

Press release, 31 August 2012

Arion Bank's financial results for the first six months of 2012

Arion Bank reported net earnings of ISK 11.2 billion for the first half of 2012, compared with ISK 10.2 billion during the same period in 2011. Return on equity was 18.8%, compared with 20.3% in the first half of 2011. Return on equity on regular operations was 11.8%, compared 11.2% during the same period in 2011. The interim financial statement for the first six months of 2012 has been reviewed by the Bank's auditors.

The Bank's capital ratio at the end of the period was 22.3%, compared with 21.4% at the end of the first half of 2011. The Financial Supervisory Authority (FME) stipulates a minimum capital ratio of 16%.

Highlights of the interim financial statement:

- Net earnings in H1 of ISK 11.2 billion, compared with ISK 10.2 billion during the same period of 2011.
- Net earnings in Q2 of ISK 6.8 billion, compared with ISK 7.2 billion during the same period of 2011.
- Earnings from regular operations of ISK 7.0 billion, compared with ISK 5.8 billion during the first half of 2011.
- Net operating income of ISK 24.9 billion, compared with ISK 24.5 billion during the first half of 2011.
- Net interest income of ISK 13.9 billion, compared with ISK 11.2 billion during the first half of 2011.
- Return on equity of 18.8%, compared with 20.3% during the first half of 2011. Return on equity on regular operations was 11.8%, compared with 11.2% during the first half of 2011.
- The interest-rate differential as a percentage of the average interest-bearing assets was 3.4%, compared with 3.2% during the first half of 2011.
- Salary expenses increased by 12% between years mainly as a result of a new financial sector tax of 5.45% levied on the salaries of employees of financial companies.
- Income tax of ISK 2.9 billion, compared with ISK 2.5 billion during the same period in 2011. The increase is partly due to a new 6% tax on the earnings of financial companies in excess of ISK 1 billion.
- Capital ratio of 22.3%, compared with 21.4% at the end of the first half of 2011.
- The Bank's liquidity ratio was 32%, which is well over the 20% minimum stipulated by the FME.
- The Bank's cash ratio was 14%, above the FME's minimum requirement of 5%.



- Loans to customers of ISK 578.9 billion at the end of the period, compared with ISK 447.7 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 of ISK 880.1 billion, compared with ISK 805.3 billion at the end of June 2011.
- Shareholders' equity of ISK 125.1 billion, compared with ISK 117.2 billion at the end of June 2011.

Höskuldur H. Ólafsson, CEO of Arion Bank:

"The Bank's results for the first six months of the year are satisfactory and in line with our expectations. I am especially pleased with the stability demonstrated by these results. The Bank's results from regular operations were reasonable but we would nevertheless like to see an improvement in the Bank's commission income and a reduction in operating expenses. We intend to focus on these issues in the months ahead.

During the first six months of 2012 we have sold holdings in companies that we acquired in the restructuring process, including Hagar, N1, BM Vallá and Penninn. The proceeds from these sales had a positive impact on the Bank's results, raising earnings by ISK 2 billion. Valuation change on loans also boosted earnings by ISK 3 billion.

During the first few months of the year we have sought to diversify the Bank's funding base by issuing covered bonds, with both inflation-linked and nominal issues. The market has responded positively to the bond issues and the Bank will continue along this path.

As always, providing our customers with a broad range of high quality services has been central to our endeavours. We continually seek new ways to improve these services and a number of initiatives are under way to achieve this aim. We have placed a strong focus on product development and we recently brought out a new smartphone app which enables customers to perform various operations simply and conveniently on their phones. The response from our customers has been positive and it encourages us to strive even harder to improve in the future."

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				
<i>In ISK million</i>	1H '12	1H '11	Diff.	%
Net interest income	13,880	11,160	2,720	24%
Net change in valuation on loans	2,532	3,944	(1,412)	(36%)
Net interest income less val. on loans	16,412	15,104	1,308	9%
Net commission income	5,338	5,099	(156)	5%
Net financial income	330	(38)	368	-
Net gain (loss) on foreign exchange	(149)	1,977	(2,126)	-
Other income	3,006	2,350	656	28%
Operating income	24,937	24,492	445	2%
Salaries and related expense	(6,169)	(5,516)	(653)	12%
Other operating expense	(5,475)	(5,253)	(222)	4%
Net earnings before taxes	13,293	13,723	(430)	(3%)
Income tax	(2,913)	(2,517)	(396)	16%
Bank Levy	(510)	(446)	(64)	14%
Net earnings from continuing operation	9,870	10,760	(890)	(8%)
Net gain (loss) from discount. oper. net of tax	1,379	(568)	1,947	-
Net earnings	11,249	10,192	1,057	10%

Operating income

Operating income during the first half of 2012 amounted to ISK 24,937 million, compared with ISK 24,492 million during the same period in 2011. While this represents a minor change between years, individual items changed significantly.

Net interest income during the first half of 2012 amounted to ISK 13,880 million, compared with ISK 11,160 million during the same period in 2011. The increase is primarily due to the much larger loan portfolio and changes in the structure of interest-bearing assets and liabilities. The interest-rate differential as a percentage of the average interest-bearing assets was 3.4%, compared with 3.2% in the same period of 2011.

Net valuation changes on loans and receivables were ISK 2,532 million, compared with ISK 3,944 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 valuation change is almost solely related to loans to companies.

Net commission income amounted to ISK 5,338 million, compared with ISK 5,099 million during the same period of 2011. Commission on payment card activities, credit activities and corporate advisory is slightly higher than during the same period last year, which explains the increase between years.

Net financial income amounted to ISK 330 million, compared with a loss of ISK 38 million during the same period of 2011. The Bank's securities portfolio is valued at ISK 147 billion and the above valuation changes were insignificant.

Net exchange rate loss amounted to ISK 149 million, compared with a profit of ISK 1,977 million during the same period of 2011. The Bank has worked to reduce its foreign exchange balance in recent years and during the quarter the balance was 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 3,006 million, compared with ISK 2,350 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, which are subsidiaries of the Bank. The year-on-year increase is primarily due



to valuation changes of real estate owned by the Bank's real estate companies and 20% capital gains on the Bank's share in Ölgerð Egils Skallagrímssonar hf.

Operating expenses

Operating expenses during the first half of 2012 amounted to ISK 11,644 million, compared with ISK 10,769 million during the same period in 2011. The cost-to-income ratio was 52.0%, compared with 52.4% during the same period in 2011. The cost-to-assets ratio was 2.6%, compared with 2.7% in 2011.

Salaries and related expenses amounted to ISK 6,169 million, compared with ISK 5,516 million during the same period of 2011. At the end of the first half of 2012 there were 1,159 full-time equivalent positions at Arion Bank, compared with 1,251 at the end of June 2011. Salaries and salary related expenses have increased from last year following the introduction of a 5.45% financial sector tax, expenses relating to employees serving their period of notice and an increase in salaries, which was in line with the increase in the wage index which was 10.4%.

Other operating expenses amounted to ISK 5,475 million, compared with ISK 5,253 million during the same period of 2011. The increase in expenses is partly owing to a rise in regulatory fees and general price increases since last year.

Taxes

Income tax amounted to ISK 2,913 million, compared with ISK 2,517 million during the same period of 2011. The effective income tax rate was 21.9% during the period, compared with 18.3% during the first half of 2011. The increase is partly due to a new 6% tax on the earnings of financial companies in excess of ISK 1 billion.

Special tax on financial companies amounted to ISK 510 million, compared with ISK 446 million last year. This increase is attributable to the growth of the Bank's balance sheet.

In addition Arion Bank and its subsidiaries have paid ISK 280 million in the form of a 5.45% financial sector tax which is levied on the salaries of employees in the financial services sector.

Discontinued operations

Net income from discontinued operations amounted to ISK 1,379 million, compared with a loss of ISK 568 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 realized 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 received the approval of the regulatory authorities. The loss on other discontinued operations and foreclosure assets owned by the Bank amounted to ISK 364 million.



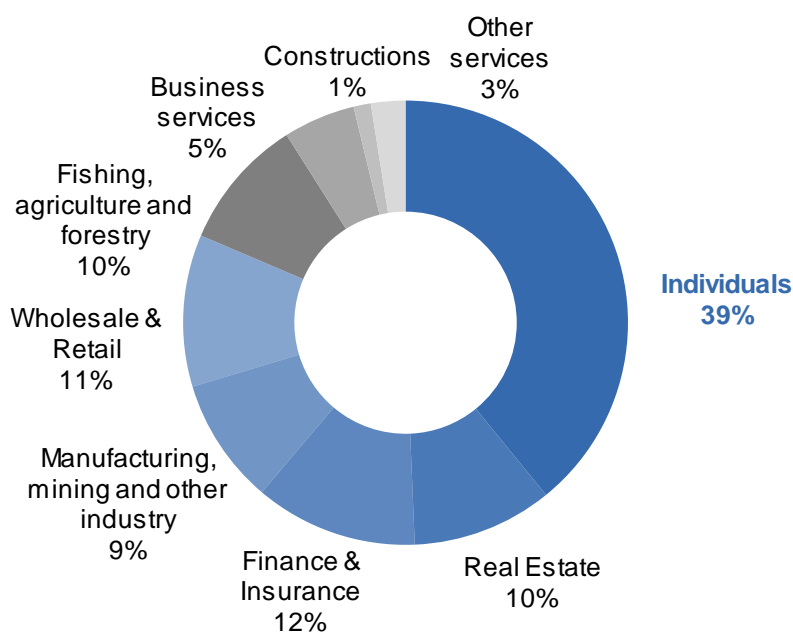
Balance sheet - highlights

Assets					
<i>In ISK million</i>	30.06.12	31.12.11	Diff.%	30.06.11	Diff.%
Cash & balances with CB	16,280	29,200	(44%)	23,867	(32%)
Loans to credit institutions	71,769	69,103	4%	72,063	(0%)
Loans to customers	578,886	561,550	3%	447,715	29%
Financial assets	147,140	157,659	(7%)	158,766	(7%)
Investment properties	28,379	27,100	5%	26,484	7%
Non current assets & disp.groups HFS	16,303	23,886	32%	38,641	(58%)
Other assets	21,293	23,623	(10%)	37,764	(44%)
Total assets	880,050	892,121	(1%)	805,300	9%

Total assets amounted to ISK 880,050 million at the end of June 2012, compared with ISK 805,300 million at the end of June 2011. This increase is primarily a result of the acquisition of Kaupthing Bank's mortgage portfolio at the end of 2011. The Bank has also sold a significant proportion of acquired assets in connection with debt settlement agreements, which is clearly indicated by the decrease in assets held for sale and discontinued operations.

Loans to customers

Loans to customers amounted to ISK 578,886 million at the end of June 2012, compared with ISK 447,715 million at the end of June 2011. Loans to customers have therefore increased by ISK 131,171 million; ISK 110,000 million of this figure relate to the acquisition of the Kaupthing mortgage portfolio while other increases relate to new loans, inflation, changes in the exchange rate and revaluation of the loan portfolio. The loans are distributed among a diverse body of lenders, with the largest category being personal customers, or 39.1% of total loans, particularly in the form of mortgage loans.





Securities

Securities holdings amounted to ISK 147,140 million at the end of June 2012, compared with ISK 158,766 million at the end of June 2011.

Financial assets					
<i>In ISK million</i>	30.06.2012	31.12.2011	Diff.%	30.06.2011	Diff.%
Bonds	128,853	140,568	(8%)	141,327	(9%)
Shares and instruments with variable income	15,408	14,045	10%	15,020	3%
Derivatives	1,363	674	102%	1,108	23%
Securities used for hedging	1,516	2,372	(36%)	1,311	16%
Financial assets total	147,140	157,659	(7%)	158,766	(7%)

Arion Bank uses cash to invest in liquid bonds among other things, 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 16,303 million at the end of the period, compared with ISK 38,641 million at the end of June 2011. This decrease is largely due to the fact that both Hagar hf. and BM Vallá hf. left the asset portfolio as subsidiaries. However, the Bank did acquire a holding in HB Grandi hf. during the year. The Bank is seeking to sell these assets and expects to reduce its holdings by the end of 2012.

Liabilities and equity					
<i>In ISK million</i>	30.06.2012	31.12.2011	Mism.%	30.06.2011	Mism.%
Due to credit institutions & CB	20,837	16,160	29%	75,345	(72%)
Deposits from customers	445,249	489,995	(9%)	448,701	(1%)
Non current liab. & disp.groups HFS	4,174	4,950	(16%)	11,911	(65%)
Other liabilities	59,519	47,150	26%	51,956	15%
Borrowings	192,953	187,203	3%	66,894	188%
Subordinated loans	32,175	32,105	0%	33,244	(3%)
Equity	125,143	114,558	9%	117,249	7%
Total liabilities and equity	880,050	892,121	(1%)	805,300	9%

Total liabilities amounted to ISK 754,907 million at the end of June 2012, compared with ISK 688,051 million at the end of June 2011. The chief reason for this increase is the acquisition of a ISK 117,000 million Kaupthing bond issue which is secured by the acquired mortgage portfolio. Other borrowing has also increased with the new covered bond issue amounting to ISK 5,000 million during the first half of 2012.

Deposits

Total deposits amounted to ISK 466,086 million at the end of June 2012, compared with ISK 524,046 million at the end of June 2011. In mid-year 2011 Kaupthing surrendered its banking licence and as a result the company's deposits at Arion Bank changed category in the Bank's balance sheet. However, this did not affect total deposits. 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; it is the system as a whole which is decreasing with greater investment opportunities opening up elsewhere.

Borrowings

Borrowings amounted to ISK 192,953 million at the end of June 2012, compared with ISK 66,894 million at the end of June 2011. The increase is attributable to new loans: firstly ISK 117,000 million in relations to the mortgage fund acquired from Kaupthing; and secondly the new issue of indexed covered bonds in the amount of 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 32,175 million at the end of June 2012, compared with ISK 33,244 million at the end of June 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 125,143 million at the end of June 2012, compared with ISK 117,249 million at the end of June 2011. The change is primarily due to earnings during the year, although this is counterbalanced by the decrease in minority interests following Hagar's exit from the group.



Key performance indicators

Key performance indicators				
	1H. '12	1H. '11	Year 2011	Year 2010
Return on equity (ROE)	18.8%	20.3%	10.5%	13.4%
Return on total assets (ROA)	2.5%	2.6%	1.4%	1.5%
Net interest margin (int.bearing assets)	3.4%	3.2%	3.4%	2.7%
Net interest margin (total assets)	2.8%	2.8%	2.9%	2.4%
Cost-to-income-ratio	52.0%	52.4%	52.5%	54.2%
Cost-to-Total assets ratio	2.6%	2.7%	2.7%	2.2%
CAD-ratio	22.3%	21.4%	21.2%	19.0%
Tier 1 ratio	17.5%	16.5%	16.4%	15.2%
Loans to deposit ratio	130.0%	99.8%	114.6%	98.5%
Secured liquidity ratio	31.6%	35.0%	34.7%	24.8%
Cash ratio	14.5%	16.0%	15.3%	11.2%
The Group's average number of employees	1,159	1,251	1,217	1,159
The Group's employees at the end of the period	1,173	1,248	1,158	1,241
The parent's empl. at the end of the period 1)	920	899	858	936

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

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.

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

Information on the Bank's financial results can be found on the Bank's website, www.arionbanki.is.