

# FINANCIAL STATEMENTS 31 MARCH 2016

INVESTOR PRESENTATION  
11 MAY 2016



# ARION BANK IS A UNIVERSAL RELATIONSHIP BANK

ARION BANK PROVIDES A FULL RANGE OF FINANCIAL SERVICES

## Retail Banking

- ~ 30% market share
- Largest private provider of residential mortgages
- Wide range of financial services for individuals and SMEs
- Strong focus on digital banking solutions

## Asset Management

- Leading player in the Icelandic market
- AuM equal to Arion Bank's total assets
- Services institutional investors and HNW clients

## Investment Banking

- A leading capital markets house and M&A advisor
- Full range of investment banking services
- Managed all IPOs in Iceland during 2015

## Corporate Banking

- Leading lender to large corporates in Iceland
- Innovative and customized solutions
- International activities in seafood and related businesses

# STRATEGIC SUBSIDIARIES IN THE ARION BANK GROUP

ARION BANK PROVIDES A FULL RANGE OF FINANCIAL SERVICES

## VALITOR

- The largest online and e-commerce payment services company in Iceland
- Operations in Iceland, Denmark and the UK
- Member of VISA EU and MasterCard International

## STEFNIR

- Iceland's largest fund management company
- Retail and professional clients
- Range of mutual, investment and institutional investment funds

## okkar

- Leading life insurance company in Iceland
- Focus on modern personal insurance services
- Sales and distribution partnerships with Arion Bank

## vörður

- Vörður is the 4th largest non-life insurance company in Iceland, with a market share of more than 10%
- Arion Bank has reached a deal to acquire the whole company
- Acquisition is subject to approval of Icelandic regulators

# HIGHLIGHTS OF THE FIRST QUARTER OF 2016

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## GOOD ACCESS TO INTERNATIONAL CREDIT MARKETS

### Financial results shaped by market conditions

- Substantial growth in interest income owing to higher inflation and better priced funding
- Growth in corporate loans and substantial increase in demand for loans
- Negative performance of securities markets reflected in operating results
- Commission income down, particularly as consequence of less IPO activity
- Higher salary expenses following new wage agreements and increase in number of employees

### Funding secured for longer term

- 7-year bond issue of \$747 million following agreement with Kaupthing as part of capital controls liberalization process
- Refinancing of long-term loan granted by Central Bank of Iceland and Kaupthing deposits in foreign currency held at Arion Bank
- ISK 12.4 billion in covered bonds issued during the quarter
- Bank's second issue of bonds in euros to diverse group of investors, totalling €300 million, took place in April, and approximately €220 million was used to prepay the USD issue owned by Kaupthing pursuant to an agreement
- Standard & Poor's revised the Bank's BBB- outlook from stable to positive



# HIGHLIGHTS OF THE FIRST QUARTER OF 2016

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## GOOD CORPORATE GOVERNANCE – STARTUPS THRIVING

### Recognized for good corporate governance

- Arion Bank was recognized by the Center for Corporate Governance at the University of Iceland as a company which had achieved excellence in corporate governance.

### Most effective marketing campaign

- Arion Bank won the Icelandic Advertising Award
- The Bank won the award for its advertising campaign for the Bank's express service, which builds on a new generation of ATMs, the online bank and the Arion app

### Startup Reykjavík best business accelerator

- Major increase in number of applications for the summer 2016 Startup Reykjavík – a total of 247 applications were received
- Companies which have passed through Startup Reykjavík and Startup Energy Reykjavík have raised ISK 2.2 billion in grants and equity
- Startup Reykjavík was recognized at the Nordic Startup Awards as the best business accelerator in Iceland in 2016
- The Bank signed a partnership agreement with Junior Achievement (JA) and 300 entrepreneurs from secondary schools participated in a competition for best student company held at the Bank's headquarters





# HIGHLIGHTS OF THE FIRST QUARTER OF 2016

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## OPENING OF NEW BRANCH AT KEFLAVÍK INTERNATIONAL AIRPORT PRESENTS GREAT OPPORTUNITY

### New and improved branches

- A new branch was opened at Keflavík International Airport on 1 May
  - Focus is on foreign currency exchange and VAT refunds
- Bank continues to reorganize and streamline branch network, with reduction in office space

### Changes in management and organisation

- Iðja Brá Benediktsdóttir appointed managing director of Investment Banking
- Rakef Óttarsdóttir temporarily took over as managing director of Operations. Development and Marketing division discontinued
- HR and Marketing now under CEO

### Active member of the community

- In celebration of the 80<sup>th</sup> anniversary of Bank's Employees' Association, ISK 80 million was donated to children's charities
- The Bank signed a 3-year partnership agreement with Icelandic Design Centre and is one of the main sponsors of DesignMarch
- The Bank renewed its support for Harpa and remains one of the main backers of the concert hall and conference centre
- Arion Bank is one of 11 sponsors of the Vigdís Finnbogadóttir Institute of Foreign Languages
- Participated in fundraiser for Reykjadalur summer camps for disabled children
- Opened an exhibition of the works of Kristinn E. Hrafnsson at the Bank's headquarters

# HEADLINE FIGURES FOR Q1 2016

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## Profitability

Net earnings  
**ISK 2,883**  
million  
Q1 2015:  
ISK 14,908 million

## Strength

Tier 1 ratio  
**26.2%**  
31.12.2015:  
23.4%

## Efficiency

Cost-to-  
income ratio  
**60.7%**  
Q1 2015:  
29.3%

## Asset quality

Problem  
loans  
**2.1%**  
31.12.2015:  
2.5%

Return on  
equity  
**5.7%**

Q1 2015:  
35.1%

Leverage  
ratio  
**17.3%**

31.12.2015:  
16.7%

Number of  
Employees  
**1,163**

31.12.2015:  
1,147

Mortgages/  
Total loans  
**38.7%**

31.12.2015:  
39.4%



## INCOME STATEMENT



# INCOME STATEMENT

All amounts in ISK million

## HEALTHY GROWTH IN NET INTEREST INCOME – SHARP REDUCTION IN ONE-OFFS FROM LAST YEAR

- Significant increase in net interest income due to higher inflation, higher interest rate, larger loan portfolio and increase in other interest bearing assets
- Significant decrease in net commission income, mainly due to lower IPO activity in investment banking compared to last year
- Decrease in net financial income due to one-off items in 2015 and listed equity positions performed unfavourably during the quarter

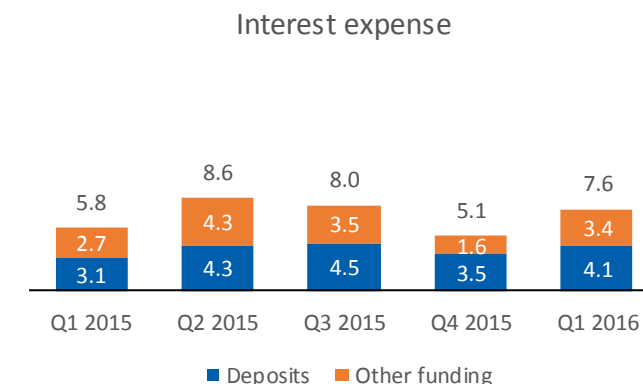
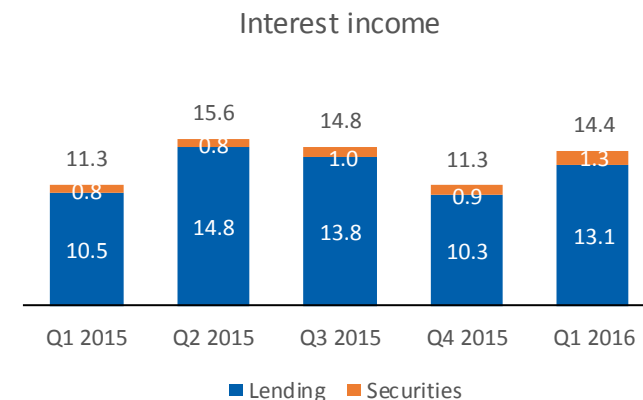
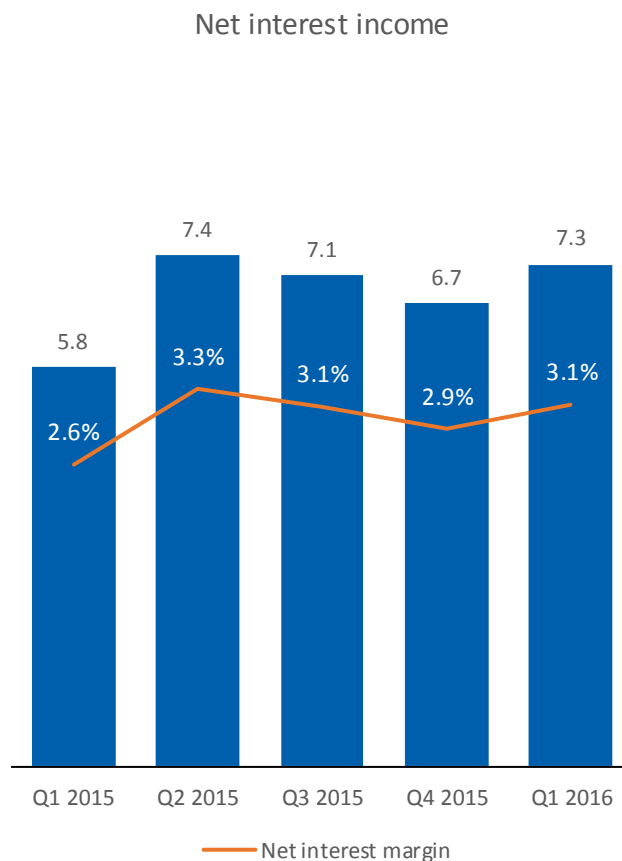
	Q1 2016	Q1 2015	Diff	Diff%
Net interest income	7,273	5,783	1,490	26%
Net commission income	3,219	3,757	(538)	-14%
Net financial income	(301)	7,539	(7,840)	-
Share of profit of associates	677	4,211	(3,534)	-84%
Other income	1,235	491	744	152%
<b>Operating income</b>	<b>12,103</b>	<b>21,781</b>	<b>(9,678)</b>	<b>-44%</b>
Salaries and related expense	(4,108)	(3,492)	(616)	18%
Other operating expenses	(3,234)	(2,896)	(338)	12%
Bank levy	(742)	(730)	(12)	2%
Net impairment	(503)	1,782	(2,285)	-
<b>Net earnings before taxes</b>	<b>3,516</b>	<b>16,445</b>	<b>(12,929)</b>	<b>-79%</b>
Income tax	(737)	(1,720)	983	-57%
Net gain from disc. operations	104	183	(79)	-43%
<b>Net earnings</b>	<b>2,883</b>	<b>14,908</b>	<b>(12,025)</b>	<b>-81%</b>

# NET INTEREST INCOME

All amounts in ISK billion

## INCREASED NET INTEREST INCOME MAINLY RELATED TO HIGHER INFLATION

- Net interest income increase both in comparison with previous period and Q1 2015. The increase is due to higher inflation, higher interest rate and increase in interest bearing assets
- New funding from borrowings, mostly a long term bond issued to Kaupthing



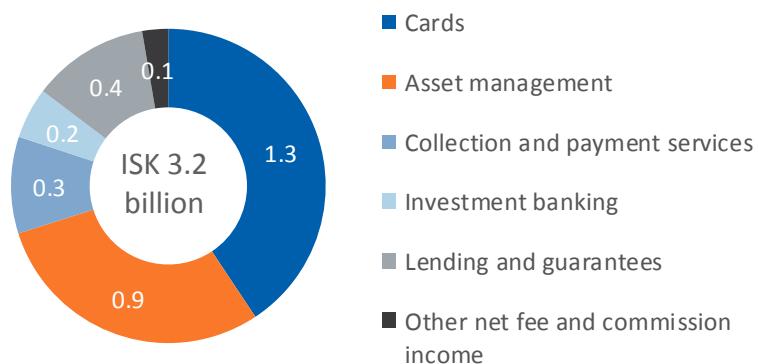
# NET COMMISSION INCOME

All amounts in ISK billion

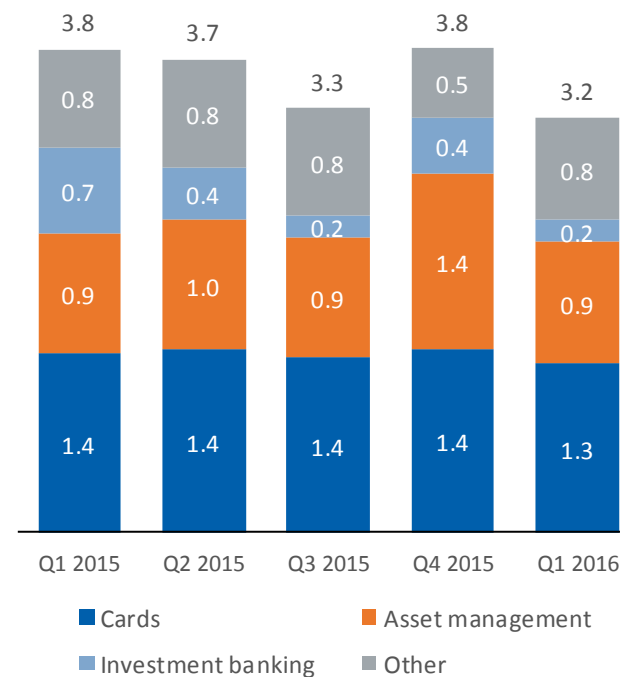
## STABLE COMMISSION BASE IN CARDS AND ASSET MANAGEMENT

- Net commission decrease from Q1 2015 mainly due to lower IPO activity in investment banking
- Asset management stable from Q1 last year but reduction from Q4 is related to performance based income at year end
- Other sources of net commission income remain stable
- Net commission income from cards expected to grow during the year

Breakdown of Net commission income Q1 2016



Net commission income

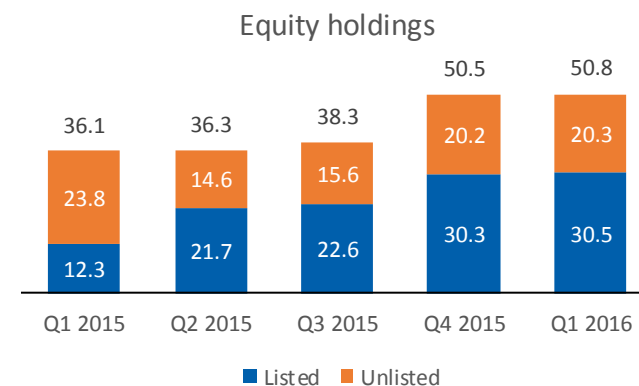
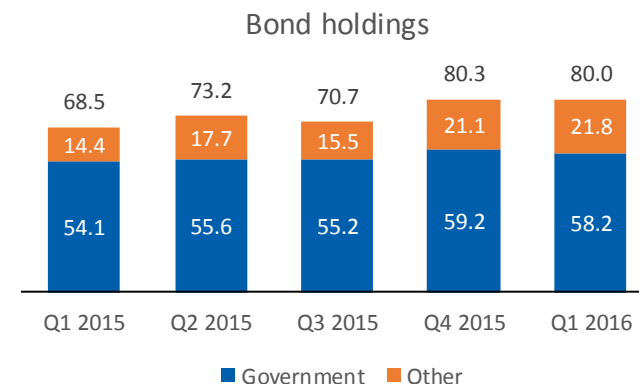
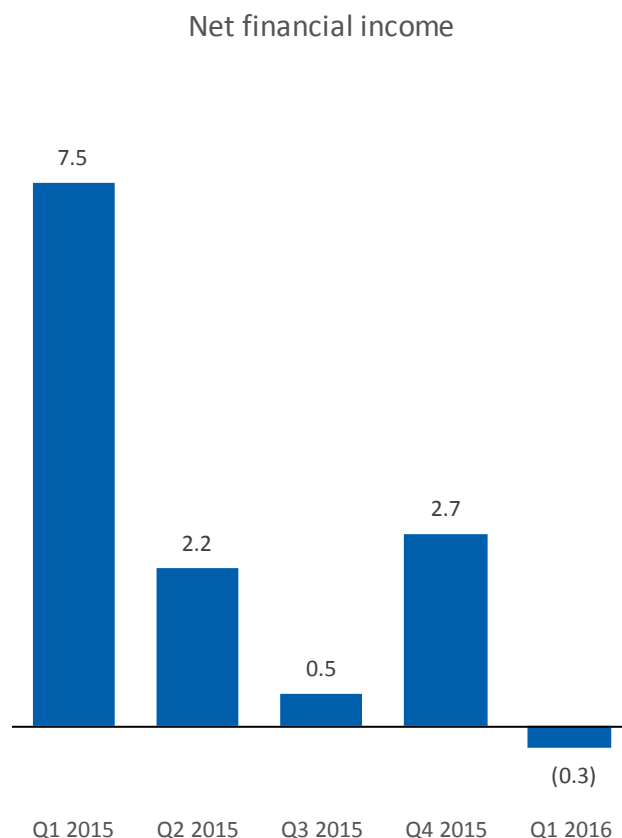


# NET FINANCIAL INCOME

All amounts in ISK billion

## THE ICELANDIC EQUITY MARKET WAS CHALLENGING DURING THE QUARTER

- The Icelandic stock index OMXI8 was volatile during Q1 but was approximately the same level at year end 2015 and at the end of the quarter
- The Bank still holds significant equity positions in Reitir, Síminn and HB Grandi following the listings of those companies. Share prices in both Síminn and HB Grandi decreased during the period
- Returns on bond holdings mostly due to interest income



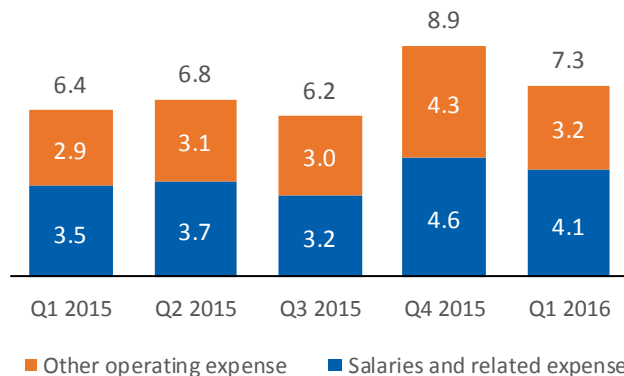
# TOTAL OPERATING EXPENSE

All amounts in ISK billion

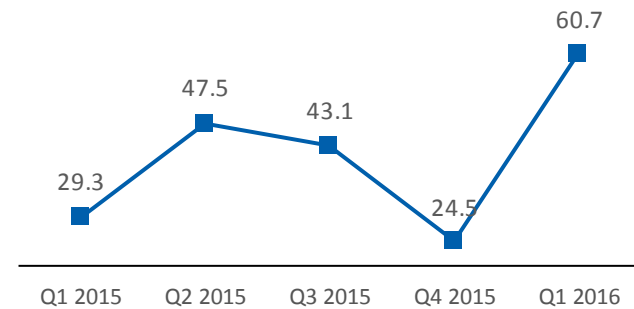
## NEW WAGE AGREEMENTS HAVE A MAJOR IMPACT

- Increase in salaries greatly affected by new wage agreements
- Increase in IT expenditures, professional services and marketing expenses compared with prior year
- Cost-to-income ratio volatile due to large one-off income items in previous periods
- Number of employees continues to grow in subsidiaries and at the Bank in relation to a new branch at the Keflavik Airport

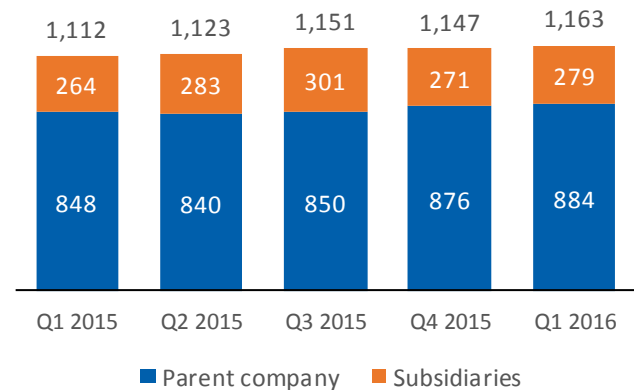
Total operating expense



Cost-to-income ratio (%)



Number of employees





# BALANCE SHEET



# BALANCE SHEET

All amounts in ISK billion

## THE BANK IS WELL PREPARED FOR THE LIFTING OF THE CAPITAL CONTROLS

- Healthy increase in loans to customers
- Decrease in investment in associates due to sale of Bakkavor Group Ltd.
- Decrease in deposits due to funding agreement with Kaupthing
- Increase in borrowings due to funding agreement with Kaupthing and new issues during the period
- Very strong equity position

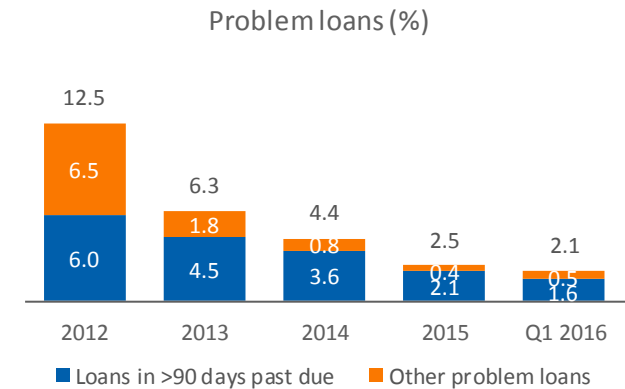
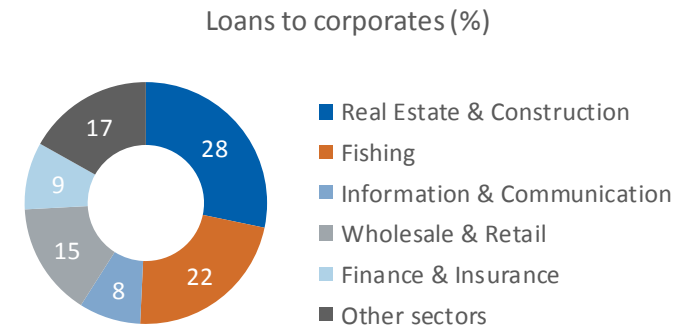
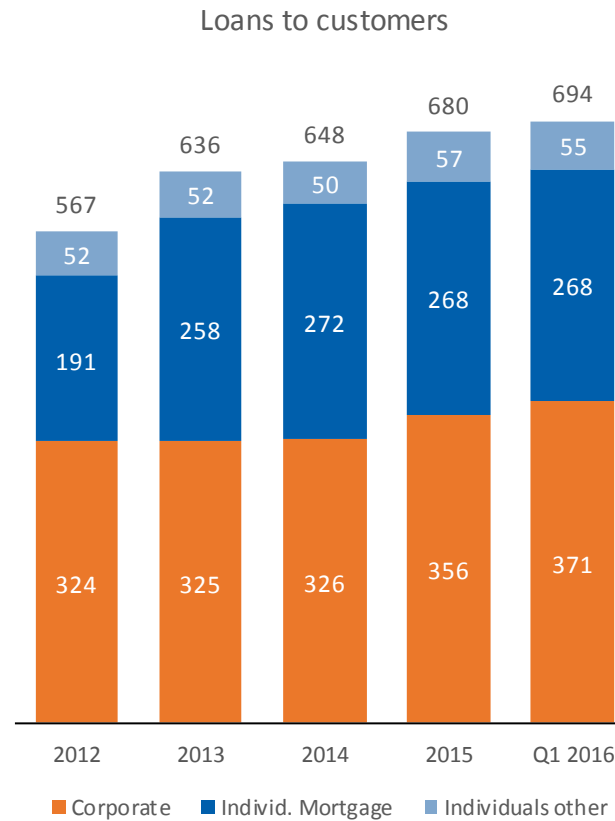
<b>Assets</b>	<b>31.03.2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Cash & balances with CB	70	48	21	38	30
Loans to credit institutions	92	87	109	102	101
Loans to customers	694	680	648	636	567
Financial assets	133	133	102	87	138
Investment property	6	8	7	29	29
Investments in associates	1	27	22	18	7
Other assets	33	27	26	30	30
<b>Total Assets</b>	<b>1,029</b>	<b>1,011</b>	<b>934</b>	<b>939</b>	<b>901</b>
<b>Liabilities and Equity</b>					
Due to credit institutions & CB	11	11	23	28	33
Deposits from customers	433	469	455	472	449
Other liabilities	59	62	61	58	59
Borrowings	311	256	201	205	195
Subordinated loans	10	10	32	32	34
Share holders equity	195	193	161	140	127
Non-controlling interest	10	9	2	5	4
<b>Total Liabilities and Equity</b>	<b>1,029</b>	<b>1,011</b>	<b>934</b>	<b>939</b>	<b>901</b>

# LOANS TO CUSTOMERS

All amounts in ISK billion

## CONTINUED DEMAND FOR CORPORATE LENDING

- Continued good balance in loans to corporates and individuals
- Increase in loans to customers during the period, mostly to corporate customers in the fishing industry and wholesale and retail
- Strong pipeline for corporate loans
- Good diversification in the corporate loan book
- Problem loans continue to decrease

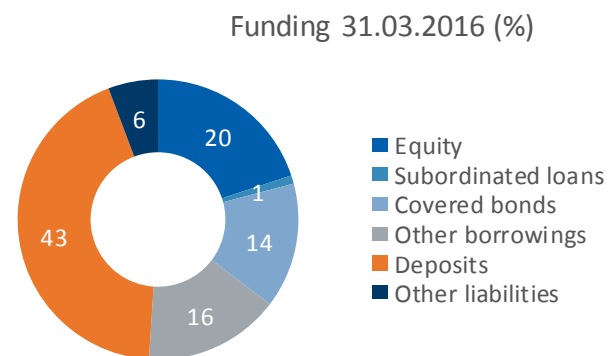
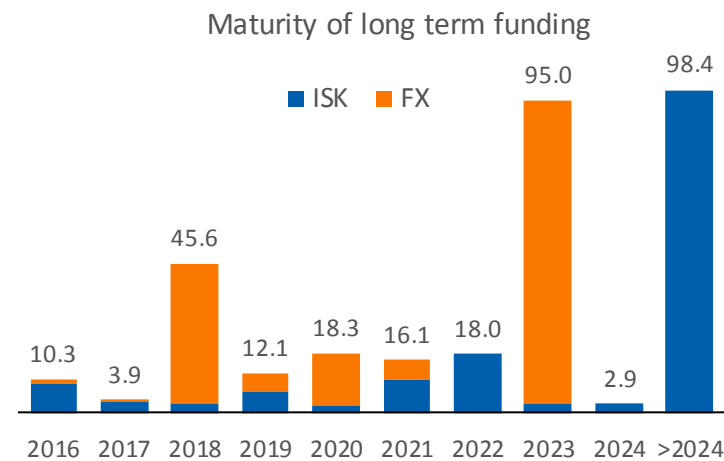
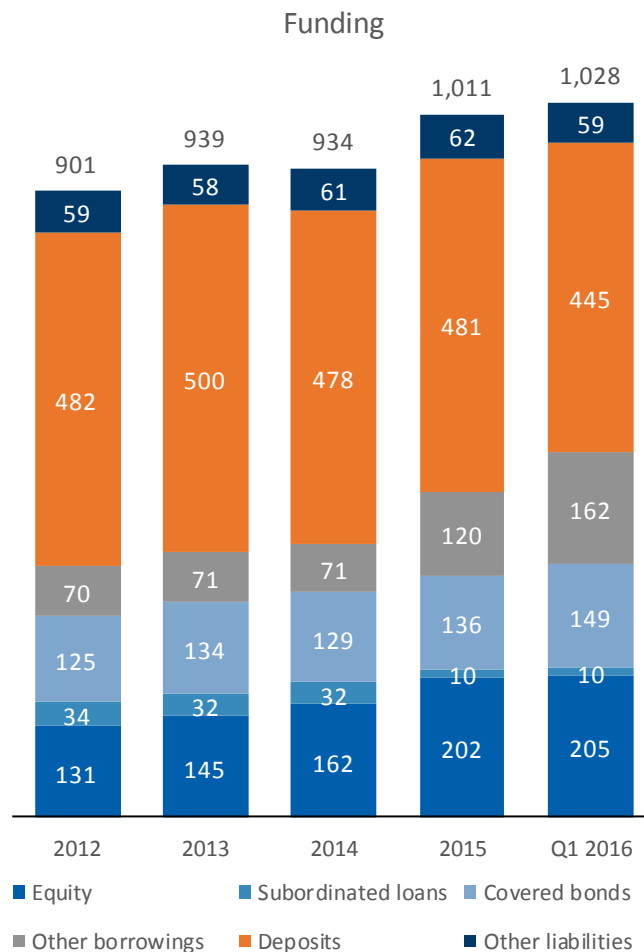


# FUNDING

All amounts in ISK billion

## THE BANK HAS BEEN LEADING THE RE-ENTRY INTO THE INTERNATIONAL MARKETS

- In January the Bank and Kaupthing reached a funding agreement under which the Bank issued a 7 year USD 748 million bond under the Bank's EMTN programme. The bond bears floating LIBOR plus 2.6% for the first two years and will be repriced then at market terms
- The bond will offset loans in foreign currency taken by Arion Bank from the Central Bank of Iceland, which are now owned by Kaupthing, and Kaupthing deposits in foreign currency at Arion Bank.
- The Bank continues to issue Covered Bonds in the Icelandic market, total of ISK 12.4 billion in Q1

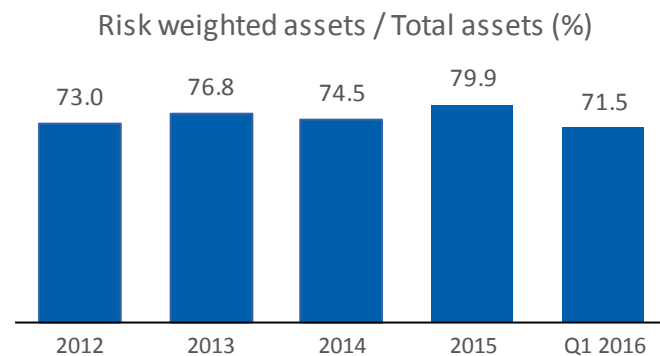
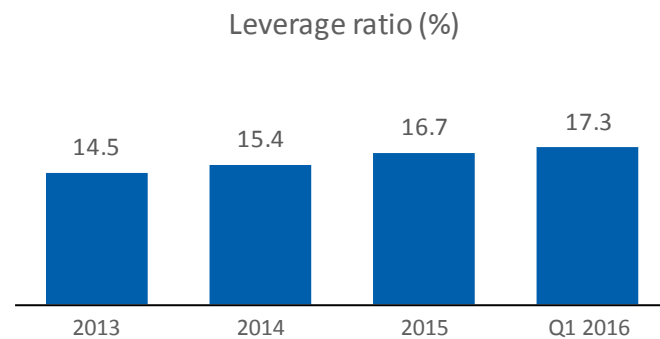
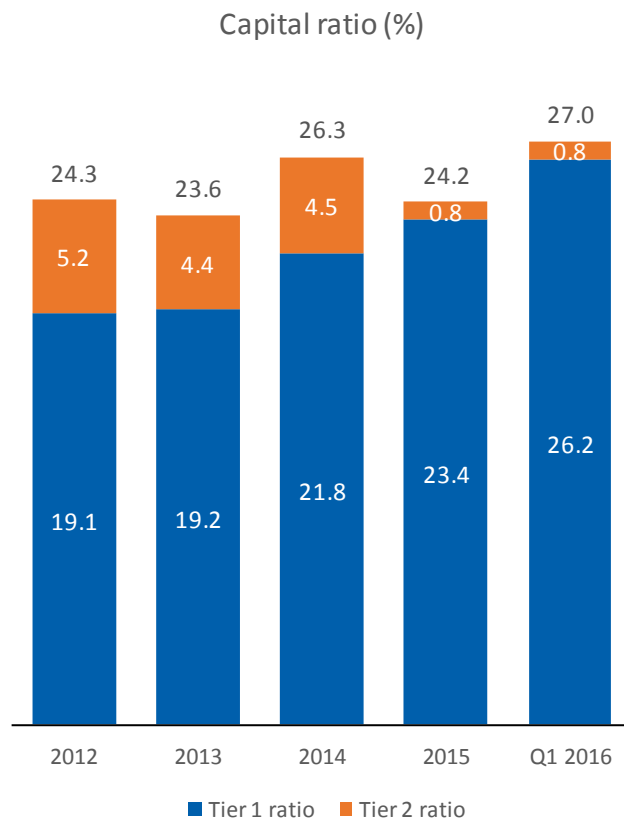


# CAPITAL BASE

All amounts in ISK billion

## VERY STRONG CAPITAL BASE OFFERS VARIOUS ALTERNATIVES

- No dividend payment in 2016
- Solid level of capitalization due to strong profit generation
- The Bank uses standardized approach calculating RWA
- Reduction in risk weighted assets due to decrease in loan commitments and lower FX imbalance







## OUTLOOK AND KEY FINANCIAL INDICATORS

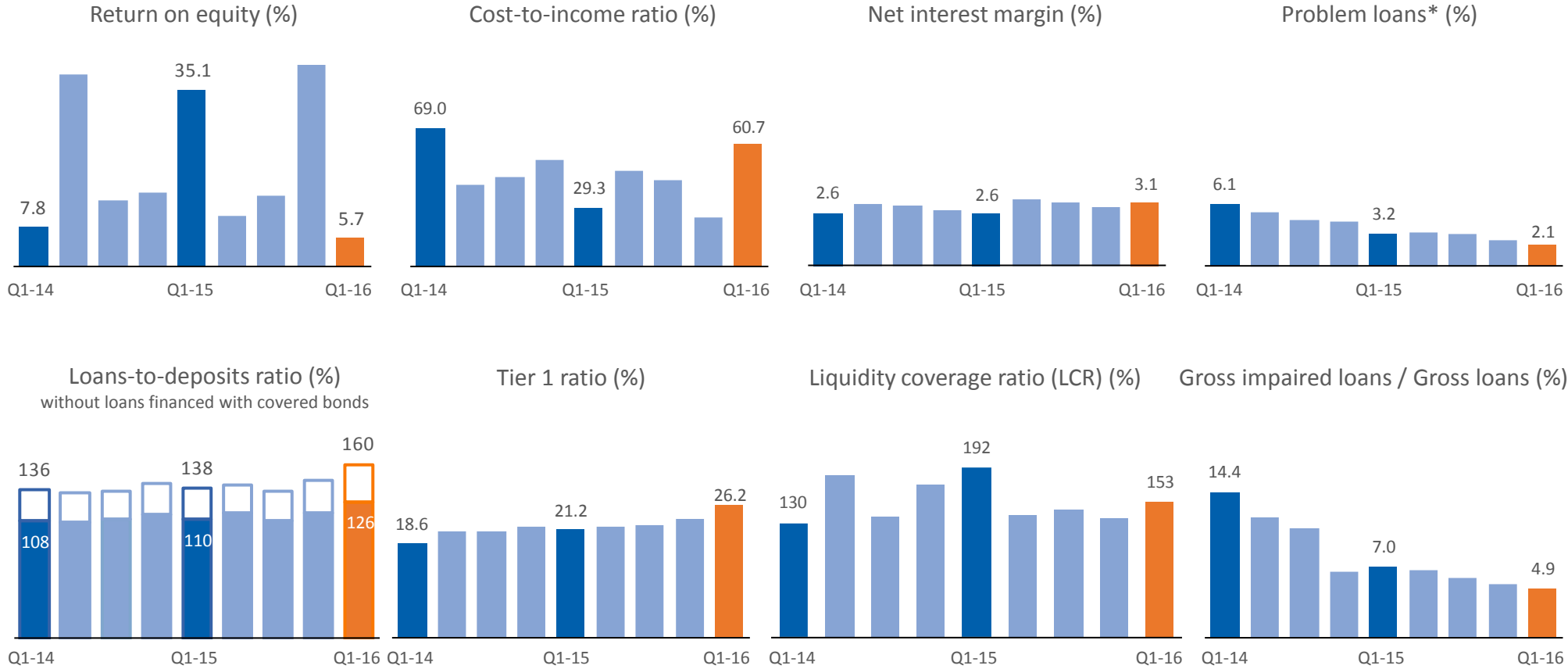
# OUTLOOK

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## STRONGER DEMAND IN THE ECONOMY GIVES PROMISING SIGNS FOR THE FUTURE

- Exciting times ahead in a rather challenging environment
- Arion Bank occupies strong position owing to its robust liquidity
  - The Bank's strategy is to manage lending rates
  - There is high demand for corporate loans, and loans have grown year on year
  - The Bank strives to help its customers achieve their growth objectives, both at home and abroad
  - Competition on the mortgage market has intensified after the pension funds became more active. This reduces the proportion of retail loans in the Bank's portfolio
- The Bank has placed greater emphasis on digital services with the aim of increasing income and reducing operating expenses
- The Bank will continue to seek ways to diversify its sources of funding
- Arion Bank's strong capital position makes it well set to face future challenges
- Credit rating is expected to be upgraded as the sovereign rating is revised upwards, opening up more funding opportunities for the Bank
- The liberalization of the capital controls will present new opportunities, and the Bank foresees no significant changes to the balance sheet although its structure will be altered
- Under agreements between Kaupthing and the government Arion Bank will be sold to new owners and preparations have already begun

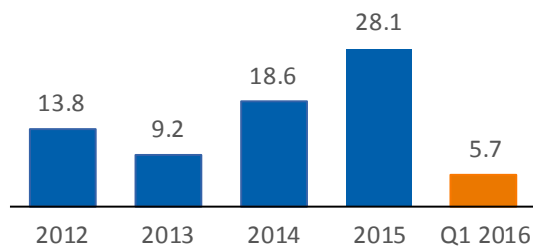
# KEY FINANCIAL INDICATORS



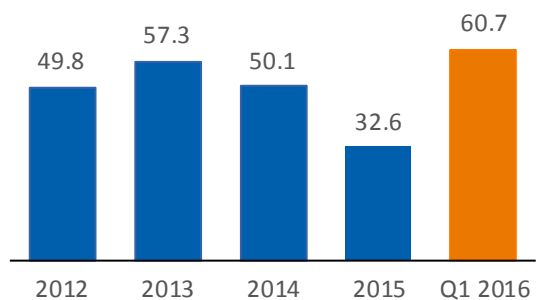
\* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

# KEY FINANCIAL INDICATORS

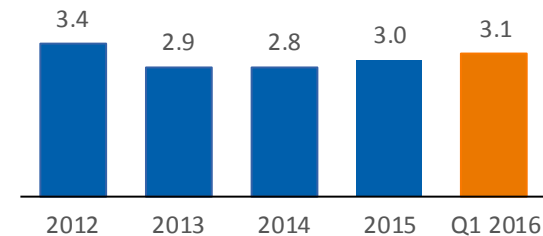
Return on equity (%)



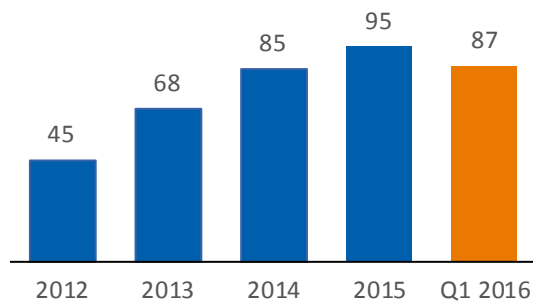
Cost-to-income ratio (%)



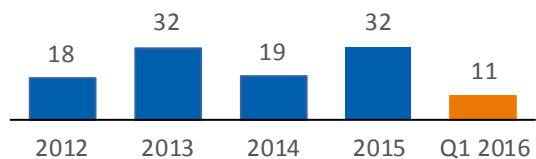
Net interest margin (%)



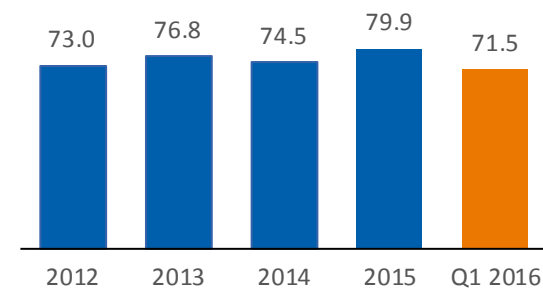
CPI Imbalance – ISK bn.



FX Imbalance – ISK bn.



Risk weighted assets / Total assets (%)







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