

Arion Bank's Q1 2012 financial results

Arion Bank reported net earnings of ISK 4.5 billion for the first quarter of 2012, compared with ISK 3.0 billion during the same period in 2011. Return on equity was 16.5% in Q1 2012, compared with 11.3% in Q1 2011. The interim financial statement for the first quarter of 2012 has not been audited.

The Bank's capital ratio at the end of the period was 20.2%, compared with 19.2% at the end of Q1 2011. The Financial Supervisory Authority (FME) stipulates a minimum capital ratio of 16%.

Highlights of the interim financial statement:

- Net earnings of ISK 4.5 billion, compared with ISK 3.0 billion during the same period of 2011.
- Earnings on regular operations of ISK 2.5 billion, compared with ISK 3.1 billion during the same period last year.
- Operating income of ISK 10.9 billion in Q1 2012, compared with ISK 9.5 billion in Q1 2011.
- Net interest income of ISK 6.2 billion in Q1 2012, compared with ISK 5.9 billion in Q1 2011.
- Return on equity was 16.5% in Q1 2012, compared with 11.3% in Q1 2011. Return on equity based on regular operations was 9.1% in Q1 2012, compared with 12.7% in Q1 2011.
- The interest-rate differential as a percentage of the average interest-bearing assets was 3.1% in Q1 2012, compared with 3.4% in Q1 2011.
- The capital ratio was 20.2%, compared with 19.2% during the same period of 2011 and 21.2% on 31 December 2011. The FME requires a capital ratio of at least 16%.
- The Bank's liquidity ratio was 30.2%, which is well over the 20% minimum stipulated by the FME.
- The Bank's cash ratio was 13.9%, above the FME's minimum requirement of 5%.
- Loans to customers totalled ISK 584.2 billion at the end of the period, compared with ISK 432.5 billion at the same time in 2011. This increase is primarily a result of the acquisition of Kaupthing Bank's mortgage portfolio at the end of 2011.
- Total assets amounted to ISK 899.4 billion at the end of Q1 2012, compared with ISK 802.7 billion at the end of Q1 2011.
- Total equity at the end of Q1 2012 amounted to ISK 119.0 billion, compared with ISK 112.7 billion at the end of Q1 2011.

Höskuldur H. Ólafsson, CEO of Arion Bank:

"The financial results for the first quarter of 2012 are pleasing and bear testament to the stability of the Bank's core operations. It is also satisfying to see the positive response from investors to the Bank's covered bond issues, both the indexed and nominal series. The bond issues are vitally important for helping to diversify the Bank's funding base. However, the uncertainty surrounding currency-linked loans and Supreme Court rulings on these cases has greatly reduced the speed at which we can resolve our customers' debt problems. This ambiguity causes our customers inconvenience and in order to eliminate further uncertainty the Supreme Court needs to issue further rulings as quickly as possible. Nevertheless these results show that the Bank is financially robust and is in prime position to meet the demands of our personal and corporate clients."

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Income statement – highlights

Statement of Comprehensive Income				
<i>In ISK million</i>	Q1 2012	Q1 2011	Diff.	%
Net interest income	6,214	5,886	328	6%
Net valuation changes on loans and receivables	(76)	(413)	337	82%
Net interest income less valuation changes	6,138	5,473	665	12%
Net fee and commission income	2,336	2,492	(156)	(6%)
Net financial income	346	729	(383)	(53%)
Net foreign exchange gain (loss)	1,083	(312)	1,395	-
Other operating income	952	1,099	(147)	(13%)
Operating income	10,855	9,481	1,374	14%
Salaries and related expense	(3,045)	(2,658)	(387)	15%
Other operating expense	(2,757)	(2,463)	(294)	12%
Earnings before taxes	5,053	4,360	693	16%
Income tax expense	(1,061)	(1,045)	(16)	2%
Bank Levy	(268)	(67)	(201)	300%
Net earnings from continuing operations	3,724	3,248	476	15%
Net gain (loss) from discontinued operation	727	(282)	1,009	-
Net earnings	4,451	2,966	1,485	50%

Net earnings during the first quarter amounted to ISK 4,451 million, compared with ISK 2,966 million during the same period of 2011, a 50% increase between years. This increase can be largely attributed to earnings generated by the sale of Hagar by Arion Bank's subsidiary Eignabjarg and to net foreign exchange gain.

Operating income

Operating income during the first quarter of 2012 amounted to ISK 10,855 million, compared with ISK 9,481 million during the same period in 2011. This increase is primarily because of changes in exchange rates in the Bank's foreign exchange balance.

Net interest income for the first quarter of 2012 amounted to ISK 6,214 million, compared with ISK 5,886 million during the same period in 2011. This increase is partly explained by the much larger loan portfolio. However, this is partly offset by the lower interest premium on the new loan portfolio. The interest-rate differential as a percentage of the average interest-bearing assets was 3.1%, compared with 3.4% in the same period of 2011.

Net valuation changes on loans and receivables was negative by ISK 76 million, compared with a loss of ISK 413 million for the same period of 2011. The Bank's loan portfolio has undergone minimal change since the Bank's annual financial statement was published at the beginning of March.

Net commission income of ISK 2,336 million, compared with ISK 2,492 million during the same period of 2011. Commission from credit cards and asset management is lower than during the same period last year, which explains the decrease between years.

Net financial income amounted to ISK 346 million, compared with ISK 729 million during the same period of 2011. The Bank's securities portfolio is valued at ISK 161 billion and the above valuation changes were relatively insignificant.

Net exchange gain amounted to ISK 1,083 million, compared with a loss of ISK 312 million during the same period last year. The Bank has systematically worked towards reducing its foreign exchange balance in recent years.



Other operating income amounted to ISK 952 million, compared with ISK 1,099 million during the same period of 2011. The main types of income included in other operating income are lease income from commercial property owned by Landfestar and income from insurance premiums at Okkar Life Insurance, both of which are subsidiaries of the Bank.

Operating expenses

Operating expenses during the first quarter of 2012 amounted to ISK 5,802 million, compared with ISK 5,121 million during the same period in 2011. The cost-to-income ratio was 53.1%, compared with 51.8% during the same period in 2011 and the cost-to-assets ratio was 2.6%, the same as the previous year.

Salaries and related expenses amounted to ISK 3,045 million, compared with ISK 2,658 million during the same period of 2011. The average number of full-time equivalent positions during the first quarter of 2012 was 1,157, compared with ISK 1,220 during the same period last year. This item has increased since last year as a result of a 5.45% financial sector tax, expenses relating to employees receiving redundancy pay, and salary increases.

Other operating expenses amounted to ISK 2,757 million, compared with ISK 2,463 million during the same period of 2011. The increase in expenses is partly owing to a rise in regulatory fees and payments to the Depositors' and Investors' Guarantee Fund.

Taxes

Income tax amounted to ISK 1,061 million, compared with ISK 1,045 million during the same period of 2011. The effective income tax rate was 21% during the period, compared with 24% during the first period of 2011.

Special tax on financial companies amounted to ISK 268 million, compared with ISK 69 million last year. This increase is due to a change in legislation whereby a tax is levied on a temporary basis to fund the payment of interest allowance.

In addition Arion Bank and its subsidiaries have paid a 5.45% financial sector tax of ISK 135 million which is levied on the salaries of workers in the financial sector.

Discontinued operations

Net gains from discontinued operations amounted to ISK 727 million, compared with a loss of ISK 282 million during the same period of 2011. The Bank realized gains on the sale of a 13.3% holding in Hagar in February of ISK 821 million. The loss on other discontinued operations and foreclosure assets owned by the Bank amounted to approximately ISK 100 million.



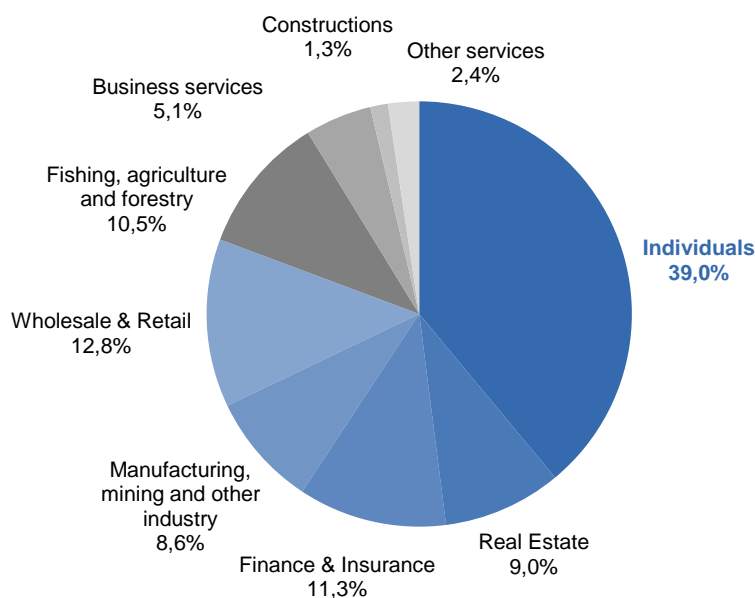
Balance sheet – highlights

Assets					
<i>In ISK millions</i>	31.03.12	31.12.11	Diff.%	31.03.11	Diff.%
Cash and balances with Central Bank	18,030	29,200	(38%)	24,629	(27%)
Loans to credit institutions	65,955	69,103	(5%)	84,733	(22%)
Loans to customers	584,154	561,550	4%	432,505	35%
Securities	161,004	157,659	2%	137,489	17%
Compensation instrument	-	-	n/a	22,507	n/a
Investment property	25,867	27,100	(5%)	27,149	(5%)
Non-current assets and disp. held for sale	21,852	23,886	(9%)	38,575	(43%)
Other assets	22,510	23,623	(5%)	35,100	(36%)
Total assets	899,372	892,121	1%	802,687	12%

Arion Bank had *total assets* of ISK 899,372 million at the end of March 2012, compared with ISK 802,687 million at the end of March 2011. This increase is primarily a result of the acquisition of Kaupthing Bank's mortgage portfolio at the end of 2011. The settlement between the Bank and Kaupthing was completed in mid-2011 and claims between the companies were settled by revaluing and transferring assets

Loans to customers

Loans to customers amounted to ISK 584,154 million at the end of March 2012, compared with ISK 432,505 million at the end of March 2011. Loans to customers have therefore increased by ISK 151,649 million; ISK 110,000 million of this figure relate to the mortgage portfolio while other increases relate to new loans, inflation, changes in the exchange rate and the revaluation of the loan portfolio. Loans are distributed among a diverse body of lenders, with the largest category being personal customers, or 39% of total loans.





Securities

Securities holdings amounted to ISK 161,004 million at the end of the first quarter of 2012, compared with ISK 137,489 million at the end of March 2011.

Securities					
In ISK millions	31.03.12	31.12.11	Diff.%	31.3.11	Diff.%
Bonds	142,493	140,568	1%	123,423	15%
Shares and equity instruments	15,096	14,045	7%	11,526	31%
Derivatives	1,313	674	95%	395	232%
Securities used for hedging	2,102	2,372	(11%)	2,145	(2%)
Total securities	161,004	157,659	2%	137,489	17%

Arion Bank used some of its cash reserves to buy liquid bonds, which explains the increase in bondholdings from the previous year. The change in shares relates to the acquisition of shares in debt settlement agreements, both in listed and private equity in Icelandic and international companies

Non-current assets and disposal groups held for sale

Non-current assets and disposal groups held for sale amounted to ISK 21,852 million at the end of the period, compared with ISK 38,575 million at the end of March 2011. This decrease is largely due to the divestment of Hagar, although the Bank did acquire holdings in N1 hf. and HB Grandi hf. during the year. The Bank aims to sell these assets and expects its holdings to decrease considerably by the end of 2012.

Liabilities and equity					
In ISK millions	31.03.12	31.12.11	Diff.%	31.03.11	Diff.%
Due to credit institutions and Central Bank	37,032	16,160	129%	68,322	(46%)
Deposits from customers	462,193	489,995	(6%)	472,359	(2%)
Non-current liabilities and disp. held for sale	4,444	4,950	(10%)	10,181	(56%)
Other liabilities	50,536	47,150	7%	47,232	7%
Borrowings	192,109	187,203	3%	65,180	195%
Subordinated liabilities	34,047	32,105	6%	26,730	27%
Equity	119,011	114,558	4%	112,683	6%
Liabilities and equity total	899,372	892,121	1%	802,687	12%

Total liabilities amounted to ISK 780,381 million at the end of the first quarter of 2012, compared with ISK 690,004 million at the end of March 2011. The chief reason for this increase is the acquisition of the Kaupthing mortgage fund for ISK 117,000 million. Furthermore, other borrowing has increased with the new covered bond issue of ISK 2,500 million in February 2012 and a new subordinated loan in 2011 of more than ISK 6 billion in connection with the Bank's dividend payment to the government.

Deposits

The Bank's total deposits amounted to ISK 499,225 billion at the end of March 2012, compared with ISK 540,681 billion at the end of March 2011. In mid-year 2011 Kaupthing returned its banking licence and as a result the company's deposits at Arion Bank changed category in the Bank's balance sheet. During the first quarter of 2012 one of the Bank's largest depositors withdrew its deposits in connection with a settlement with a foreign creditor involving the Central Bank of Iceland and other parties. The Bank believes that this change improves the quality of the deposit base and the liquidity and cash ratios



Borrowings

Borrowings amounted to ISK 192,109 million at the end of March 2012, compared with ISK 65,180 million at the end of March 2011. The increase is attributable to new loans, firstly the ISK 117,000 million mortgage fund acquired from Kaupthing and secondly the new issue of indexed covered bonds in the amount of ISK 2,500 million in February 2012 which were sold to institutional investors. The depreciation of the Icelandic króna and an increase in the consumer price index have also raised the Bank's borrowings over the last year.

Subordinated liabilities

Subordinated liabilities amounted to ISK 34,047 million at the end of the first quarter of 2012, compared with ISK 26,730 million at the end of March 2011. The change relates to a new subordinated loan granted by the government in connection with the Bank's dividend payment to the government in the second quarter of 2011 and also to a change relating to the depreciation of the Icelandic króna as the loan is linked to foreign currencies.

Shareholders' equity

Shareholders' equity amounted to ISK 119,011 million at the end of the first quarter of 2012, compared with ISK 112,683 million at the end of March 2011. The change is primarily due to earnings during the year, although this is offset by the ISK 6,074 million dividend payment to the government in 2011. The Bank's capital ratio according to the rules of the FME is 20.2%, compared with 19.7% at the end of March 2011.



Key performance indicators

Key performance indicators				
	Q1 2012	Q1 2011	2011	2010
Return on equity	16.5%	11.3%	10.5%	13.4%
Return on assets	2.0%	1.5%	1.4%	1.5%
Net Interest margin (interest bearing assets)	3.1%	3.4%	3.4%	2.7%
Net interest margin (total assets)	2.8%	3.0%	2.9%	2.4%
Cost-to-Income ratio	53.1%	51.8%	52.5%	54.2%
Cost-to-Total Assets ratio	2.6%	2.6%	2.7%	2.2%
CAR ratio	20.2%	19.2%	21.2%	19.0%
Tier 1 ratio	16.0%	15.2%	16.4%	15.2%
Loans to deposits ratio	126.4%	91.6%	114.6%	98.5%
Secured liquidity ratio	30.2%	34.7%	34.7%	24.8%
Cash ratio	13.9%	15.3%	15.3%	11.2%
The Group's average number of employees	1,157	1,220	1,217	1,159
The Group's employees at the end of the period	1,179	1,222	1,158	1,241
The Parent company's employees at period end	887	914	858	936

Financial calendar 2012

The Bank's interim and annual financial statements are scheduled for publication in the weeks specified below. This calendar may be subject to change.

Second quarter 2012	Week 35
Third quarter 2012	Week 48
Fourth quarter 2012	Week 9 2013
Annual general meeting 2013	March 2013

Further information on the Bank's financial results can be found at arionbanki.is.