Arion Bank

First quarter 2024 results

Press release 30 April 2024

Arion Bank – Q1 2024 results

Financial highlights for Q1 2024

- Arion Bank reports net earnings of ISK 4,432m in Q1 2024, compared with ISK 6,291m in Q1 2023
- Return on equity was 9.1%, compared with 13.7% in Q1 2023
- Earnings per share in ISK of 3.07 in Q1, compared with 4.32 in Q1 2023
- Net interest margin of 3.1%, the same as in Q1 2023
- Net commission income was ISK 3.4bn, lower than in previous quarters
- Core operating income, defined as net interest income, net commission income and insurance service results (excluding opex of the insurance operation), decreased by 2%, compared with Q1 2023, mainly due to fee income
- Effective tax rate was unusually high, 37.8%, due to unfavorable combination of income
- Cost-to-core income ratio in Q1 was 48.4%, compared with 46.8% in Q1 2023
- The balance sheet increased by 1.2% from year-end 2023
- Dividend payment of ISK 9 per share or a total of ISK 13.1bn in Q1 2024
- Loans to customers increased by 2.2% during the quarter. The increase was 3.2% in corporate lending and 1.4% in loans to individuals, mainly mortgages
- Deposits from customers increased by 1.2% during the quarter
- The Bank's capital ratio was 23.2% and the CET1 ratio was 18.8% at the end of March. The ratios are determined on the basis of the unaudited net earnings in the quarter and take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank's dividend policy and ISK 5bn approved buyback of own shares. The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 22.9% and the CET1 ratio was 18.6%. These ratios comfortably exceed the requirements made by the FSA and Icelandic law

Benedikt Gíslason, CEO of Arion Bank

"Net earnings in the first quarter were below our target. Lower earnings during the quarter are mainly due to weaker fee income and a high effective tax rate since the loss on equities holdings held against forward contracts resulted in a 38% tax rate in the quarter. Capital and liquidity positions remain strong, as does the Bank's funding. We are now working on reaching our target CET 1 ratio. At the end of the period this ratio was 18.8%, 3.5 points above the regulatory minimum, with our target being 1.5 to 2.5 points higher than this requirement. A share buyback program is currently in progress and forms part of our strategy to bring this ratio closer to our targets.

Economic activity has slowed down against a backdrop of higher interest rates and this is one of the factors which has resulted in subdued fee income during the period. Following an invitation to tender by ISAVIA, we also closed our branch at Keflavík International Airport after having had a presence at the airport since 2016. We are proud of the service we provided to visitors during these eventful years. Our employees did a brilliant job, in often challenging circumstances, at welcoming travellers passing through the airport.

A fund managed by our subsidiary Stefnir has recently acquired Heimstaden Iceland, the country's largest apartment rental company which owns approximately 1,600 properties in Iceland. The majority of Icelandic pension funds participated in the fund and total committed equity capital amounts to ISK 40 billion. The fund aims to drive the development of new housing and to double the number of units owned by the company by 2030. We are delighted to see how positively the fund has started and how many pension funds committed to this key project."

Income Statement

In ISK millions	**Q1 2024**	**Q1 2023**	**Δ**	**Δ %**
Net interest income	11,245	10,993	252	2%
Net commission income	3,365	4,444	(1,079)	(24%)
Insurance service results	(215)	(736)	521	(71%)
Net financial income	29	794	(765)	(96%)
Other operating income	50	14	36	257%
Operating income	**14,474**	**15,509**	**(1,035)**	**(7%)**
Operating expenses	(6,554)	(6,440)	(114)	2%
Bank levy	(460)	(449)	(11)	2%
Net impairment	(315)	(52)	(263)	-
Net earnings before income tax	**7,145**	**8,568**	**(1,423)**	**(17%)**
Income tax expense	(2,704)	(2,287)	(417)	18%
Net earnings from cont. operations	**4,441**	**6,281**	**(1,840)**	**(29%)**
Discontinued operations, net of tax	(9)	10	(19)	-
Net earnings	**4,432**	**6,291**	**(1,859)**	**(30%)**

KFI's		
Return on equity (ROE)	9.1%	13.7%
Return on total assets (ROA)	1.2%	1.7%
Earnings per share (in ISK)	3.07	4.32
Cost to core income ratio	48.4%	46.8%
Net interest margin (NIM)	3.1%	3.1%
Core income / REA	6.6%	6.9%

Net interest income in the first quarter of 2024 increased by 2.3%, compared with the first quarter of 2023. The net interest margin (NIM) as a percentage of average interest-bearing assets was 3.1% for the quarter, the same as for the first quarter of 2023. Despite lower inflation in Q1 2024 compared with Q1 2023 the effect of inflation is positive by ISK 868m due to increased net CPI balance, which increased by ISK 100bn between years. The Central Bank base rate was 9.25% at the end of March 2024, compared with 7.5% at the end of March 2023. Average interest-bearing assets increased by 3.5%, compared with the first quarter of 2023, mainly loans to customers. At the same time interest-bearing liabilities increased by 3.0%, mainly deposits.

Net commission income was ISK 3.4bn in the first quarter, compared with ISK 4.4bn in the previous year. The quarter was slower in terms of lending and corporate finance compared with a strong quarter in 2023. Specific items that impact the first quarter 2024 are the closing of the Keflavík airport branch in January, which reduced fees by ISK 80m from Q4 2023 and will result in a reduction in fees of ISK 100-200m per quarter going forward, and the reclassification of card insurance fees to net insurance of ISK 87m. Income from asset management remains rather stable but turnover-based fees from cards, payment services and capital markets decreased from recent quarters.

Insurance service results of the insurance company Vördur were negative by ISK 215m during the quarter, after the elimination of intercompany transactions. There has been strong growth of 13.5% in insurance revenues, compared with the first quarter of 2023, whereas claims increase by 7.0% between quarters. Seasonality in claims normally results in Q4 and Q1 annual highs in the claim ratio. The combined ratio for the first quarter of 2024 was 103.9%, compared with 115.4% for the same period in 2023.

Net financial income was ISK 29m for the quarter in a continuing challenging market environment.

Operating expenses increased by 1.8% in the first quarter, compared with the same period in 2023. When operating expenses of the insurance operation are included (post IFRS 17 cost related to the insurance business is accounted for through insurance service results), the increase was 1.2%. At the same time inflation was 7%. There is an ongoing focus on operating expenses and efficiency within the Group. Cost-to-core income ratio was 48.4% in the first quarter, compared with 46.8% in the first quarter 2023, when including the operating expenses of the insurance operation. Salary expenses increased by 2.8% compared with the first quarter of 2023, mainly due to higher lay-off expenses and an increase in the number of FTEs. At the end of March, the number of full-time equivalent positions (FTEs) was 815, an increase of 3.4% from the same period in 2023.

Net impairment was ISK 315m in the first quarter of 2024. The main effect in the quarter was due to additional impairments on mortgages to individual customers from Grindavík, who have had to leave their homes due to volcanic activity, or ISK 0.4bn.

Income tax, as reported in the financial statements, comprises 21% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1bn. The effective income tax rate was unusually high in the first quarter 2024 or 37.8%. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate. The effective tax rate was significantly impacted by equity forward business in the first quarter of 2024. Profit and loss of equity forward contracts is offset in the income statement. However, loss from subsequent equity holdings is not deductible for tax purposes, while profit from underlying contracts is taxable income.

Balance sheet

The balance sheet increased by 1.2% from year-end 2023 and the liquidity position remains strong.

Assets

In ISK millions	**31.03.2024**	**31.12.2023**	**Δ**	**Δ %**	**31.03.2023**	**Δ**	**Δ %**
Cash & balances with CB	102,405	102,095	310	0%	80,272	22,133	28%
Loans to credit institutions	33,782	28,835	4,947	17%	62,899	(29,117)	(46%)
Loans to customers	1,178,700	1,152,789	25,911	2%	1,114,128	64,572	6%
Financial instruments	195,914	205,706	(9,792)	(5%)	204,997	(9,083)	(4%)
Investment property	9,542	9,493	49	1%	7,875	1,667	21%
Intangible assets	7,885	8,051	(166)	(2%)	8,575	(690)	(8%)
Other assets	16,204	18,703	(2,499)	(13%)	21,898	(5,694)	(26%)
Total assets	**1,544,432**	**1,525,672**	**18,760**	**1%**	**1,500,644**	**43,788**	**3%**
KFI's							
REA / Total assets	60.7%	59.7%			60.4%		
Share of stage 3 loans, gross	1.9%	1.4%			1.7%		

Loans to customers increased by 2.2% or ISK 26bn from the end of 2023, with loans to corporates increasing by 3.2%, and loans to individuals growing by 1.4%. Part of this growth, or ISK 8bn, is due to inflation and changes in currencies. The growth rate has decreased in recent quarters, especially in corporates with the economic environment slowing down following the changes in the interest rate environment. The diversification of the corporate loan book continues to be good and in line with the Bank's credit strategy.

The Bank's liquidity position is strong with the total LCR ratio at 144% and the ISK LCR ratio at 107%. This is reflected in the strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments. The average duration of liquidity in the bond portfolio is less than one year and there is no HTM accounting.

Liabilities and equity

In ISK millions	**31.03.2024**	**31.12.2023**	**Δ**	**Δ %**	**31.03.2023**	**Δ**	**Δ %**
Due to credit institutions & CB	3,205	2,771	434	16%	24,188	(20,983)	(87%)
Deposits from customers	802,068	792,710	9,358	1%	775,023	27,045	3%
Other liabilities	73,138	69,152	3,986	6%	84,086	(10,948)	(13%)
Borrowings	433,047	420,460	12,587	3%	390,734	42,313	11%
Subordinated liabilities	41,558	41,278	280	1%	46,681	(5,123)	(11%)
Total liabilities	**1,353,016**	**1,326,371**	**26,645**	**2.0%**	**1,320,712**	**32,304**	**2%**
Shareholders equity	190,925	198,798	(7,873)	(4%)	179,276	11,649	6%
Non-controlling interest	491	503	(12)	(2%)	656	(165)	(25%)
Total equity	**191,416**	**199,301**	**(7,885)**	**(4%)**	**179,932**	**11,484**	**6%**
Total liabilities and equity	**1,544,432**	**1,525,672**	**18,760**	**1%**	**1,500,644**	**43,788**	**3%**
KFI's							
Loans to Deposits ratio	147.0%	145.4%			143.8%		
CET 1 ratio	18.8%	19.7%			18.6%		
Capital adequacy ratio	23.2%	24.1%			23.7%		

Deposits from customers remain the most important source of funding for Arion Bank, with 59% of total liabilities in deposits. The increase from year-end 2023 is mainly from individuals and pension funds.

The maturity profile of *Borrowings* is balanced, and the Bank has broad funding options. The Bank issued ISK 11.5bn covered bonds in the quarter. Funding spreads in the international market have developed favorably in recent months. The Bank will continue to regularly issue in the domestic market and access the international markets periodically. The Bank has no significant FX maturities until December 2024. Following a strategic review, the Bank will operate with one international credit rating agency, Moody's.

Shareholders' equity decreased due to ISK 13.1m dividend payment which was partly offset by the net earnings of ISK 4,432m in the quarter. The leverage ratio was 12.0% at the end of March, compared with 12.4% at the end of 2023, which is high by international standards. CET1 capital is ISK 9.8-19.1bn in excess of target capital structure. However, since currently the Bank does not fully utilize AT1 capacity, CET1 capital of ISK 4.2bn is used to make up that shortfall.

For further information on the accounts please visit Arion Bank's website.

Medium-term financial targets of Arion Bank

	Actuals Q1 2024	Arion Bank's medium-term financial targets
Return on equity	9.1%	Exceed 13%
Core operating income / REA	6.6%	Exceed 7.2%
Insurance revenue growth (YoY)	13.5%	In excess of market growth (11.2% in 2023)
Combined ratio	103.9%	Below 95%
Cost-to-core income ratio	48.4%	Below 45%
CET1 ratio above regulatory capital requirements	350 bps	150-250 bps management buffer (assumes fully utilized AT1) (~16.8 - 17.8% based on optimal capital requirements and optimal AT1 and T2 ratios)
Dividend pay-out ratio	50%	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both

Investor meeting / webcast in English on 2 May at 10:30 CEST (8:30 GMT)

Arion Bank will be hosting a meeting at the Bank's headquarters in Borgartún 19, Reykjavík, on Thursday 2 May at 10:30 CEST (8:30 GMT) where CEO Benedikt Gíslason and CFO Ólafur Hrafn Höskuldsson will present the results and Chief Economist Erna Björg Sverrisdóttir will give an update on the economic environment. The meeting will take place in English and will also be streamed live.

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

Participants attending virtually will be able to ask questions during the meeting through a message board on the same site. Answers will be provided by presenters at the end of the webcast.

Financial calendar

Arion Bank's financial calendar is available on the Bank's website.

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