

Earnings Press Release, 8 August 2019

Arion Bank's Q2 2019 financial results

Continuing positive trends in core operations, but irregular items affect net earnings

Arion Bank reported net earnings of ISK 2.1 billion for the second quarter of 2019, compared with ISK 3.1 billion for the same period of 2018. Return on equity was 4.3% for the second quarter of 2019, compared with 5.9% for the same period in 2018. Return on equity excluding the subsidiary Valitor, which is classified as held for sale, was 6.6% for the second quarter of 2019, compared with 7.2% for the same period in 2018.

Total assets amounted to ISK 1,233 billion at the end of June 2019, compared with ISK 1,164 billion at the end of 2018. Total equity amounted to ISK 195 billion, compared with ISK 201 billion at the end of 2018.

The Bank's capital ratio at the end of June 2019 was 22.8%, compared with 22.0% at the end of 2018. The CET1 ratio was 21.4% at the end of June 2019, compared with 21.2% at the end of 2018.

Arion Bank is in the process of divesting the Bank's subsidiary Valitor Holding hf. Valitor is classified as held for sale in the Interim Financial Statements.

The Board of Directors of Arion Bank has appointed Benedikt Gíslason, who has extensive experience of the Icelandic financial market, as the Bank's new CEO from 1 July 2019.

Highlights of the Income Statement and key income related performance indicators:

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff.	
Net interest income	7,808	7,314	7%	
Net commission income	2,478	2,712	(9%)	
Net insurance income	823	758	9%	
Net financial income	1,023	1,119	(9%)	
Share of profit of associates	(7)	2	-	
Other operating income	95	600	(84%)	
Operating income	12,220	12,505	(2%)	
Salaries and related expenses	(3,805)	(3,949)	(4%)	
Other operating expenses	(2,813)	(2,978)	(6%)	
Operating expenses	(6,618)	(6,927)	(4%)	
Bank levy	(912)	(879)	4%	
Net impairment	(988)	(166)	495%	
Net earnings before income tax	3,702	4,533	(18%)	
Income tax expense	(891)	(1,302)	(32%)	
Discontinued operations, net of tax	(715)	(169)	323%	
Net earnings	2,096	3,062	(32%)	
KPI's				
Return on equity	4.3%	5.9%		
Earnings per share (in ISK)	1.16	1.35		
Cost to income ratio	54.2%	55.4%		

Highlights of the Balance Sheet and key performance indicators:

<i>In ISK millions</i>	30.06.2019	31.12.2018	Diff.	% diff.
Loans to customers	821,731	833,826	(12,095)	(1%)
Other assets	411,688	330,500	81,188	25%
Liabilities	1,038,129	963,468	74,661	8%
Equity	195,289	200,859	(5,570)	(3%)
Loans to Deposits ratio	162.8%	178.9%		
RWA / Total assets	63.1%	68.4%		
CET 1 ratio	21.4%	21.2%		

For detailed information on the accounts please refer to Arion Bank's Consolidated Interim Financial Statements for the first half of 2019 on the Bank's website, www.arionbanki.is/ir.



BENEDIKT GÍSLASON, CEO OF ARION BANK

“Arion Bank’s financial results for the second quarter were disappointing. However, it is good to see that the Bank’s core operations are developing positively, and net interest income continues to grow, both compared with Q1 2019 and Q2 2018. The quality of the loan book remains good but the economy has begun to slow down, something reflected by a decrease in the size of the loan book and loan impairments. Additionally the composition of the loan book is changing, reflecting the Bank’s emphasis on returns instead of growth. Commission income remains stable and earnings from the insurance operation of the Bank’s subsidiary Vördur were strong. Operating expenses are moving in the right direction and one of our key tasks in the near term is to make further improvements in this area.

Arion Bank is a leading innovator and developer of financial services in Iceland. It is exciting to take the helm of such a dynamic and forward-looking company. Over the last few years the Bank has launched a whole range of exciting digital products for our customers, some of which have gone on to win international awards. More recently the Bank has introduced new digital solutions such as Apple Pay, which our customers have welcomed with open arms. The Bank has also recently brought out a product which enables customers to analyze their household finances more effectively in the App. Soon customers will be able to use the App to get personalized quotes for car and home insurance from Vördur, and it will be the first time we offer services from another company in the App. The App continues to win acclaim and in a recent survey the Arion App was yet again rated as the best banking app in Iceland.

We will continue along this path and we are about to begin shaping the key focuses in our strategy and business for the next few years, so that the Bank is fully prepared to deal with the major changes occurring in the financial services sector. We will look at various areas of the Bank’s operations, such as capital structure, quality of the loan portfolio, increased risk diversification, and cost efficiency, where digital solutions play a key role. The aim is to further consolidate the Bank’s position, increase profitability and ensure that the Bank remains a leading provider of cutting-edge financial services.

Preparing for the future is of the utmost importance and every positive step we take counts. In the spring Arion Bank and Kolvidur signed an agreement on offsetting the carbon emissions produced by the Bank’s activities. Kolvidur will fix the carbon in plants and soil through soil reclamation and forestry to offset the Bank’s carbon emissions in 2019. Kolvidur intends to plant up to 5,000 trees in respect of the current operating year. Carbon offsetting the Bank’s day-to-day operations is an important component of the Bank’s environment policy.”



INCOME STATEMENT

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff.	Q1 2019	% diff.
Net interest income	7,808	7,314	7%	7,434	5%
Net commission income	2,478	2,712	(9%)	2,218	12%
Net insurance income	823	758	9%	253	225%
Net financial income	1,023	1,119	(9%)	766	34%
Share of profit of associates	(7)	2	-	727	-
Other operating income	95	600	(84%)	310	(69%)
Operating income	12,220	12,505	(2%)	11,708	4%
Salaries and related expenses	(3,805)	(3,949)	(4%)	(3,630)	5%
Other operating expenses	(2,813)	(2,978)	(6%)	(3,232)	(13%)
Operating expenses	(6,618)	(6,927)	(4%)	(6,862)	(4%)
Bank levy	(912)	(879)	4%	(906)	1%
Net impairment	(988)	(166)	495%	(1,081)	(9%)
Net earnings before income tax	3,702	4,533	(18%)	2,859	29%
Income tax expense	(891)	(1,302)	(32%)	(622)	43%
Discontinued operations, net of tax	(715)	(169)	323%	(1,219)	(41%)
Net earnings	2,096	3,062	(32%)	1,018	106%

Operating income amounted to ISK 12.2 billion for the second quarter of 2019, compared with ISK 12.5 billion for the same period in 2018, a decrease of 2%. Net interest income and net insurance income developed well, whereas net commission income and net financial income decreased between years. Other operating income decreased significantly between years.

Net interest income increased by 7% compared with the same period in 2018. The net interest margin (NIM) as a percentage of average interest-bearing assets was 2.8% during the second quarter of 2019, the same as for the second quarter of 2018. The NIM was 2.7% during the first quarter of 2019. Average interest-bearing assets increased by 2.6% during the second quarter of 2019 but increased by 6.7% from the same period of 2018. CPI imbalance decreased by 36% from the same period in 2018 with a reduced effect on NIM from increased inflation.

Net commission income decreased by 9% in the second quarter of 2019 compared with the same period in 2018 but increased by 12% from the first quarter of 2019. The fluctuation in net commission income is mainly due to seasonality in the operation and unusually high prepayment fees from corporates and individuals, prepaying their loans in reductive interest rate environment in Q2 2018.

Net financial income is positive by ISK 1,023 million, compared with ISK 1,119 million for the second quarter of 2018, and has improved compared with net financial income of ISK 766 million for the first quarter of 2019. The capital markets were relatively favorable in the second quarter of 2019. Arion Bank sold its 19% share in the investment company Stodir at the end of the second quarter at a profit of ISK 0.3 billion. Stodir is one of the largest shareholders in Arion Bank and it was considered good governance to simplify the relationship between the two companies. In general, returns on bonds and equity holdings have been positive through the years.

Net insurance income amounted to ISK 823 million, compared with ISK 758 million for the same period of 2018, and ISK 253 million during the first quarter of 2019. The increase in 2019 is primarily driven by increased insurance premiums earned at the insurance company Vördur and a lower claim rate. The combined ratio for the second quarter of 2019 was 89.0% compared with 88.4% for the same period in 2018.

Other operating income was ISK 95 million during the second quarter, compared with ISK 600 million during the same period in 2018 and ISK 310 million during the first quarter of 2019. Fair value changes on investment property are the main reason for the fluctuations between quarters.

Operating expenses amounted to ISK 6,618 million during the second quarter, compared with ISK 6,927 million in the same period in 2018 and ISK 6,862 million during the first quarter of 2019. The Bank's cost-to-income ratio was 54.2% for the second quarter, compared with 55.4% for the same period in 2018 and 58.6% during the first quarter of 2019. The cost-to-total assets ratio was 2.2% for the second quarter, compared with 2.4% during the second quarter of 2018 and 2.3% for the first quarter of 2019.

Salaries and related expenses amounted to ISK 3,805 million for the second quarter of 2019, a decrease of 4% compared with the same period of 2018 but a 5% increase compared with the first quarter of 2019. The average salary per employee increased by 5.4% from the second quarter of 2018, slightly lower than the increase in the general salary index in Iceland. Full-time equivalent positions (FTEs) at the end of the period totalled 880 for the Group, 86 fewer than in the same period in 2018 and 24 fewer than at year-end 2018. The decrease from the second quarter of 2018 is mainly due to an increased emphasis on process automation, reflected by the digital strategy and general cost focus.



Other operating expenses amounted to ISK 2,813 million during the second quarter of 2019, compared with ISK 2,978 million during the same period in 2018 and ISK 3,232 million during the first quarter of 2019. There is a slight decrease between years, mainly in professional services and housing. There is an increase in IT expenses due to a new core system, SOPRA, which will support the continued digital focus of the Bank.

Net impairment was negative by ISK 988 million during the second quarter of 2019, compared with a negative net impairment of ISK 166 million in the same period in 2018 and ISK 1,081 million in the first quarter of 2019. Impairment related to TravelCo was ISK 0.5 billion in the second quarter of 2019 and general impairments were made on corporate clients due to the more challenging economic environment in Iceland.

Income tax amounted to ISK 891 million during the second quarter of 2019, compared with ISK 1,302 million in the same period in 2018 and ISK 622 million during the first quarter of 2019. Income tax, as reported in the financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1 billion. The effective income tax rate was 23.1% for the first half of 2019, compared with 28.7% during the same period of 2018. The combination of income is the main drivers for the shift in the effective tax rate. In 2019 positive developments in the equity markets result in a lower tax rate whereas last year equity markets developed in a more negative direction.

Discontinued operations, net of tax was negative by ISK 715 million during the second quarter of 2019, compared with a loss of ISK 169 million for the same period in 2018 and a loss of ISK 1,219 million in the first quarter of 2019. Discontinued operations are mainly due to the operating results of the subsidiary Valitor, which is classified as held for sale. In April 2019 Reykjavík District Court issued a decision on the case Datacell ehf. and Sunshine Press Production ehf. vs. Valitor hf. Valitor was ordered to pay the plaintiffs a total of ISK 1.2 billion in damages. Valitor has settled on paying the compensatory damages in accordance with Reykjavik District Court's ruling. The net effect on the Income Statement during the first quarter of 2019 was ISK 0.6 billion after tax considerations.



First six months of 2019

<i>In ISK millions</i>	H1 2019	H1 2018	% diff.
Net interest income	15,242	14,141	8%
Net commission income	4,696	4,917	(4%)
Net insurance income	1,076	901	19%
Net financial income	1,789	2,506	(29%)
Share of profit of associates	720	(18)	-
Other operating income	405	868	(53%)
Operating income	23,928	23,315	3%
Salaries and related expenses	(7,435)	(7,565)	(2%)
Other operating expenses	(6,045)	(6,121)	(1%)
Operating expenses	(13,480)	(13,686)	(2%)
Bank levy	(1,818)	(1,683)	8%
Net impairment	(2,069)	(301)	587%
Net earnings before income tax	6,561	7,645	(14%)
Income tax expense	(1,513)	(2,192)	(31%)
Discontinued operations, net of tax	(1,934)	(442)	338%
Net earnings	3,114	5,011	(38%)
KPI's			
Return on equity	3.2%	4.7%	
Earnings per share (in ISK)	1.72	2.35	
Cost to income ratio	56.3%	58.7%	

Net earnings during the first six months of 2019 were significantly lower than during the same period in 2018, with return on equity 3.2%, compared with 4.7% for the first half of 2018.

Net interest income for the first six months of 2019 increased by 8% compared with the first six months of 2018. *Net interest margin* was 2.8% compared with 2.7% for the same period in 2018. *Net financial income* decreased by 29% compared with last year but net financial income for the first six months of 2018 was positively affected by market changes in equity holdings, mainly from sale redemption (Refresco) and changes in holdings of listed and unlisted equity holdings. *Share of profit of associates* is positively affected by the sale of the associate Farice in the first half of 2019.

Operating expenses decreased by 2% between the first six months 2019 and the same period last year. The number of FTEs has decreased by 86 from the end of June 2018. *Net impairment* was significant for the first six months of 2019. Net impairment was affected by the bankruptcy of WOW Air as well as the operational difficulties at TravelCo. *Income tax expense* was 31% lower during the first six months of 2019 compared with the same period in 2018, mainly due to the different combination of income during the period.

The loss from *discontinued operations* increased during the first six months of 2019, compared with the same period in 2018, largely due to the continued growth and investments in Valitor and aforementioned compensatory damages.



Earnings of operating segments

Arion Bank divides its operations into five profit centers plus subsidiaries and support units. The Bank's profit centers are Asset Management, Corporate Banking, Investment Banking, Retail Banking and Treasury.

All operating segments except for Treasury made a profit before income tax in the second quarter of 2019.

2nd quarter 2019 <i>In ISK millions</i>	Asset Manage- ment	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other div., headq. and subsidi.	Total
Net interest income	224	2,322	89	4,444	850	(121)	7,808
Net commission income	851	309	505	1,199	(111)	(275)	2,478
Other income	71	269	0	32	(87)	1,649	1,934
Operating income	1,146	2,900	594	5,675	652	1,253	12,220
Operating expenses	(749)	(1,093)	(454)	(3,351)	(365)	(606)	(6,618)
Bank levy	(46)	(214)	(10)	(301)	(341)	0	(912)
Net impairment	(3)	(1,216)	0	275	3	(47)	(988)
Net earnings before income tax	348	377	130	2,298	(51)	600	3,702

2nd quarter 2018 <i>In ISK millions</i>	Asset Manage- ment	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other div., headq. and subsidi.	Total
Net interest income	175	1,464	94	4,310	1,189	82	7,314
Net commission income	865	305	425	1,235	(82)	(36)	2,712
Other income	43	18	(1)	74	143	2,202	2,479
Operating income	1,083	1,787	518	5,619	1,250	2,248	12,505
Operating expenses	(630)	(878)	(398)	(3,398)	(313)	(1,310)	(6,927)
Bank levy	(41)	(180)	(14)	(312)	(333)	1	(879)
Net impairment	0	(413)	0	238	10	(1)	(166)
Net earnings before income tax	412	316	106	2,147	614	938	4,533

1st quarter 2019 <i>In ISK millions</i>	Asset Manage- ment	Corporate Banking	Investment Banking	Retail Banking	Treasury	Other div., headq. and subsidi.	Total
Net interest income	205	2,144	63	4,562	574	(114)	7,434
Net commission income	757	320	475	1,092	(95)	(331)	2,218
Other income	135	(474)	6	98	(223)	2,514	2,056
Operating income	1,097	1,990	544	5,752	256	2,069	11,708
Operating expenses	(733)	(1,107)	(426)	(3,346)	(343)	(907)	(6,862)
Bank levy	(46)	(190)	(11)	(339)	(320)	0	(906)
Net impairment	(5)	(1,032)	0	(43)	(1)	0	(1,081)
Net earnings before income tax	313	(339)	107	2,024	(408)	1,162	2,859



Asset Management

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff	Q1 2019	% diff
Net interest income	224	175	28.0%	205	9.3%
Net commission income	851	865	(1.6%)	757	12.4%
Other income	71	43	65.1%	135	(47.4%)
Operating income	1,146	1,083	5.8%	1,097	4.5%
Operating expenses	(749)	(630)	18.9%	(733)	2.2%
Bank levy	(46)	(41)	12.2%	(46)	0.0%
Net impairment	(3)	0	-	(5)	-
Net earnings before income tax	348	412	(15.5%)	313	11.2%

The operating income and net earnings of Asset Management have been relatively stable. Lower commission income compared with the same period last year is mainly due to major clients who insourced some of their asset management in 2018, affecting the assets under management and fee income of the division. Operating expenses increased compared with the second quarter of 2018 and first quarter of 2019 partly due to a change in the method of allocating expenses. Assets under management at the end of the period amounted to ISK 1.072 billion and increased by 10.4% from year-end 2018 and 2.5% from the end of the second quarter of 2018.

Corporate Banking

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff	Q1 2019	% diff
Net interest income	2,322	1,464	58.6%	2,144	8.3%
Net commission income	309	305	1.3%	320	(3.4%)
Other income	269	18	-	(474)	-
Operating income	2,900	1,787	62.3%	1,990	45.7%
Operating expenses	(1,093)	(878)	24.5%	(1,107)	(1.3%)
Bank levy	(214)	(180)	18.9%	(190)	12.6%
Net impairment	(1,216)	(413)	194.4%	(1,032)	17.8%
Net earnings before income tax	377	316	19.3%	(339)	-

Net interest income in Corporate Banking increased significantly between years and from the first quarter of 2019, partly due to the transfer of loans to SMEs from Retail Banking and an increased focus on return rather than growth in the corporate lending book. Operating expenses increased compared with the second quarter of 2018 and the first quarters of 2019, partly due to the transfer of employees from Retail Banking to Corporate Banking and a change in the method of allocating expenses. The negative net valuation changes in the loan portfolio during the second quarter of 2019 can be primarily attributed to TravelCo. General impairments were also made in the second quarter on corporate clients due to the more challenging economic environment in Iceland while in the first quarter the impairment of lending and guarantees to Wow air played a major role. Impairments in the second quarter of 2018 were made against a number of customers.

Investment Banking

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff	Q1 2019	% diff
Net interest income	89	94	(5.3%)	63	41.3%
Net commission income	505	425	18.8%	475	6.3%
Other income	0	(1)	-	6	-
Operating income	594	518	14.7%	544	9.2%
Operating expenses	(454)	(398)	14.1%	(426)	6.6%
Bank levy	(10)	(14)	(28.6%)	(11)	(9.1%)
Net earnings before income tax	130	106	22.6%	107	21.5%

Investment Banking operations have been relatively stable but at a low level during the last few quarters. Corporate Finance has continued to be engaged in internal projects at the Bank, such as resolving complex recovery cases and arranging the sale of the equity holdings in Stodir. Revenues from equities and fixed income brokerage at Capital Markets continued to be strong, with the Bank being a leader in terms of turnover on Nasdaq Iceland in recent years.



Retail Banking

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff	Q1 2019	% diff
Net interest income	4,444	4,310	3.1%	4,562	(2.6%)
Net commission income	1,199	1,235	(2.9%)	1,092	9.8%
Other income	32	74	(56.8%)	98	(67.3%)
Operating income	5,675	5,619	1.0%	5,752	(1.3%)
Operating expenses	(3,351)	(3,398)	(1.4%)	(3,346)	0.1%
Bank levy	(301)	(312)	(3.5%)	(339)	(11.2%)
Net impairment	275	238	15.5%	(43)	-
Net earnings before income tax	2,298	2,147	7.0%	2,024	13.5%

Operating income increased by 1% between the second quarter of 2019 and the second quarter of 2018 but decreased by 1% compared with the first quarter of 2019. Operating expenses decreased compared with the second quarter of 2018 and the first quarter of 2019, partly due to the transfer of employees from Retail Banking to Corporate Banking.

Treasury

<i>In ISK millions</i>	Q2 2019	Q2 2018	% diff	Q1 2019	% diff
Net interest income	850	1,189	(28.5%)	574	48.1%
Net commission income	(111)	(82)	35.4%	(95)	16.8%
Other income	(87)	143	-	(223)	(61.0%)
Operating income	652	1,250	(47.8%)	256	154.7%
Operating expenses	(365)	(313)	16.6%	(343)	6.4%
Bank levy	(341)	(333)	2.4%	(320)	6.6%
Net impairment	3	10	(70.0%)	(1)	-
Net earnings before income tax	(51)	614	-	(408)	-

Operating income from Treasury decreased significantly in the second quarter of 2019 compared with the same period of 2018 but is higher than in the first quarter of 2019. The decrease from last year is mainly due to increased interest bearing liabilities, reflected in net interest income and negative net financial income, mainly foreign exchange loss.

BALANCE SHEET

Arion Bank's **total assets** increased by 6% from year-end 2018.

<i>In ISK millions</i>	30.06.2019	31.12.2018	Diff.	% diff.	31.03.2019	% diff.
Cash & balances with CB	107,649	83,139	24,510	29%	94,124	14%
Loans to credit institutions	69,064	56,322	12,742	23%	84,978	(19%)
Loans to customers	821,731	833,826	(12,095)	(1%)	829,246	(1%)
Financial assets	144,161	114,557	29,604	26%	128,103	13%
Investment property	7,120	7,092	28	0%	7,101	0%
Investments in associates	818	818	0	0%	807	1%
Intangible assets	7,580	6,397	1,183	19%	7,081	7%
Assets and disposal groups held for sale	55,109	48,584	6,525	13%	51,321	7%
Other assets	20,188	13,592	6,596	49%	19,934	1%
Total assets	1,233,419	1,164,327	69,092	6%	1,222,695	1%

Cash and balances with the Central Bank and *Loans to credit institutions* increased in total by ISK 37,252 million from year-end 2018 but decreased slightly from the end of the first quarter of 2019. The liquidity position at period end is unusually high due to increased short term FX-deposits and a decrease in loans to customers, as the Bank has prepared prepayments of structured covered bonds of ISK 12 billion in July 2019.

Loans to customers totalled ISK 821,731 million at the end of the period, representing a 1.5% decrease from year-end 2018 and a 0.9% decrease from the end of the first quarter of 2019. The strategic focus on return rather than growth is the main reason for this decrease, and the Icelandic economy is also stabilizing following a significant period of growth during the last few years. The decrease was mainly related to corporates in the seafood and real estate sectors and financial and insurance activities. During the second quarter of 2019 the Bank had to make impairments in relation to the acquisition of TravelCo, a total of ISK 0.5 billion and additional impairments were made on corporate clients due to more challenging economic environment in Iceland.



Financial assets amounted to ISK 144,161 million at the end of the period, compared with ISK 114,557 million at the end of 2018. The combination of securities held by the Bank, especially bond holdings, is closely related to the liquidity position at any given time. The decrease in shares and instruments with variable income from Q1 2019 is mainly due to the sale of 19% shareholding in Stodir at the end of June.

<i>In ISK millions</i>	30.06.2019	31.12.2018	Diff.	% diff.	31.03.2019	% diff.
Bonds	94,570	71,451	23,119	32%	81,027	17%
Shares and instruments w . variable income	19,569	20,265	(696)	(3%)	23,595	(17%)
Derivatives	7,035	6,241	794	13%	6,024	17%
Securities used for hedging	22,987	16,600	6,387	38%	17,457	32%
Securities total	144,161	114,557	29,604	26%	128,103	13%

Assets and disposal groups held for sale amounted to ISK 55,109 million at the end of the period, compared with ISK 48,584 million at year-end 2018 and ISK 51,321 million at the end of the first quarter. The subsidiaries Valitor Holding ehf., Stakksberg ehf. and now Sólbjarg ehf. (TravelCo) are classified as held for sale. The total assets of Valitor at the end of the period were ISK 37,155 million.

Liabilities increased by 8% from year-end 2018. **Equity** decreased due to a dividend payment in 2019, totalling ISK 9.1 billion, net of own shares. Net earnings for the period partly offset the decrease.

<i>In ISK millions</i>	30.06.2019	31.12.2018	Diff.	% diff.	31.03.2019	% diff.
Due to credit institutions & CB	8,703	9,204	(501)	(5%)	9,183	(5%)
Deposits from customers	504,897	466,067	38,830	8%	490,474	3%
Financial liabilities at fair value	2,065	2,320	(255)	(11%)	2,286	(10%)
Other liabilities	42,563	35,226	7,337	21%	45,840	(7%)
Borrowings	436,897	417,782	19,115	5%	445,077	(2%)
Subordinated loans	10,763	6,532	4,231	65%	7,283	48%
Liabilities associated w . disposal groups HFS	32,242	26,337	5,905	22%	29,498	9%
Shareholders equity	195,159	200,729	(5,570)	(3%)	192,924	1%
Non-controlling interest	130	130	0	0%	130	0%
Total liabilities and equity	1,233,419	1,164,327	69,092	6%	1,222,695	1%

Deposits from customers amounted to ISK 504,897 million at the end of June 2019 and had increased by 8% from year-end 2018 and 3% from the end of the first quarter of 2019. The continuing focus on deposits, especially from SMEs and corporates through Retail Banking and Corporate Banking, has been a success but some short term FX-deposits are positioned at the Bank at period end. Deposits remain the most important source of funding for Arion Bank.

Borrowings amounted to ISK 436,897 million at the end of June 2019, a 5% increase from year-end 2018 but a slight decrease from the end of the first quarter of 2019 following payments of EMTN issuance from 2016 and a prepayment of ISK 7 billion on the structured covered bonds program. The Bank has issued several private placements through the EMTN program, a total of ISK 14.4 billion and has continued to issue covered bonds on the Icelandic market, a total of ISK 25.2 billion during the first six months of 2019, as well as other smaller issuances.

Subordinated liabilities amounted to ISK 10,763 million at the end of June 2019, compared with ISK 6,532 million at the end of 2018. The Bank issued Tier 2 subordinated bonds in ISK for the total amount of ISK 2.5 billion during the second quarter. At the end of June 2019 the total issued Tier 2 bonds amounted to ISK 10.8 billion, or 1.4% additional capital. Furthermore the Bank issued ISK 4.9 billion in early July 2019, increasing the Tier 2 to ISK 15.7 billion, or 2.0% additional capital. In June 2019 the Bank received a tax ruling from the Icelandic tax office stating that coupons on AT1 issue will not be deductible. The Bank is currently evaluating its options regarding AT1 issuance.

Shareholders' equity amounted to ISK 195,159 million at the end of June 2019, compared with ISK 200,729 million at the end of 2018. The decrease is explained by a dividend payment of ISK 9.1 billion, which is partly offset by an increase in equity due to the financial results for the period. In April 2019 Arion Bank's share capital was reduced by ISK 186 million at nominal value, totalling 186 million shares, by cancelling the vast majority of the Bank's own shares. Arion Bank's share capital is ISK 1,814 million after the reduction. The CET 1 ratio was 21.4% at the end of June, compared with 21.2% at year-end 2018.



KEY PERFORMANCE INDICATORS

	Q2 2019	Q2 2018	H1 2019	H1 2018
Return on equity (ROE)	4.3%	5.9%	3.2%	4.7%
Return on total assets (ROA)	0.7%	1.1%	0.5%	0.9%
Net interest margin (int. bearing assets)	2.8%	2.8%	2.8%	2.7%
Net interest margin (total assets)	2.5%	2.5%	2.5%	2.5%
Cost-to-income ratio	54.2%	55.4%	56.3%	58.7%
Cost-to-Total assets ratio	2.2%	2.4%	2.2%	2.4%
Effective tax rate	24.1%	29.6%	23.1%	30.1%
CAD ratio	22.8%	21.9%	22.8%	21.9%
CET 1 ratio	21.4%	21.8%	66.2%	21.8%
Share of stage 3 loans, gross*	2.4%	-	2.3%	-
RWA/Total assets	63.1%	67.8%	63.1%	67.8%
Loans to deposit ratio	162.8%	168.8%	162.8%	168.8%
The Group's employees at the end of the period	880	966	880	966
The Parent's employees at the end of the period	770	823	770	823

* (Gross loans in stage 3 + POCI loans in RISK class 5) / Gross carrying amount of loans to customers

ARION BANK PREPAYS COVERED BONDS IN OCTOBER 2019

In October, Arion Bank is planning to prepay in full the contractual covered bond issuance (Arion CB2) in the amount of ISK 60 billion, which today is largely owned by the Housing Financing Fund (HFF). The bond class that the Bank is prepaying is on terms that are higher than the terms of financing that the Bank can obtain in the market today. At the same time, the Bank has agreed to sell HFF a mortgage loan portfolio in the amount of ISK 50 billion.

The Bank's customers will not be affected by HFF's acquisition and Arion Bank will continue to service and administer the loans. Customers can therefore continue to use the Bank's branch if they need services in relation to their loans, and the loans will still be visible in the Bank's online banking and app. First and foremost, these are index-linked mortgages that carry fixed interest rates and were granted in the years 2004-2006, and Arion Bank acquired the loans from Kaupthing ehf. at the end of 2011.

The prepayment of the bond series is expected to have a positive impact on the Bank's operations from the fourth quarter of 2019 due to lower capital costs and lower bank tax, as well as any discounts that the Bank would have recognized following a prepayment or during the life of the loans will be fully recognized when all the conditions of the agreement are met. The sale also has a positive effect on the Bank's capital ratios.

The agreement with HFF and the prepayment of covered bonds are subject to several conditions, including the approval of the Icelandic Competition Authority.

FINANCIAL TARGETS

Arion Bank's medium-term targets are as follows:

RoE	Exceed 10%
CET 1	Reduce to circa 17%
Loan growth	Prudent lending in line with economic growth
Cost to Income ratio	Reduce to circa 50%
Dividend policy	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buy-back of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above limitations set by regulators in addition to the Bank's Management Buffer.



CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a meeting / webcast on Friday 9 August at 8:30 GMT (10:30 CEST) where CEO Benedikt Gíslason, CFO Stefán Pétursson, deputy CFO Eggert Teitsson and Head of Investor Relations Sture Stölen will present the results and answer questions from participants. The meeting will take place in English at the Bank's headquarters, Borgartún 19, and will be streamed live.

Those attending the meeting in Borgartún 19 need to register [here](#). To participate in the webcast via telephone and to put forward questions please call in using the relevant number indicated below before the start of the webcast:

IS: +354 800 7520
SE: +46 850 558 358
UK: +44 33 3300 9263
US: +1 83 3526 8381

The webcast will be accessible live on financialhearings.com and a link will also be made available on the Bank's website under Investor Relations.

For further information please contact Arion Bank's Investor Relations at ir@arionbanki.is, Sture Stölen, head of investor relations, +46 72 368 6507 or Theódór Fridbertsson, investor relations, +354 444 6760.

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FINANCIAL CALENDAR 2019

The Bank's Financial Statements are scheduled for publication as stated below.

Third quarter 2019	30 October 2019
Full year 2019 and fourth quarter 2019	12 February 2020
AGM	17 March 2020
First quarter 2020	6 May 2020
Second quarter 2020	29 July 2020
Third quarter 2020	28 October 2020

This calendar may be subject to change.

This is information that Arion Bank hf. is obliged to make public pursuant to the EU Market Abuse Regulation. The information was submitted for publication through the agency of the contact persons set out above.

Forward-looking statements

This release contains forward-looking statements that reflect management's current views with respect to certain future events and potential financial performance. The information in the release is based on company data available at the time of the release. Although Arion Bank believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Accordingly, results could differ materially from those set out in the forward-looking statements as a result of various factors. The most important factors that may cause such a difference for Arion Bank include, but are not limited to: a) the macroeconomic development, b) change in inflation, interest rate and foreign exchange rate levels, c) change in the competitive environment and d) change in the regulatory environment and other government actions. This release does not imply that Arion Bank has undertaken to revise any forward-looking statements, beyond what is required by applicable law or applicable stock exchange regulations if and when circumstances arise that will lead to changes after the date when this release was made. Arion Bank assumes no responsibility or liability for any reliance on any of the information contained herein. It is prohibited to distribute or publish any information in this release without Arion Bank's prior written consent.