

## ARION BANK'S Q1 2016 FINANCIAL RESULTS

Arion Bank reported net earnings of ISK 2.9 billion for the first three months of 2016, compared with ISK 14.9 billion for the same period of 2015. Return on equity was 5.7%, compared with 35.1% for the first three months of 2015.

Earnings from regular operations amounted to ISK 2.6 billion, compared with ISK 4.0 billion in the first quarter of 2015. Return on equity from regular operations was 5.1%, compared with 9.8% for the same period last year. Total assets amounted to ISK 1,028.6 billion at the end of March, compared with ISK 1,011.0 billion at the end of 2015. Shareholders' equity totalled ISK 195.2 billion at the end of March, compared with ISK 192.8 billion at the end of 2015.

The Bank's capital ratio at the end of the period was 27.0%, compared with 24.2% at the end of 2015. Tier 1 Capital increased during the year to 26.2%, compared with 23.4% at the end of 2015.

Highlights of the income statement and key performance indicators:

### Income Statement

<i>In ISK million</i>	<b>Q1 2016</b>	<b>Q1 2015</b>	<b>Diff</b>	<b>Diff%</b>
Net interest income	7,273	5,783	1,490	26%
Net commission income	3,219	3,757	(538)	(14%)
Net financial income	(301)	7,539	(7,840)	(104%)
Share of profit of associates	677	4,211	(3,534)	(84%)
Other income	1,235	491	744	152%
<b>Operating income</b>	<b>12,103</b>	<b>21,781</b>	<b>(9,678)</b>	<b>-44%</b>
Salaries and related expense	(4,108)	(3,492)	(616)	18%
Other operating expenses	(3,234)	(2,898)	(336)	12%
Bank levy	(742)	(730)	(12)	2%
Net impairment	(503)	1,782	(2,285)	-128%
<b>Net earnings before taxes</b>	<b>3,516</b>	<b>16,443</b>	<b>(12,927)</b>	<b>-79%</b>
Income tax	(737)	(1,720)	983	(57%)
Net gain from disc. operations	104	183	(79)	-43%
<b>Net earnings</b>	<b>2,883</b>	<b>14,906</b>	<b>(12,023)</b>	<b>-81%</b>

### KPI's:

Return on equity (ROE)	5.7%	35.1%	-29.5%
Net interest margin (int. bearing assets)	3.1%	2.6%	0.5%
Cost-to-income ratio	60.7%	29.3%	31.3%
Tier 1 ratio	26.2%	21.2%	5.0%



## HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK:

“The financial results for the first quarter are satisfactory, especially given that the conditions on the Icelandic securities market were negative for the Bank. The Bank performed well in its regular operations, particularly in terms of interest income, which was up on last year, mainly as a result of higher inflation and higher interest rates as well as reduced interest expenses. However, the Bank's operating expenses increased during the quarter, not least as a result of collective wage agreements and a rise in the number of employees, chiefly at Valitor, a subsidiary of the Bank which is expanding internationally.

The Bank has introduced some changes to its funding and it is now longer term than before. Most significant in this respect was the agreement reached at the beginning of the year with Kaupthing to refinance an older loan and Kaupthing's foreign currency deposits at Arion Bank. This involved issuing a 7-year bond in the amount of ISK 93 billion. In April Arion Bank issued its second benchmark bond in euros at improved terms over last year's issue. The Bank's solid position and its upgraded credit rating mean that the international credit markets are more accessible than ever.

Startup Reykjavík will be held for the fifth time this summer. This year saw a surge in applications and it will be announced in the next few days which ten companies will be selected to take part. Startup Reykjavík was recently named the best business accelerator in Iceland in 2016 at the Nordic Startup Awards. Later this year Startup Reykjavík Energy will be held for the third time. Arion Bank has already invested in 54 companies through these two accelerators and a further 17 will be added this year. The companies which have passed through the accelerators have raised ISK 2.2 billion in additional funding in the form of equity and grants. We have also invested ISK 1 billion in the fund Eyrir Sprotar, whose role is to invest in new companies showing considerable growth potential. The Bank is a devoted advocate of innovation and also sponsors the ambitious NKG innovation competition for school pupils, and earlier this year we signed an agreement with Junior Achievement which promotes innovation at secondary schools. In connection with this, the student company of the year was recently chosen at a ceremony at Arion Bank. It is our view that by supporting innovation at various levels of education and different stages of a company's development we are fostering an environment in which an even more varied business sector can prosper in the future.

Many exciting developments are taking place in FinTech and a great number of innovations are being made in this field. At the beginning of June we are hosting the Arion Bank FinTech Hackathon. It is open to everybody and participants will get the chance to develop and program innovative financial solutions for corporate and retail customers.”

## CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a conference call in English on Thursday 12 May at 1:00 pm GMT, where Stefán Pétursson, Chief Financial Officer, will discuss the highlights of the Bank's financial results. People interested in participating can contact [ir@arionbanki.is](mailto:ir@arionbanki.is) to obtain dial-in information.

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## INCOME STATEMENT

### Income Statement

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Net commission income	3,219	3,757	(538)	(14%)
Net financial income	(301)	7,539	(7,840)	(104%)
Share of profit of associates	677	4,211	(3,534)	(84%)
Other income	1,235	491	744	152%
<b>Operating income</b>	<b>12,103</b>	<b>21,781</b>	<b>(9,678)</b>	<b>-44%</b>
Salaries and related expense	(4,108)	(3,492)	(616)	18%
Other operating expenses	(3,234)	(2,896)	(338)	12%
Bank Levy	(742)	(730)	(12)	2%
Net change in valuation	(503)	1,782	(2,285)	-128%
<b>Net earnings before taxes</b>	<b>3,516</b>	<b>16,445</b>	<b>(12,929)</b>	<b>-79%</b>
Income tax	(737)	(1,720)	983	-57%
<b>Net earnings from continuing operation</b>	<b>2,779</b>	<b>14,725</b>	<b>(11,946)</b>	<b>-81%</b>
Net gain from disc. operations	104	183	(79)	-43%
<b>Net earnings</b>	<b>2,883</b>	<b>14,908</b>	<b>(12,025)</b>	<b>-81%</b>

**Operating income** amounted to ISK 12.1 billion, compared with ISK 21.8 billion in the first three months of 2015. The main changes between years are in net financial income and the share of profit of associates which were significant in 2015 due to valuation changes and earnings from the sale of shareholdings.

*Net interest income* increased by 26% from the previous year. The net interest margin as a percentage of average interest-bearing assets was 3.1% during the first quarter of 2016, compared with 2.6% for the same period in 2015. The increased interest margin is largely explained by higher inflation and higher interest rates during the first quarter of 2016 than 2015 and also by changes in the funding structure in 2015.

*Net commission income* decreased by 14% between years, primarily as a result of less activity in investment banking. Approximately 80% of net commission income originates from corporate clients.

*Net financial income* was negative during the first quarter by ISK 301 million due to unfavorable market conditions, compared with a substantial profit during the same period 2015.

*Share in the profit of associates* amounts to ISK 677 million during the first quarter of 2016, compared with ISK 4,211 million during the same period of 2015. Last year this item was heavily influenced by valuation changes and the sale of shareholdings in connection with the stock market listing of companies in 2015.

*Other operating income* increased by ISK 744 million from the previous year and amounted to ISK 1,235 million in the first quarter of 2016. The increase is mainly related to profits from the sale of assets during the period.

**Operating expenses** amounted to ISK 7,343 million during the first quarter of 2016, compared with ISK 6,390 million during the same period of 2015. The Bank's cost-to-income ratio was 60.7% during the period, compared with 29.3% in 2015. This substantial increase in the cost-to-income ratio is almost entirely attributable to high income from valuation changes in equities and asset sales in the first quarter of 2015. The cost-to-assets ratio was 2.9%, compared with 2.6% for the first three months in 2015.

*Salaries and related expenses* amounted to ISK 4,108 million during the period, an increase of 18% from the first three months in 2015. The increase is mainly a result of a rise in the number of employees and renewed wage agreements late in 2015 and in March 2016 effective from 1 January 2016. The average salary per employee increased by 15.1% from the same period in 2015 but at the same time the salary index rose by 13.3%. Full-time equivalent positions at the end of March were 1,163 at the Group, 51 more than at the end of March 2015, mainly as a result of increased international activities at one of the Bank's subsidiaries.

*Net valuation change* was negative by ISK 503 million during the first three months of 2016. There were considerable valuation increases in loans to corporates as a result of the settlement of loans, but this was partly offset by a valuation decrease in mortgages to individuals following the government's debt relief package at the beginning of 2015.



*Income tax* amounted to ISK 737 million, compared with ISK 1,720 million during the first three months of 2015. Income tax, as reported in the annual financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial institutions in excess of ISK 1 billion. The effective income tax rate was 21.0% during the first three months of 2016, compared with 10.5% in the same period of 2015. The unusually low effective income tax rate in 2015 is mainly explained by tax exempt earnings at corporates relating to valuation changes and profits on equity positions.

Arion Bank's **regular operations** have solid foundations. Net interest income and net commission income are relatively stable but income from shareholdings and bonds does fluctuate. There was a considerable year-on-year increase in operating expenses which was mainly related to higher salaries under new wage agreements. In respect of regular operations Arion Bank makes adjustments for capital gains and valuation changes in acquired equity positions, the temporary bank levy, the effect of subsidiaries engaged in unrelated operations and valuation changes in loans. Taking the above factors into account, net earnings for the first quarter of 2016 decreased by ISK 305 million to ISK 2,578 million. Return on equity from regular operations in the first quarter of 2016 was 5.1%, compared with 9.8% for the same period in 2015. The cost-to-income ratio for regular operations was 58.7% during the first quarter of 2016, compared with 53.2% for the same period in 2015.

## BALANCE SHEET

Arion Bank's **total assets** increased by 2% from year end 2015. The main changes result from increases in loans to customers and financial assets. Investments in associates decreased, however.

### Assets

<i>In ISK million</i>	<b>31.03.2016</b>	<b>31.12.2015</b>	<b>Diff%</b>	<b>31.03.2015</b>	<b>Diff%</b>
Cash & balances with CB	70,218	48,102	46%	63,575	10%
Loans to credit institutions	91,672	87,491	5%	125,643	(27%)
Loans to customers	694,004	680,350	2%	649,089	7%
Financial assets	132,729	133,191	(0%)	106,674	24%
Investment property	6,382	7,542	(15%)	7,915	(19%)
Investments in associates	896	27,299	(97%)	24,965	(96%)
Intangible assets	9,153	9,285	(1%)	9,493	(4%)
Other assets	23,552	17,783	32%	16,971	39%
<b>Total assets</b>	<b>1,028,606</b>	<b>1,011,043</b>	<b>2%</b>	<b>1,004,326</b>	<b>2%</b>

*Loans to customers* totalled ISK 694,004 million at the end of March, a 2% increase from year end 2015. Loans to corporates increased slightly during the first quarter of 2016 by ISK 14 billion. These new loans are mainly in the fishing industry and the wholesale and retail sectors. Mortgage loans to individuals are virtually unchanged from year end 2015. The quality of loans to customers continues to increase. The ratio of problem loans decreased from 2.5% to 2.1% during the first quarter of 2016. The Bank defines problem loans as the ratio of the book value of loans 90 days or more in default and loans for which special impairment is required to the Bank's total loans to customers. The proportion of impaired loans decreased from 4.9% at the end of 2015 to 3.7% at the end of March 2016.

*Financial assets* amounted to ISK 132,729 million at the end of March, almost the same as at the end of 2015.

*Shareholdings in associates* decreased significantly from year end 2015, mainly due to the sale of shareholdings in Bakkavor Group Ltd in January 2016.



**Liabilities** increased slightly between years, which is primarily a result of new borrowings. **Equity and minority interest** increased as a result of the first quarter 2016 financial results.

### Liabilities and equity

<i>In ISK million</i>	<b>31.03.2016</b>	<b>31.12.2015</b>	<b>Diff%</b>	<b>31.03.2015</b>	<b>Diff%</b>
Due to credit institutions & CB	11,288	11,387	(1%)	21,561	(48%)
Deposits from customers	433,228	469,347	(8%)	471,271	(8%)
Financial liabilities at fair value	9,577	7,609	26%	7,311	31%
Other liabilities	49,391	54,383	(9%)	56,822	(13%)
Borrowings	310,540	256,058	21%	249,751	24%
Subordinated loans	9,921	10,365	(4%)	20,494	(52%)
Shareholders equity	195,154	192,786	1%	171,994	13%
Non-controlling interest	9,507	9,108	4%	5,122	86%
<b>Total liabilities and equity</b>	<b>1,028,606</b>	<b>1,011,043</b>	<b>2%</b>	<b>1,004,326</b>	<b>2%</b>

*Borrowings* amounted to ISK 310,540 million at the end of March. In January Arion Bank reached an agreement with Kaupthing under which Arion Bank issued a bond in the amount of \$747.8 million (ISK 97 billion). The bond was issued under Arion Bank's EMTN programme and is a 7-year instrument, callable on interest payment dates during the first two years. The bond bears floating LIBOR plus 2.6% interest for the first two years and will then be repriced at market terms. The bond will offset loans in foreign currency taken by Arion Bank from the Central Bank of Iceland, which are now owned by Kaupthing, and Kaupthing deposits in foreign currency at Arion Bank. The bond issue forms part of capital controls liberalization process relating to Kaupthing, first announced by the Ministry of Finance and Economic Affairs on 8 June 2015. Arion Bank continued to issue covered bonds which are secured in accordance with the Covered Bond Act No. 11/2008 and issued new bonds in the amount of ISK 12.4 billion during the quarter. Arion Bank continues to strengthen its position in the international funding markets and in April 2016 Arion Bank issued new senior unsecured bonds for a total of €300 million (ISK 42 billion). Orders totaling over €500 million from more than 70 investors were received. The 3-year bonds have a fixed coupon of 2.50%.

*Shareholders' equity* amounted to ISK 195,154 million at the end of March 2016, compared with ISK 192,786 million at the end of 2015. The increase is explained by the financial results for the period. The Tier 1 ratio was 26.2% at the end of March 2016, compared with 23.4% at the end of 2015. According to the FME's rules on calculating capital ratios, it is not permitted to take financial results into account unless they are endorsed by an auditor. The capital ratio according to the FME's rules was 26.6% at the end of March, compared with 24.2% at the end of 2015.



## KEY PERFORMANCE INDICATORS

	Q1 2016	2015	Q1 2015
Return on equity (ROE)	5.7%	28.1%	35.1%
Return on total assets (ROA)	1.1%	5.0%	6.2%
Net interest margin (int. bearing assets)	3.1%	3.0%	2.6%
Net interest margin (total assets)	2.9%	2.7%	2.4%
Cost-to-income ratio	60.7%	32.6%	29.3%
Cost-to-Total assets ratio	2.9%	2.9%	2.6%
Effective tax rate	17.3%	5.7%	10.0%
CAD ratio	27.0%	24.2%	23.9%
Tier 1 ratio	26.2%	23.4%	21.2%
Problem loans	2.1%	2.5%	3.2%
RWA/Total assets	71.5%	79.9%	72.5%
Loans to deposit ratio	160.2%	145.0%	137.7%
The Group's average number of employees	1,150	1,139	1,113
The Group's employees at the end of the period	1,163	1,147	1,112
The Parent's average number of employees	878	885	852
The Parent's employees at the end of the period	884	876	848

## FINANCIAL CALENDAR FOR 2016

The Bank's interim financial statements are scheduled for publication as stated below.

Second quarter 2016	31 August 2016
Third quarter 2016	16 November 2016

This calendar may be subject to change.