Press release, 28 November 2012

Arion Bank’s financial results for the first nine months of 2012

Arion Bank reported net earnings of ISK 14.5 billion for the first nine months of 2012, compared with ISK 13.6 billion during the same period in 2011. Return on equity was 15.9%, compared with 17.6% in the same period of 2011. Return on equity from regular operations was 11.9%, compared with 11.3% a year ago. The interim financial statement for the first nine months of 2012 has not been audited.

The Bank’s capital ratio at the end of the period was 22.5%, compared with 21.2% at the end of 2011.

Highlights of the interim financial statement:

- Net earnings in the first nine months of ISK 14.5 billion, compared with ISK 13.6 billion during the same period of 2011.
- Net earnings in third quarter of ISK 3.3 billion, compared with ISK 3.5 billion during the same period of 2011.
- Earnings from regular operations of ISK 10.9 billion, compared with ISK 8.9 billion during the same period of 2011.
- Net operating income of ISK 34.4 billion, compared with ISK 34.0 billion during the same period of 2011.
- Net interest income of ISK 20.1 billion, compared with ISK 16.8 billion in the same period of 2011. The increase is largely due to the increase in the size of the loan portfolio following the Bank’s acquisition of a mortgage portfolio from Kaupthing.
- Return on equity was 15.9%, compared with 17.6% in the same period last year. Return on equity from regular operations was 11.9%, compared with 11.3% in the same period last year.
- The interest-rate differential as a percentage of average interest-bearing assets was 3.3% during the period, compared with 3.2% during the same period of 2011.
- Salary expenses increased by 7% between years, partly as a result of the new 5.45% bank levy on the salaries of employees of financial companies.
- Deferred income tax of ISK 3.4 billion, compared with ISK 3.1 billion for the same period of 2011. The relatively higher income tax is partly due to a new 6% tax on the earnings of financial companies in excess of ISK 1 billion.
- Capital ratio of 22.5%, compared with 21.2% at the end of 2011.
- Liquidity ratio of 31%, which is well over the 20% minimum stipulated by the FME.
- Cash ratio of 18%, well above the FME’s minimum requirement of 5%.
- Loans to customers of ISK 572.5 billion at the end of the period, compared with ISK 561.6 billion at the end of 2011.
- Total assets of ISK 876.2 billion at the end of the period, compared with ISK 892.1 billion at the end of 2011.
- Shareholders’ equity at the end of September 2012 of ISK 128.4 billion, compared with ISK 114.6 billion at the end of 2011.

Höskuldur H. Ólafsson, CEO of Arion Bank:

“The Bank’s results for the first nine months of the year are most satisfactory and in line with our projections. There are a number of positive signs in operations. Return on equity from regular operations is close to 12% which is pleasing. These results provide further confirmation of the stability achieved in the Bank's operations in the last few years, something which is of great importance to us.

In the last few months the Bank has expanded its service offering, and our customers have responded to this favourably. These new services include Startup Reykjavík which is aimed at entrepreneurs and innovation companies; the Arion Bank app; vehicle financing with FÍB; and new options for parents on parental leave. We strive to ensure that we remain a leader in product development on the financial market.

It is vital that we maintain a strong capital ratio and at the end of September it was 22.5%, clear testament to the financial strength of the Bank. The external environment remains challenging. Uncertainty remains in the legal environment although some issues have been clarified. There are also question marks concerning the major industries in Iceland, and investment has still not recovered properly. The government has yet to announce how and when the capital controls will be lifted and there are clouds on the horizon internationally too. Nevertheless, great progress has been made in strengthening and developing the Bank and indeed the Icelandic economy so that the basic foundations have been laid for further growth".

For further information please contact Haraldur Gudni Eidsson of Arion Bank's Communications division at haraldur.eidsson@arionbanki.is, or tel. +354 856 7108.

Income statement – highlights

Income Statement				
In ISK millions	**9M '12**	**9M '11**	**Diff.**	**Diff. %**
Net interest income	20,134	16,836	3,298	20%
Net change in valuation on loans	479	3,759	-3,280	-87%
Net interest income less val. on loans	20,613	20,595	18	0%
Net commission income	8,053	7,574	479	6%
Net financial income	491	348	143	41%
Net gain (loss) on foreign exchange	559	1,979	-1,420	-72%
Other income	4,643	3,477	1,166	34%
Operating income	**34,359**	**33,973**	**386**	**1%**
Salaries and related expense	-8,813	-8,221	-592	7%
Other operating expense	-8,061	-7,554	-507	7%
Net earnings before taxes	**17,485**	**18,198**	**-713**	**-4%**
Income tax	-3,375	-3,079	-296	10%
Bank Levy	-771	-684	-87	13%
Net earnings from continuing operation	**13,339**	**14,435**	**-1,096**	**-8%**
Net gain from discountinued operation net of tax	1,198	-787	1,985	-
Net earnings	**14,537**	**13,648**	**889**	**7%**

Operating income

Operating income during the first nine months of 2012 amounted to ISK 34,359 million, compared with ISK 33,973 million during the same period in 2011. While the year-on-year increase is negligible, individual items changed significantly.

Net interest income during the first nine months of 2012 amounted to ISK 20,134 million, compared with ISK 16,836 million during the same period in 2011. The increase is explained by the huge increase in the size of the loan portfolio following the Bank's acquisition of a mortgage portfolio from Kaupthing at the end of 2011. In addition, indexed loans have increased as a proportion of interest-bearing assets and liabilities and give higher interest due to inflation during the period. The interest-rate differential as a percentage of the average interest-bearing assets was 3.3%, compared with 3.2% in the same period of 2011.

Net valuation changes on loans and receivables amounted to ISK 479 million, compared with ISK 3,759 million for the same period of 2011. As was the case last year, the increase in value of loans is linked to the restructuring of the loan portfolio; several major restructuring cases were brought to a conclusion during the period. The increase in valuation is almost solely related to loans to larger companies, while the decrease in value is primarily linked to loans to private customers and smaller companies.

Net commission income amounted to ISK 8,053 million, compared with ISK 7,574 million during the same period of 2011. Commission on payment card activities and lending activities is slightly higher than during the same period last year, which explains the increase between years.

Net financial income amounted to ISK 491 million, compared with ISK 348 million during the same period of 2011. The Bank’s securities portfolio was valued at ISK 138 billion at the end of September 2012, and the above valuation changes were thus insignificant.

Net exchange gain amounted to ISK 559 million, compared with ISK 1,979 million during the same period of 2011. The Bank has worked to reduce its foreign exchange balance in recent years and the balance has been brought down to less than 15% of its capital base, which is in compliance with the rules of the Central Bank of Iceland.

Other operating income amounted to ISK 4,643 million, compared with ISK 3,477 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 Landeyjar and income from insurance premiums at Okkar Life Insurance, all of which are subsidiaries of the Bank. Also included are valuation changes relating to properties owned by the Bank's real estate companies; this explains the majority of the increase between years.

Operating expenses

Operating expenses during the first nine months of 2012 amounted to ISK 16,874 million, compared with ISK 15,775 million during the same period in 2011. The cost-to-income ratio was 49.8%, compared with 52.2% during the same period in 2011. The cost-to-assets ratio was 2.5%, compared with 2.6% a year ago.

Salaries and related expenses amounted to ISK 8,813 million, compared with ISK 8,221 million during the same period of 2011. During the first nine months 2012 there were on average 1,160 full-time equivalent positions at Arion Bank, compared with 1,248 during the same period in 2011. Salaries and salary related expenses have increased from last year following the introduction of a 5.45% bank levy, expenses relating to employees serving their period of notice and an increase in salaries in line with the increase in the wage index which was 9% between periods.

Other operating expenses amounted to ISK 8,061 million, compared with ISK 7,554 million during the same period of 2011. The increase in expenses is partly due to a rise in regulatory fees and general price increases since last year.

Taxes

Income tax amounted to ISK 3,375 million, compared with ISK 3,079 million during the same period of 2011. The effective income tax rate was 19.3% during the period, compared with 16.9% during the first nine months of 2011.

Special tax on financial companies amounted to ISK 771 million, compared with ISK 684 million last year. This increase is particularly attributable to the growth of the Bank’s balance sheet.

In addition Arion Bank and its subsidiaries have paid more than ISK 400 million in the form of a 5.45% bank tax which is levied on the salaries of employees in the financial services sector.

Discontinued operations

Net income from discontinued operations amounted to ISK 1,198 million, compared with a loss of ISK 787 million during the same period of 2011. The Bank realized a profit of ISK 875 million from the sale of its holding in Hagar during the first half of the year. The Bank also generated a profit of ISK 868 million from the sale of its 39% stake in N1 hf. The sale was formally completed at the beginning of June after having been approved by the regulatory authorities. The loss on other discontinued operations and foreclosure assets owned by the Bank amounted to ISK 545 million.

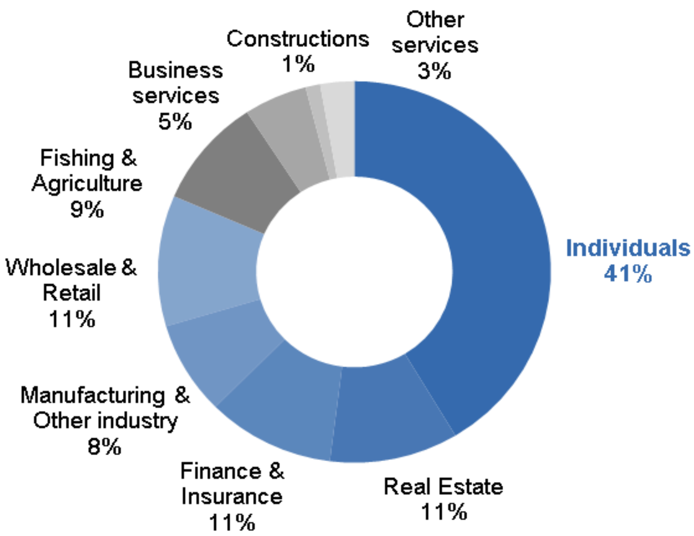
Balance sheet – highlights

Assets					
In ISK millions	**30.09.2012**	**31.12.2011**	**Diff.%**	**30.09.2011**	**Diff.%**
Cash & balances with CB	16,026	29,200	-45%	38,000	-58%
Loans to credit institutions	88,007	69,103	27%	60,422	46%
Loans to customers	572,484	561,550	2%	444,074	29%
Financial assets	137,924	157,659	-13%	174,295	-21%
Investment properties	28,171	27,100	4%	26,912	5%
Non current assets & disposal groups HFS	13,711	23,886	-43%	40,193	-66%
Other assets	19,922	23,623	-16%	39,156	-49%
Total assets	**876,245**	**892,121**	**-2%**	**823,052**	**6%**

Arion Bank had *total assets* of ISK 876,245 million at the end of September 2012, compared with ISK 892,121 million at the end of 2011. Changes in individual balance sheet items can be attributed to changes in liquidity managements which have resulted in a decrease in securities holdings and the sale of acquired assets in connection with debt settlement agreements. Non-current assets and disposal groups held for sale decrease significantly.

Loans to customers

Loans to customers totalled ISK 572,484 million at the end of September 2012, compared with ISK 561,550 million at the end of 2011. Loans have therefore increased by ISK 10,934 million. This increase is a result of the depreciation of the króna, indexation and a slight increase in loans to customers in excess of loan repayments. The loans are distributed among a diverse body of lenders, with the largest category being personal customers, or 41% of total loans, particularly in the form of housing loans.



Securities

Securities holdings amounted to ISK 137,924 million at the end of September 2012, compared with ISK 157,659 million at the end of 2011.

Financial assets					
In ISK million	**30.09.2012**	**31.12.2011**	**Diff.%**	**30.09.2011**	**Diff.%**
Bonds	119,697	140,568	-15%	158,549	-25%
Shares and instruments with variable income	15,860	14,045	13%	14,324	11%
Derivatives	969	674	44%	1,057	-8%
Securities used for hedging	1,398	2,372	-41%	365	283%
Financial assets total	**137,924**	**157,659**	**-13%**	**174,295**	**-21%**

Arion Bank uses cash to invest in liquid bonds, which explains the fluctuations in bondholdings between periods. Changes in equities holdings are largely connected 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 13,711 million at the end of the period, compared with ISK 23,886 million at the end of 2011. The decrease is mainly due to the exit of the subsidiaries BM Vallá ehf. and Penninn á Íslandi ehf. from the asset portfolio and the fact that major holdings in Hagar hf. and N1 hf. were divested. The Bank is endeavouring to sell these assets and expects to reduce its holdings significantly during 2013.

Liabilities and equity					
In ISK million	**30.09.2012**	**31.12.2011**	**Diff.%**	**30.09.2011**	**Diff.%**
Due to credit institutions & CB	16,459	16,160	2%	30,209	-46%
Deposits from customers	454,405	489,995	-7%	511,473	-11%
Non current liabilities & disposal groups HFS	2,683	4,950	-46%	11,901	-77%
Other liabilities	49,352	47,150	5%	49,617	-1%
Borrowings	192,412	187,203	3%	67,317	186%
Subordinated loans	32,502	32,105	1%	31,875	2%
Equity	128,432	114,558	12%	120,660	6%
Total liabilities and equity	**876,245**	**892,121**	**-2%**	**823,052**	**6%**

Total liabilities amounted to ISK 747,813 million at the end of September 2012, compared with ISK 777,563 million at the end of 2011. The reason for the decrease is a reduction in deposits at the Bank, particularly of deposits owned by investors who have funds tied up by the capital controls. Other borrowing has increased with a new covered bond issue amounting to ISK 5,000 million during the first half of 2012.

Deposits

Total deposits amounted to ISK 470,864 million at the end of September 2012, compared with ISK 506,155 million at the end of 2011. During the first quarter of 2012 one of the Bank's largest depositors withdrew its entire 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. Despite the decrease in deposits in recent quarters, the Bank has maintained its share on the deposit market in most categories; deposits are decreasing in general with greater investment opportunities opening up elsewhere.

Borrowings

Borrowings amounted to ISK 192,412 million at the end of September 2012, compared with ISK 187,203 million at the end of 2011. The increase is largely due to new covered bond issues amounting to ISK 5,000 million during the first half of 2012. The increase in the CPI has some effect as a significant proportion of the Bank's liabilities are inflation-linked.

Subordinated liabilities

Subordinated liabilities amounted to ISK 32,502 million at the end of September 2012, compared with ISK 32,105 million at the end of 2011. The change is insignificant and is only connected to changes in the exchange rate of foreign currencies linked to the loans.

Shareholders' equity

Shareholders' equity amounted to ISK 128,432 million at the end of September 2012, compared with ISK 114,558 million at the end of 2011. The change primarily relates to earnings generated during the year.

Key performance indicators

Key performance incicators	9 M '12	9 M '11	Year 2011	Year 2010
Return on equity (ROE)	15.9%	17.6%	10.5%	13.4%
Return on total assets (ROA)	2.2%	2.3%	1.4%	1.5%
Net interest margin (interest bearing assets)	3.3%	3.2%	3.4%	2.7%
Net interest margin (total assets)	3.0%	2.8%	2.9%	2.4%
Cost-to-income ratio	49.8%	52.2%	52.5%	54.2%
Cost-to-Total assets ratio	2.5%	2.6%	2.7%	2.2%
CAD-ratio	22.5%	21.4%	21.2%	19.0%
Tier 1 ratio	17.7%	16.5%	16.4%	15.2%
Loans to deposit ratio	126.0%	80.3%	114.6%	98.5%
Secured liquidity ratio	30.6%	36.0%	34.7%	24.8%
Cash ratio	17.7%	16.0%	15.3%	11.2%
The Group's average number of employees	1,160	1,244	1,217	1,159
The Group’s employees at the end of the period	1,177	1,168	1,158	1,241
The parent’s employees at the end of the period 1)	936	870	858	936

1) Former employees of Verdis and SPOL are included in parent numbers for 2012.

Financial calendar 2012 and 2013

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

Fourth quarter 2012	Week 9 2013
Annual general meeting 2013	March 2013
First quarter 2013	Week 21 2013
Second quarter 2013	Week 35 2013
Third quarter 2013	Week 48 2013