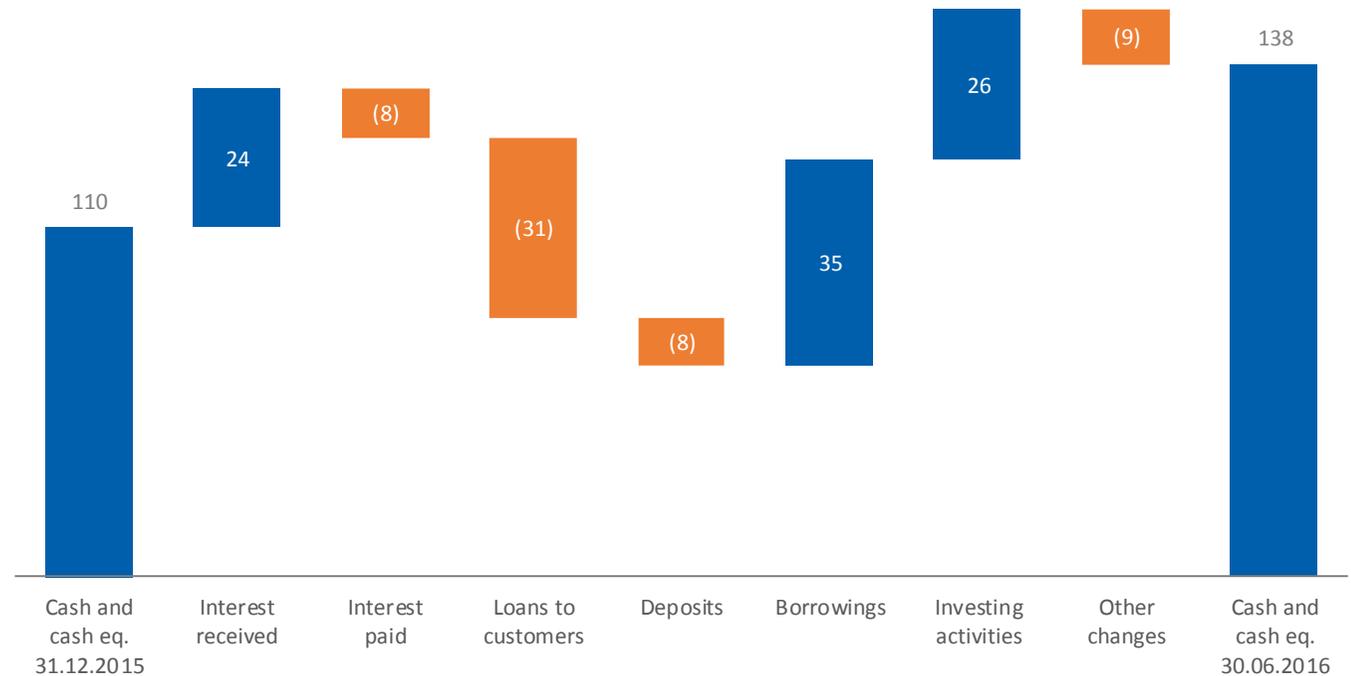


CASH FLOW

All amounts in ISK billion

NEW LENDING FUNDED WITH NEW LONG-TERM BORROWINGS

- Increase in cash and cash equivalents mostly due to sale of Bakkavor Group Ltd. ISK 27 billion, included in investing activities
- Large non-cash changes due to funding agreement with Kaupthing in deposits and borrowings

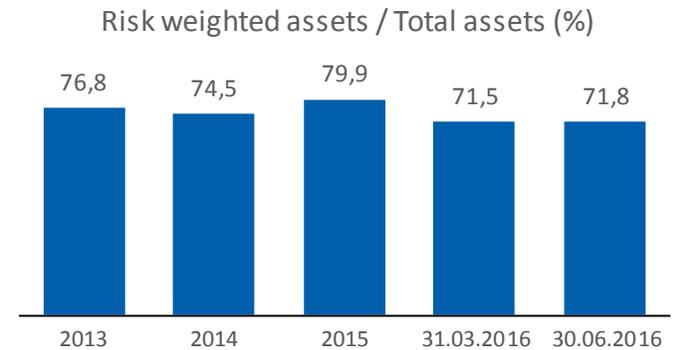
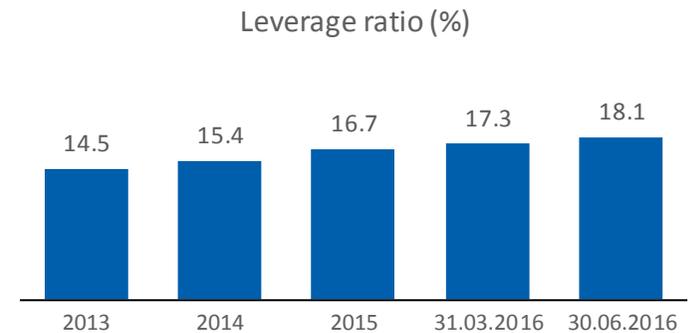
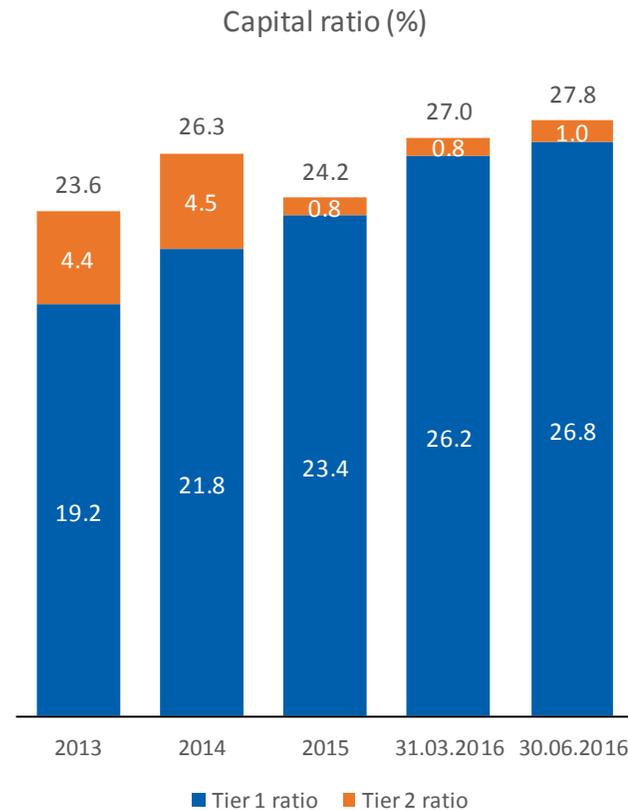


CAPITAL BASE

All amounts in ISK billion

STRONG CAPITAL BASE

- No dividend payment in 2016
- Solid level of capitalization due to strong profit generation in previous years
- The Bank uses standardized approach calculating RWA
- Reduction in risk weighted assets due to decrease in loan commitments and lower FX imbalance





OUTLOOK AND KEY FINANCIAL INDICATORS

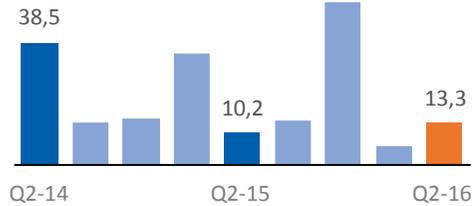
OUTLOOK

STRONGER DEMAND IN THE ECONOMY GIVES PROMISING SIGNS FOR THE FUTURE

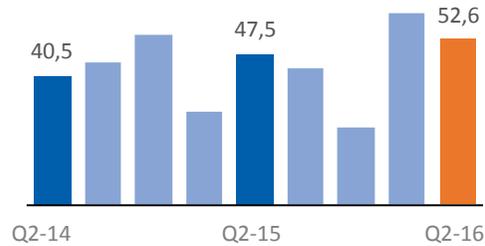
- Exciting times ahead in a favorable and growing economy
- The liberalization of the capital controls will present new opportunities and the Bank foresees no significant changes to the balance sheet
- Arion Bank occupies strong position owing to its strong liquidity
 - There is high demand for corporate loans and loans have grown year on year
 - The Bank strives to help its customers achieve their growth objectives, both at home and abroad
 - Competition on the mortgage market has intensified after the pension funds became more active. This reduces the proportion of retail loans in the Bank's portfolio
- The Bank seeks ways to diversify its sources of funding and will continue to do so
- Credit rating is expected to be upgraded as the sovereign rating is revised upwards, opening up more funding opportunities for the Bank
- Arion Bank's strong capital position makes it well set to face future challenges
- The Bank has placed greater emphasis on digital services with the aim of increasing income and reducing operating expenses
- In the context of the continued strong development of the Icelandic economy, Arion Bank and Kaupthing, its majority owner, are currently assessing a range of strategic alternatives with regards to Kaupthing's shares held in the bank
 - This may include a possible IPO; however, no decision has been made at this point in time with respect to any specific transaction and timing thereof

KEY FINANCIAL INDICATORS

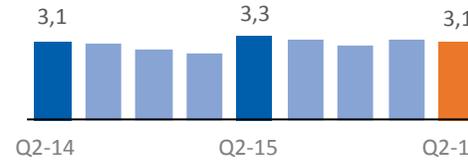
Return on equity (%)



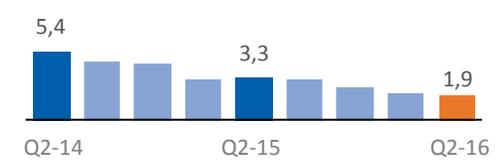
Cost-to-income ratio (%)



Net interest margin (%)

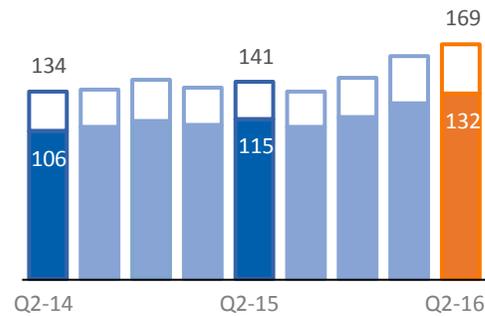


Problem loans* (%)

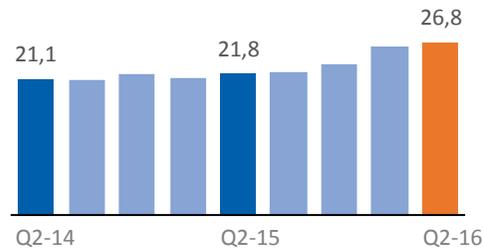


Loans-to-deposits ratio (%)

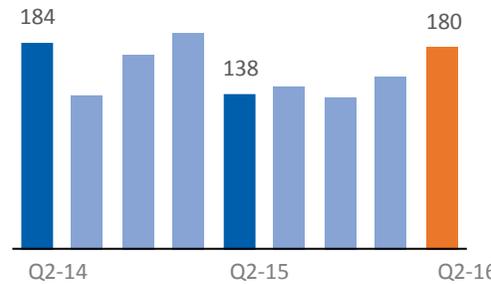
without loans financed with covered bonds



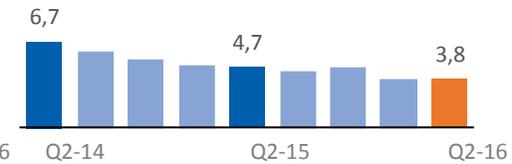
Tier 1 ratio (%)



Liquidity coverage ratio (LCR) (%)



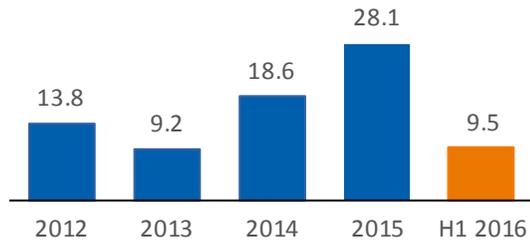
Gross impaired loans/Gross loans (%)



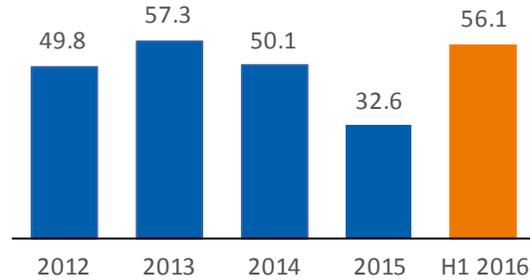
* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

KEY FINANCIAL INDICATORS

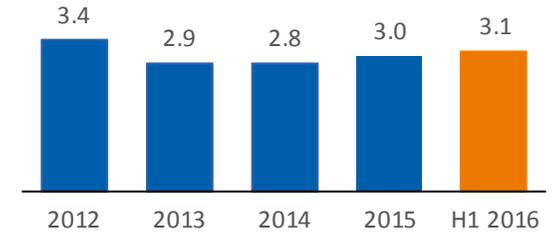
Return on equity (%)



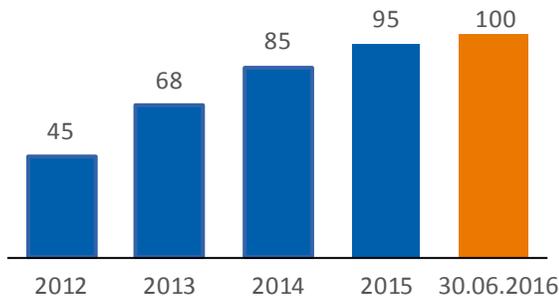
Cost-to-income ratio (%)



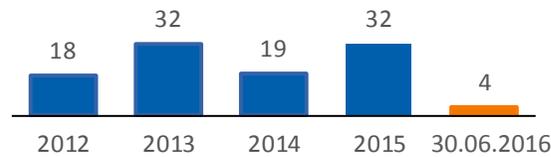
Net interest margin (%)



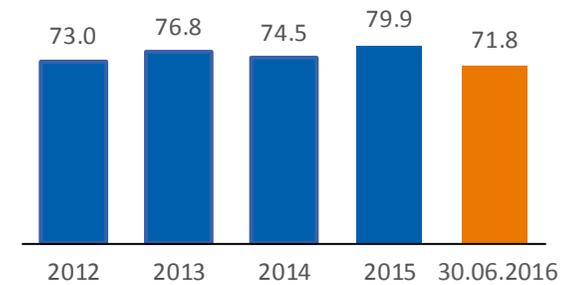
CPI Imbalance – ISK bn.



FX Imbalance – ISK bn.



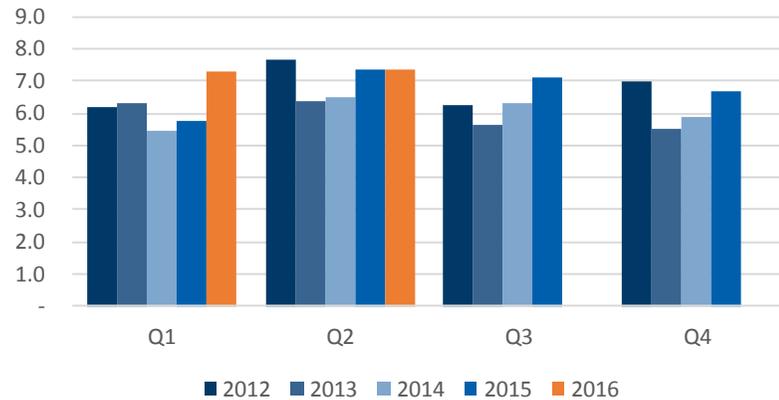
Risk weighted assets/Total assets (%)



DEVELOPMENT OF KEY FIGURES

All amounts in ISK billion

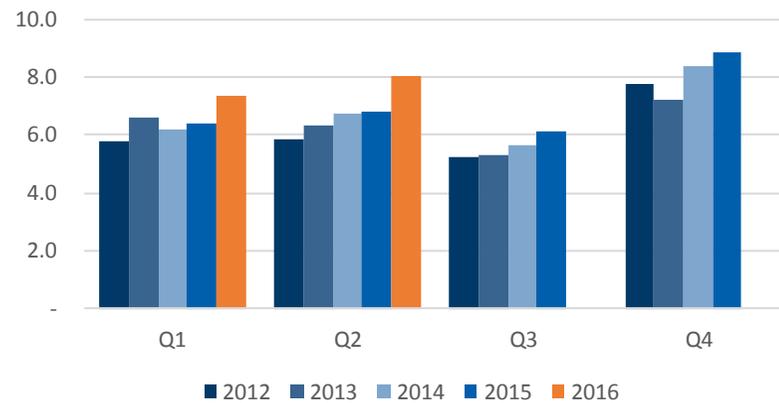
Net interest income



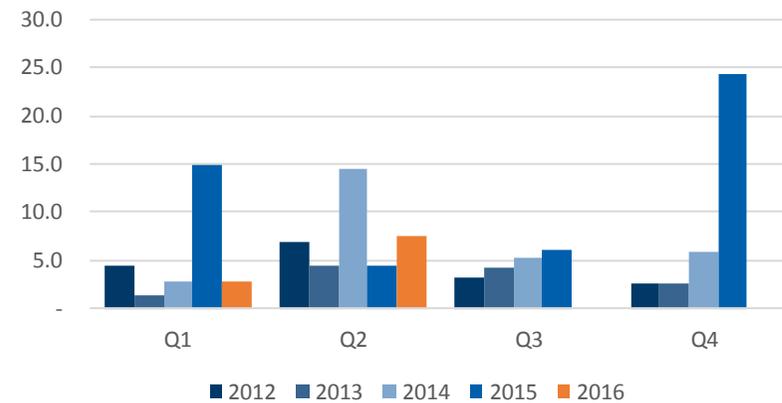
Net commission income



Total operating expenses



Net earnings





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