

A low-angle photograph of a modern glass skyscraper against a clear blue sky. The building's facade is composed of large glass panels reflecting the sky and other parts of the building. The structure is angular and contemporary.

# FINANCIAL STATEMENTS 30.06.2014

INVESTOR PRESENTATION

# HIGHLIGHTS OF H1 2014

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- Excellent results in H1
- Strong position in domestic lending
- New international lending
- Strong position in Asset Management, Capital Markets and Corporate Finance
- Problem loan situation steadily improving
- Very good progress in commission income
- Ongoing focus on operating expenses
- Special taxes on major banks are a burden
- Strong capital and liquidity
- Irregular items still have considerable effect



# HIGHLIGHTS OF FIRST HALF OF 2014

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## FINANCIALLY ROBUST BANK WITH SOLID FUNDAMENTALS

- Sound operations and solid results
  - Return on equity 23.4%
  - Irregular items still have impact
- Strong balance sheet
- Higher commission income offsets decrease in interest income
- Bank's sale of holding in HB Grandi has positive impact on results
- New Arion Bank branch at Borgartún 18, Reykjavík
  - Focus on high quality personal advisory services and wide range of other services
- IT moved into Borgartún 18 to consolidate operations
- Good progress in implementation of A Plus lean management
- Arion Bank intranet nominated for Icelandic Web Awards 2013
- New director elected to Board of Directors
  - Kirstín Þ. Flygenring

# HIGHLIGHTS OF FIRST HALF OF 2014

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## SALE AND LISTING OF HB GRANDI ON NASDAQ OMX

- IPO of HB Grandi hf.
  - Arion Bank's Investment Banking division arranged the offering and listing on the Icelandic stock exchange
- Investment Banking completed a successful offering of new bond series in Landfestar ehf., LF 14 1
- Frjálsi Pension Fund named best institutional investor in real estate investments from among 40 European countries by magazine IPE Real Estate
- Frjálsi Pension Fund named pension fund of year in Iceland by magazine Acquisition International
- Advising and arranging funding for United Silicon and Silicor Materials
- Assigned credit rating by Standard & Poor's (S&P) at beginning of 2014, BB+
- Preparation for a Eurobond issue
  - Successful roadshow in Q2
  - Strong demand but spread too high at the time
  - The Bank is fully funded and no refinancing needs in the medium term
- Arion Research published its macroeconomic forecast

# HIGHLIGHTS OF FIRST HALF OF 2014

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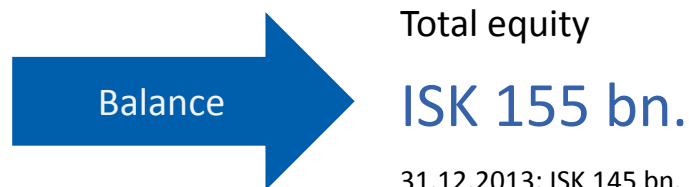
## STRONG EMPHASIS ON EQUAL OPPORTUNITIES AT THE BANK

- Equal opportunities action plan came out
- The Bank signed the UN Women and UN Global Compact's Statement of Support for the Women's Empowerment Principles
- The Bank participated in international financial literacy week as the main sponsor of Institute for Financial Literacy
- Musician and economist Jón Jónsson held a series of lectures for young people all around Iceland on the fundamentals of financial literacy
- The Bank was one of main sponsors of Men and Cancer campaign and Moustache March organized by the Icelandic Cancer Society
- Arion Bank employees raised more than ISK 2 million for the Icelandic Cancer Society at an evening fundraiser for cancer research
- The Bank hosted numerous meetings, courses, conferences, lectures and art exhibitions

# HIGHLIGHTS OF H1 2014



# FINANCIAL HIGHLIGHTS



# INCOME STATEMENT





# INCOME STATEMENT

## EXCELLENT RESULTS IN H1 2014

Slight decrease in net interest income relating to generally low inflation and deflation in February and June.

Substantial increase in commission income across the board.

Positive net valuation change mainly a result of restructuring efforts.

Sale of stake in HB Grandi has a substantial positive effect.

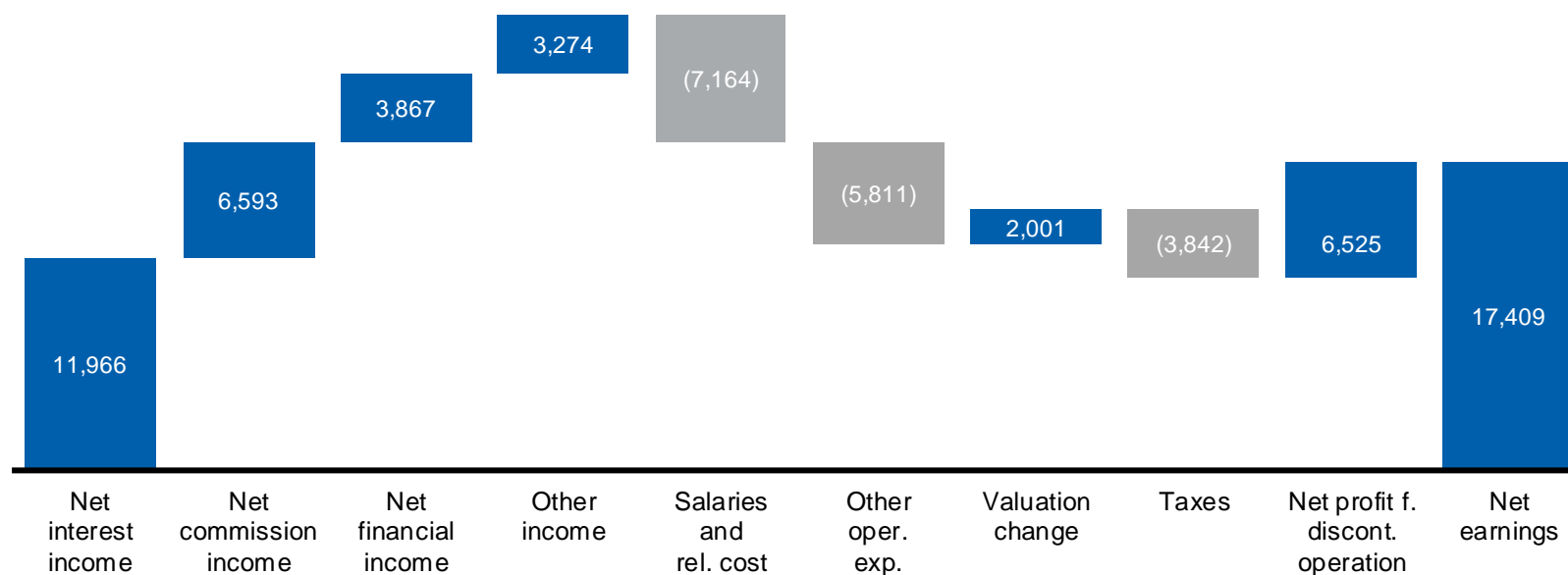
Bank levy was raised substantially at year end 2013.

Million ISK	H1 2014	H1 2013	Diff	%
Net interest income	11,966	12,667	(701)	(6%)
Net commission income	6,593	5,298	1,295	24%
Net financial income	3,867	296	3,571	1,206%
Other income	3,274	2,425	849	35%
<b>Operating income</b>	<b>25,700</b>	<b>20,686</b>	<b>5,014</b>	<b>24%</b>
Salaries and related cost	(7,164)	(6,679)	(485)	7%
Other operating expenses	(5,811)	(6,228)	417	(7%)
Net change in valuation	2,001	134	1,867	1,393%
<b>Net earnings before taxes</b>	<b>14,726</b>	<b>7,913</b>	<b>6,813</b>	<b>86%</b>
Income tax	(2,467)	(1,749)	(718)	41%
Bank levy	(1,375)	(188)	(1,187)	631%
Net gain from discontinued operations, net of tax	6,525	(65)	6,590	(10,138%)
<b>Net earnings</b>	<b>17,409</b>	<b>5,911</b>	<b>11,498</b>	<b>195%</b>
Shareholders of Arion Bank	17,263	6,137	11,126	181%
Minority interest	146	(226)	372	(165%)



# INCOME STATEMENT

## BREAKDOWN OF NET EARNINGS IN H1 2014



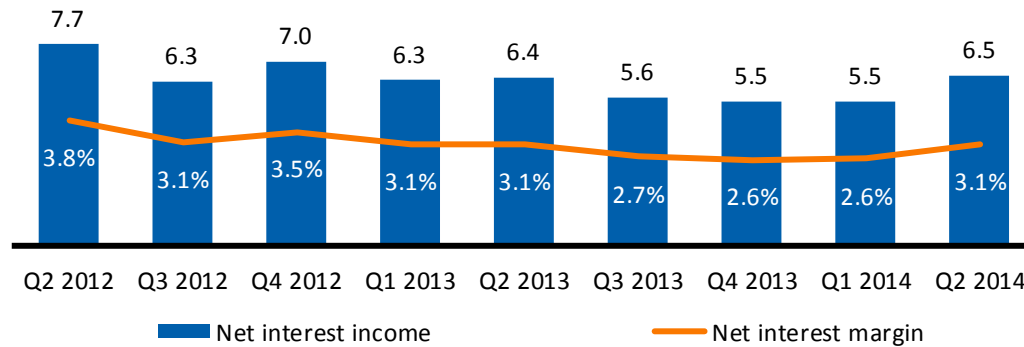
# NET INTEREST INCOME

INCREASE IN NET INTEREST INCOME IN Q2 AFTER SLIGHT DEPRESSION IN PRIOR QUARTERS

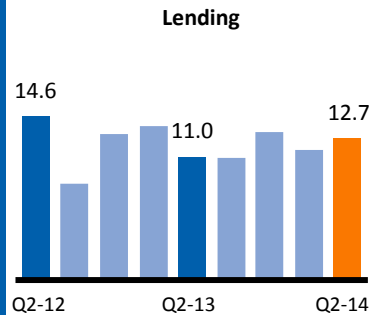
Increase in net interest income in Q2 mainly explained by higher inflation.

Challenge to maintain net interest margin in a competitive environment.

By quarters from Q2 2012 – Q2 2014



Interest income by type (ISK bn.)

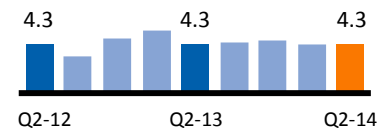


Securities & other



Interest expenses by type (ISK bn.)

Deposits



Funding



# NET COMMISSION INCOME

GROWTH EXPECTATIONS ARE MATERIALIZING

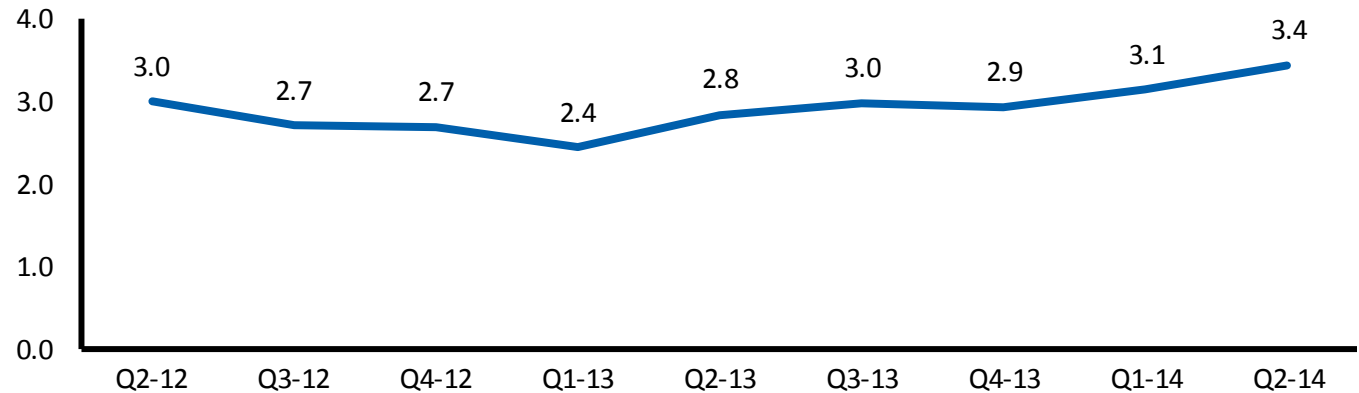
Good progress in net commission income, increased by 21% from H1 2013.

Gradual increase in commission from Asset Management and cards.

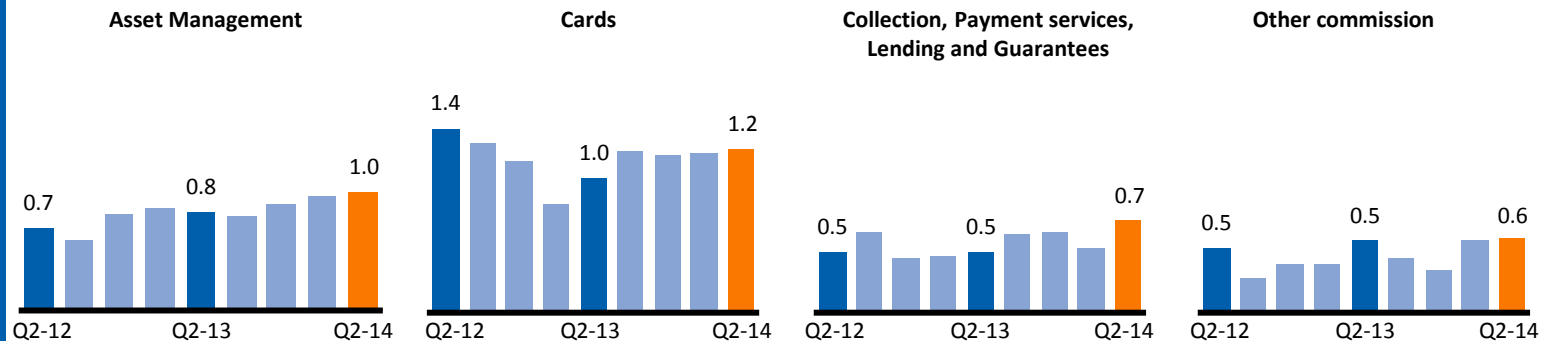
Increased commission in lending mostly from Corporate Banking.

Capital Markets and Corporate Finance activities are main contributors to other commission income.

Net commission income from Q2 2012 – Q2 2014 (ISK bn.)



By type from Q2 2012 – Q2 2014 (ISK bn.)



# NET FINANCIAL INCOME

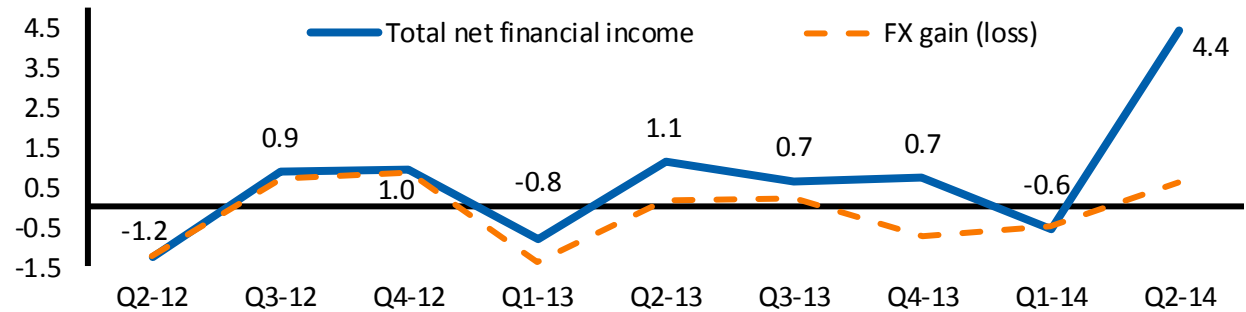
THE BANK HAS SUCCESSFULLY REDUCED ITS FX IMBALANCE

High income relating to share price development of HB Grandi.

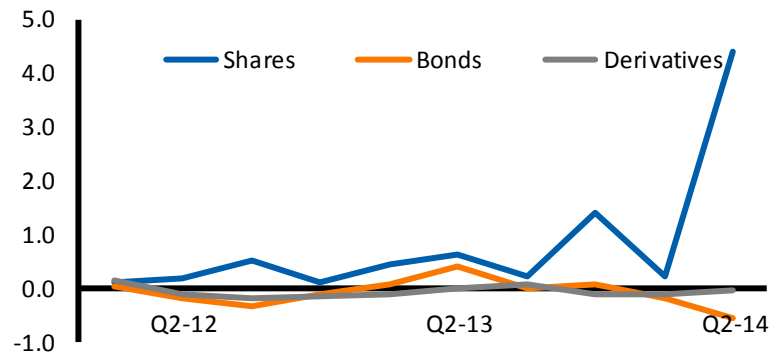
Other shares and bonds generally under performing.

FX imbalance of Arion Bank has decreased substantially from year end 2013.

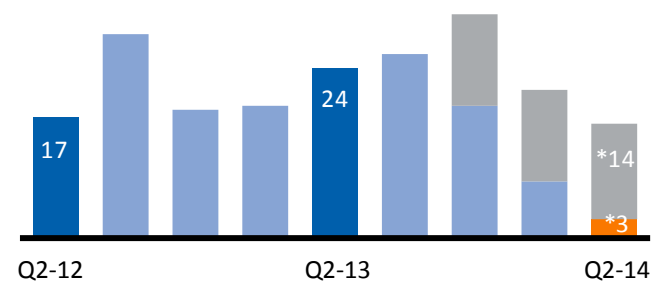
By quarters from Q2 2012 – Q2 2014 (ISK bn.)



Other financial income from Q2 2012 – Q2 2014 (ISK bn.)



FX imbalance from Q2 2012 – Q2 2014 (ISK bn.)



\*Arion Bank has ISK 2.6 bn. and subsidiaries ISK 13.7 bn. in FX imbalance

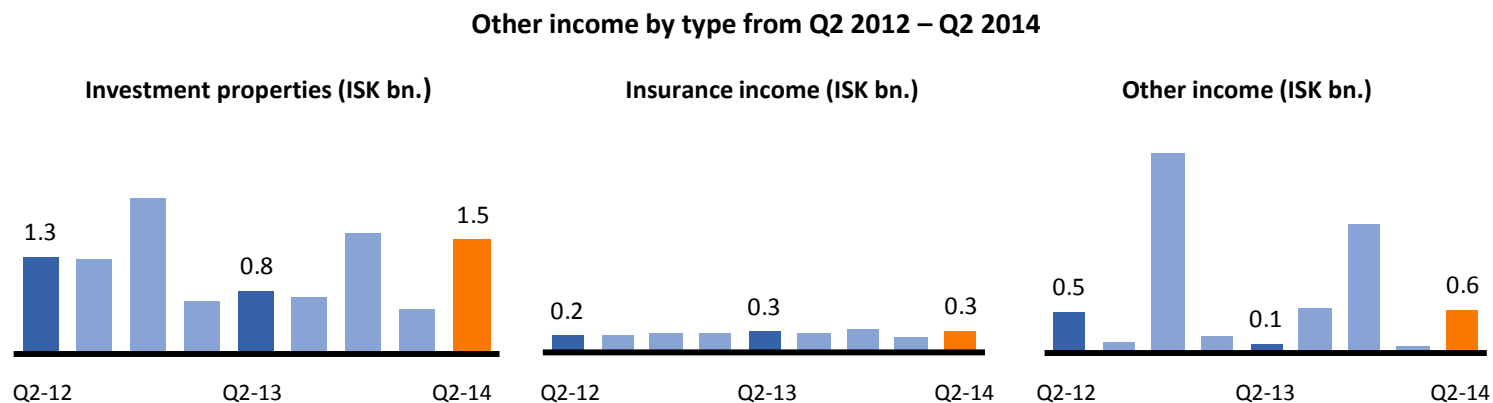
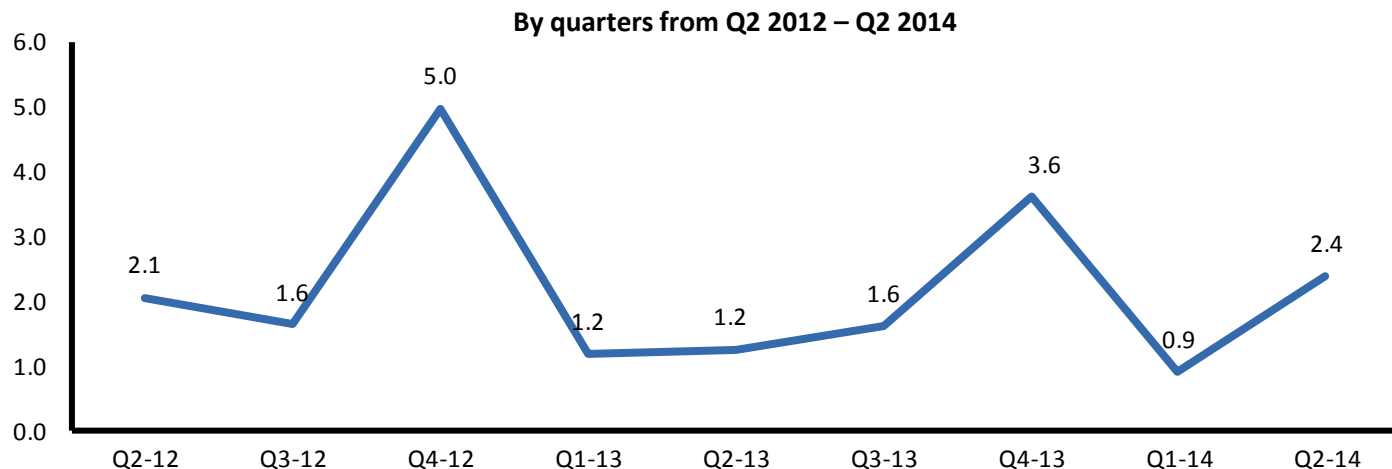
# OTHER INCOME

VOLATILITY IN OTHER INCOME EXPECTED TO DECREASE WITH THE SALE OF LANDFESTAR

Stable rental income of ISK 1.1 bn. from investment properties. Due to the sale of Landfestar ehf. rental income in H2 will be immaterial.

Valuation change of ISK 0.9 million in Investment properties in Q2.

Stable insurance income from OKKAR líf.



# TOTAL OPERATING EXPENSES

OPERATING EFFICIENCY IS A FOCUS FOR THE BANK GOING FORWARD

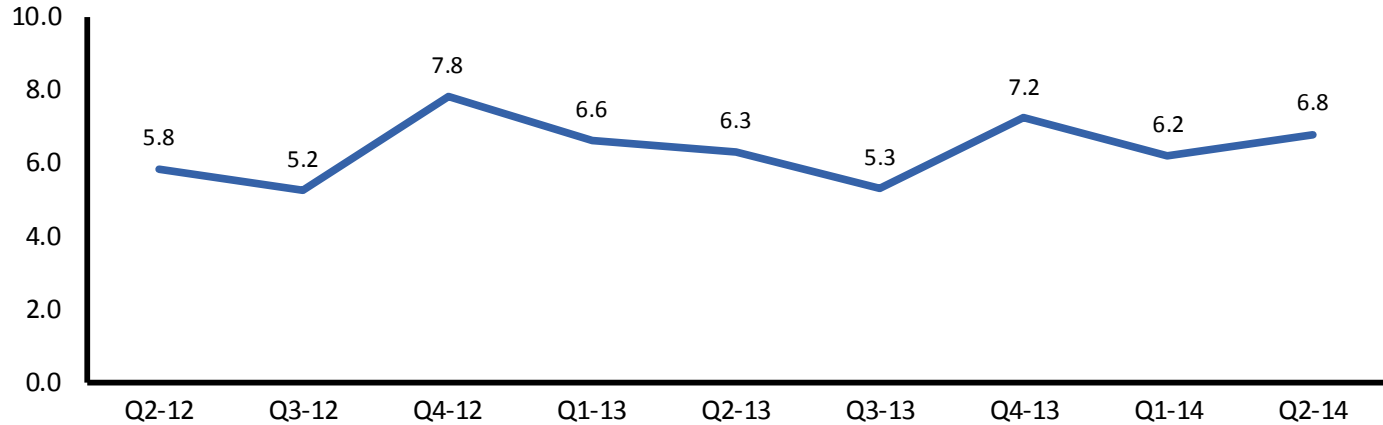
Number of employees gradually decreasing.

Salaries and related expenses increase from last year, mainly due to the Bank's performance plan.

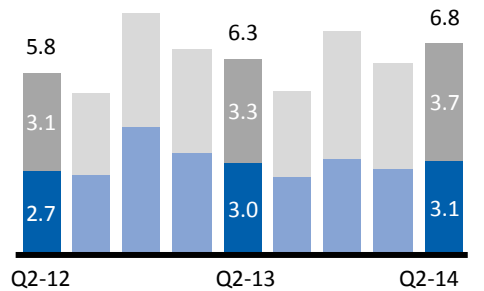
Other operating expenses decreased from H1 2013.

Total operating expenses virtually unchanged from H1 2013 to H1 2014.

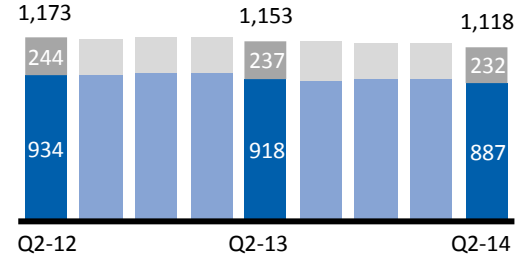
By quarters from Q2 2012 – Q2 2014 (ISK bn.)



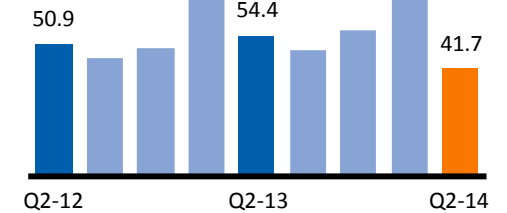
By type (ISK bn.)



Total employees



Cost-to-income ratio (%)



■ Salaries & relat. exp. ■ Other oper.exp.

■ Parent company ■ Subsidiaries



# BALANCE SHEET



# BALANCE SHEET

## STRONG BALANCE SHEET - WELL POSITIONED FOR FUTURE GROWTH

The Bank has succeeded in maintaining loans to customers in a competitive domestic environment.

Increased demand for new loans and the Bank is well prepared to meet such demand.

Investment property reduced with the sale of Landfestar ehf.

Other changes mainly due to liquidity management.

<b>Assets</b>					
<b>Billion ISK</b>	<b>30.6.2014</b>	<b>31.3.2014</b>	<b>Diff%</b>	<b>31.12.2013</b>	<b>Diff%</b>
Cash & balances with CB	17	19	(7%)	38	(54%)
Loans to credit institutions	140	95	47%	102	37%
Loans to customers	637	642	(1%)	636	0%
Financial assets	99	100	(0%)	87	15%
Investment property	6	29	(79%)	29	(79%)
Other assets	49	49	1%	48	4%
<b>Total assets</b>	<b>949</b>	<b>933</b>	<b>2%</b>	<b>939</b>	<b>1%</b>

<b>Liabilities and Equity</b>					
<b>Billion ISK</b>	<b>30.6.2014</b>	<b>31.3.2014</b>	<b>Diff%</b>	<b>31.12.2013</b>	<b>Diff%</b>
Due to credit institutions & CB	29	26	13%	28	5%
Deposits from customers	474	471	1%	472	1%
Other liabilities	60	54	10%	58	4%
Borrowings	200	203	(2%)	205	(2%)
Subordinated loans	31	31	(0%)	32	(2%)
Equity	155	148	5%	145	7%
<b>Total liabilities and equity</b>	<b>949</b>	<b>933</b>	<b>2%</b>	<b>939</b>	<b>1%</b>

# LOANS TO CUSTOMERS ARE WELL DIVERSIFIED

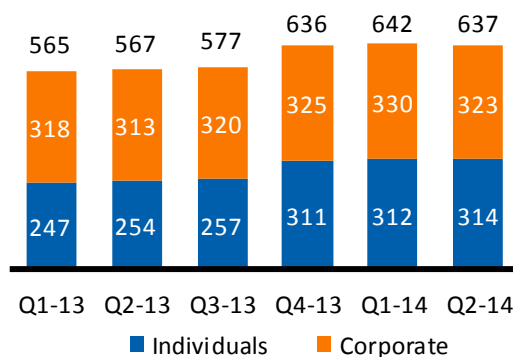
WITH LOANS TO INDIVIDUALS REPRESENTING 49% OF TOTAL LOANS TO CUSTOMERS

Corporate portfolio quite stable. Large repayments but increased demand for new loans.

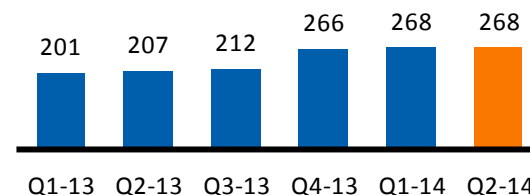
The Bank has taken a leading position in the Icelandic market as regards lending to new export revenue generating industries both in the health care sector as well as in power intensive industries.

It is the strategic objective of the Bank to maintain a well diversified loan portfolio in all corporate sectors.

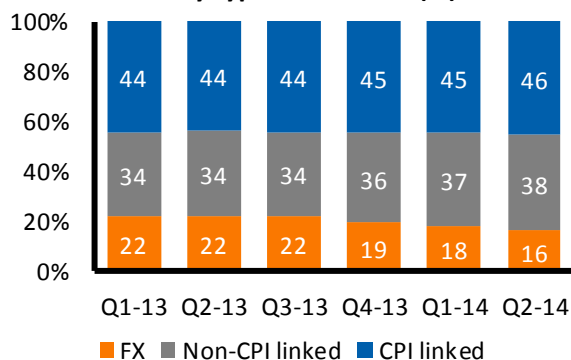
**Development (ISK bn.)**



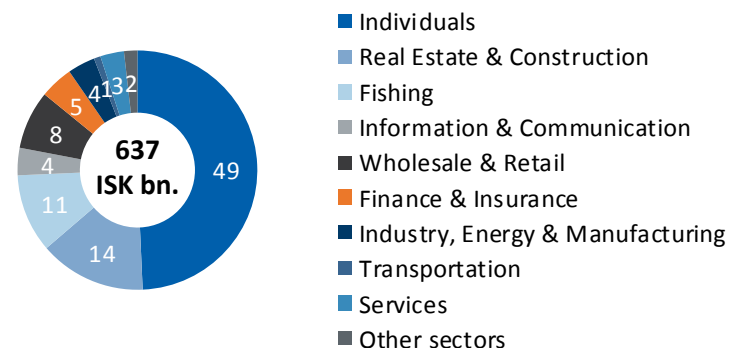
**Mortgage loans (ISK bn.)**



**By type 30.06.2014 (%)**



**By sectors 30.06.2014 (%)**



# IMPROVING ASSET QUALITY

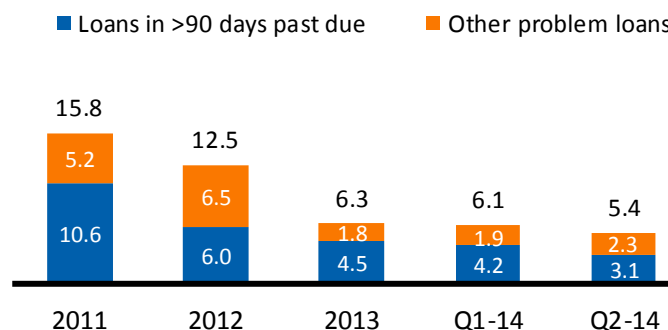
## PROBLEM LOANS APPROACHING LEVELS AT OTHER NORDIC BANKS

Good progress in loans over 90 days in default.

The focus on problem loans is ongoing and the objective is to be well below 5% at year end 2014.

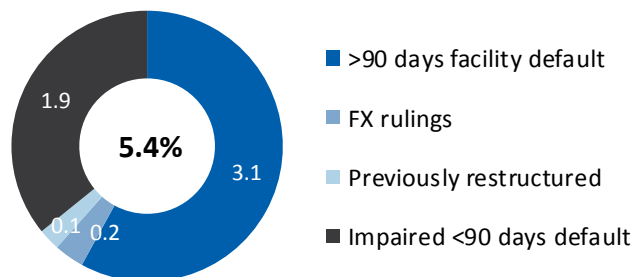
Problem loans as a percentage of equity are now starting to resemble those of other Nordic banks.

Development of problem loans\* (%)

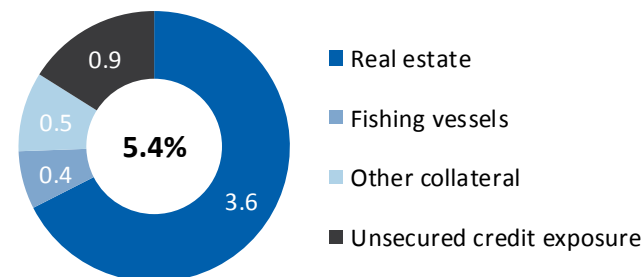


\*The Bank defines problem loans as book value of loans (i.e. net of impairment) that are either individually impaired or are over 90 days past due and not impaired as % of total book value of loans to customers

Problem loans by status (%)



Collateral behind problem loans (%)



# STRONG FUNDING PROFILE

NO SIGNIFICANT REDEMPTION OF LONG-TERM FUNDING REQUIRED IN THE MEDIUM TERM

Limited need for refinancing.

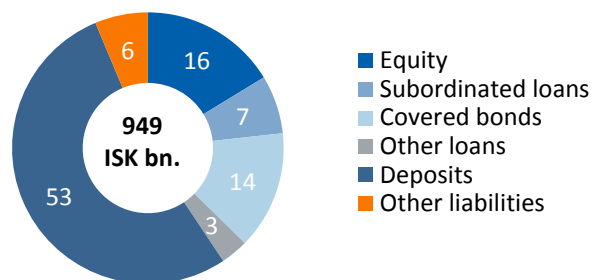
Well balanced funding profile.

No significant redemption of long-term debt until 2020.

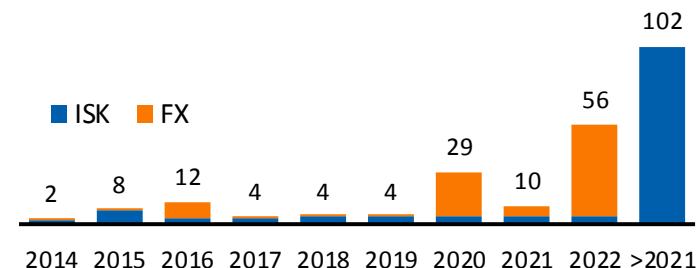
A BB+ credit rating from Standard & Poor's increases possibilities for new funding and potential refinancing.

Increased liquidity has allowed the Bank to reduce term deposits.

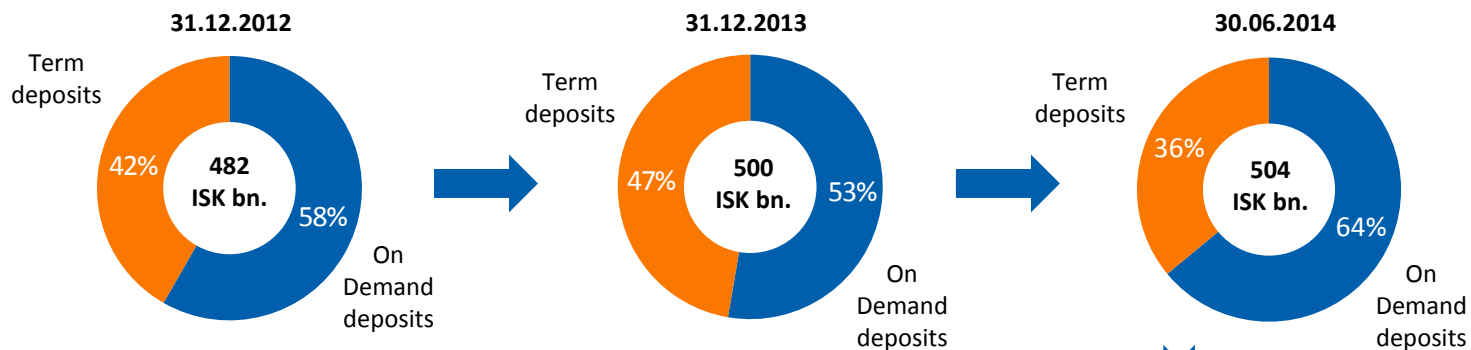
Breakdown of liabilities and equity (%)



Maturity of long-term funding 30.06.2014 (ISK bn.)



Development of total deposits by maturity



# VERY SOLID CAPITAL BASE

INCREASED CAPITAL RATIO DESPITE DIVIDEND PAYMENT OF ISK 7.8 BILLION

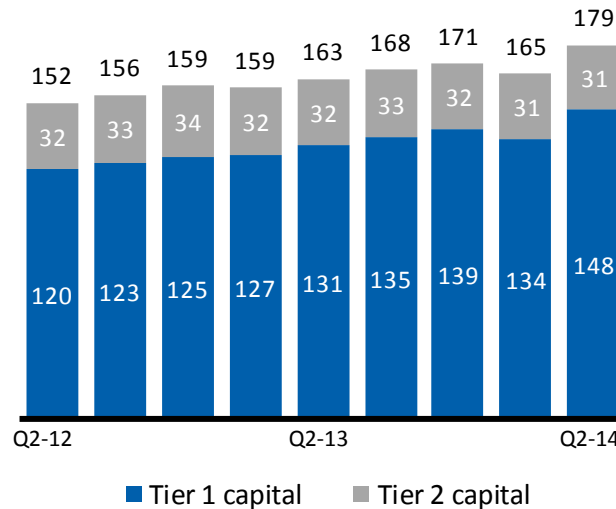
Arion Bank has maintained very solid levels of capitalization due to strong profit generation.

The Bank's capital base is composed of core Tier 1 and Tier 2 capital.

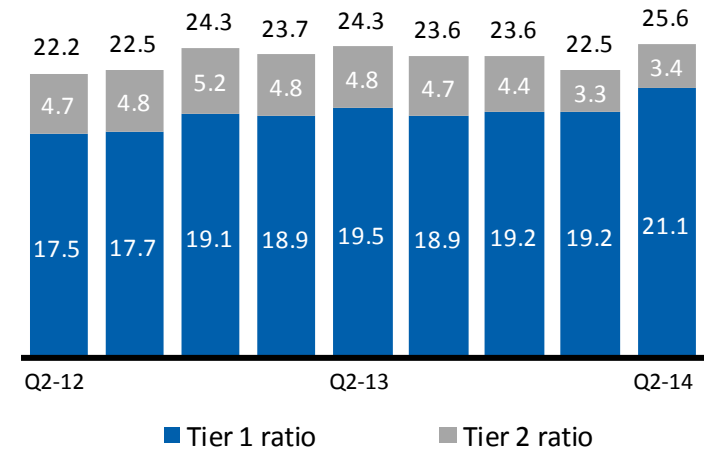
The Bank is using standardized approach calculating RWA.

RWA/Total Assets is approx. 74%.

**Total capital base (ISK bn.)**



**Total capital ratio (%)**

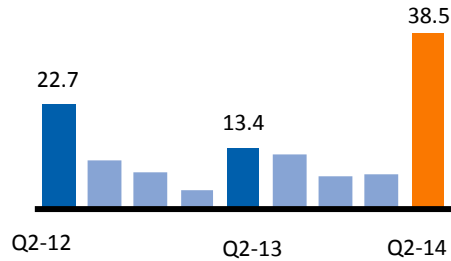


## KEY FINANCIAL INDICATORS



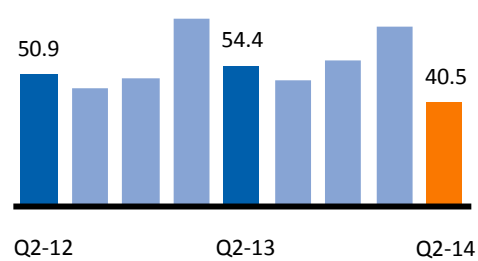
# KEY FINANCIAL INDICATORS

**Return on equity (%)**

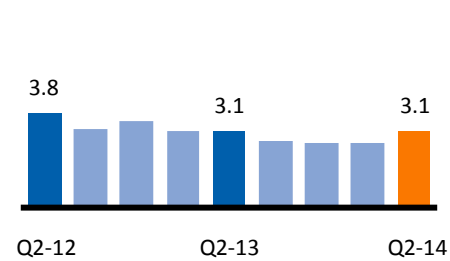


**Cost-to-income ratio (%)**

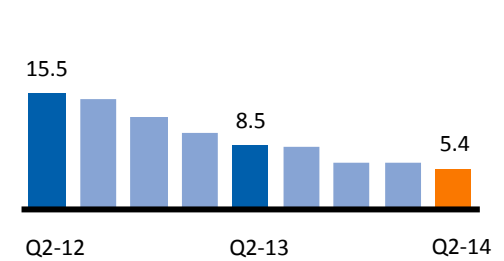
without net valuation change



**Net interest margin (%)**

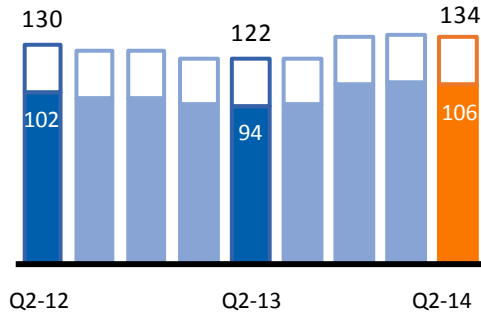


**Problem loans\* (%)**

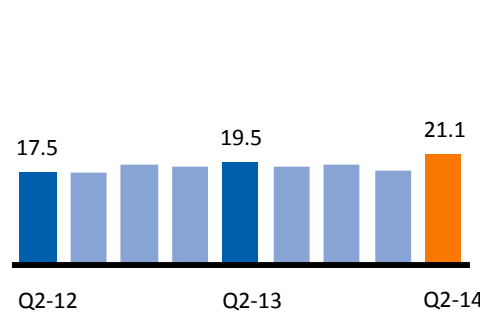


**Loans-to-deposits ratio (%)**

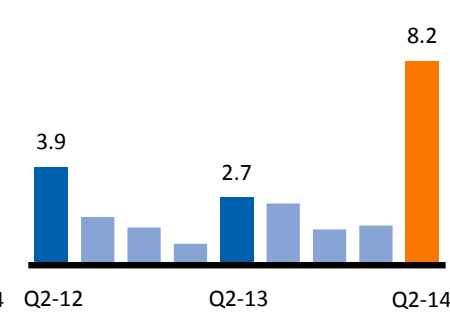
without loans financed with covered bonds



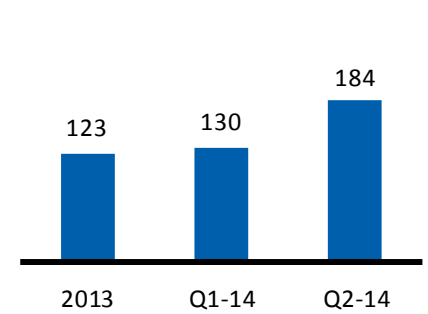
**Tier 1 ratio (%)**



**Return on risk weighted assets (%)**



**Liquidity coverage ratio (LCR) (%)**

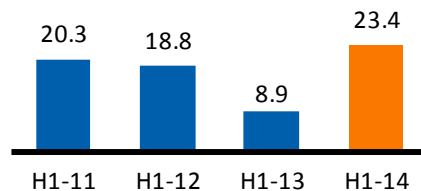


\* Problem loans (past due but not impaired loans over 90 days + individually impaired loans) as % of loans to customers

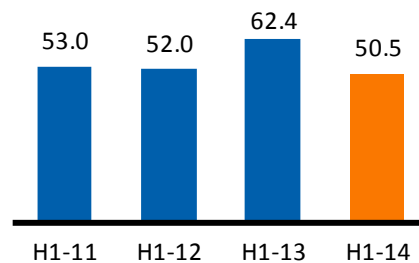


# KEY FINANCIAL INDICATORS

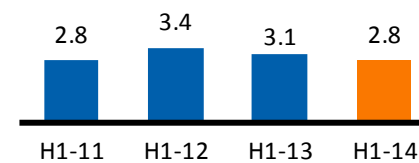
**Return on equity YTD (%)**



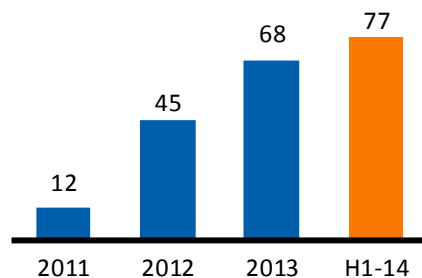
**Cost-to-income ratio YTD (%)**  
without net valuation change



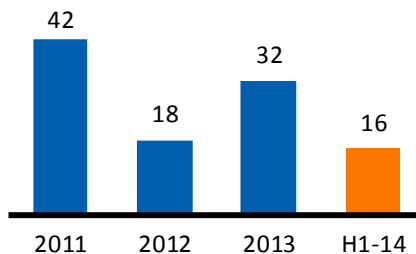
**Net interest margin YTD (%)**



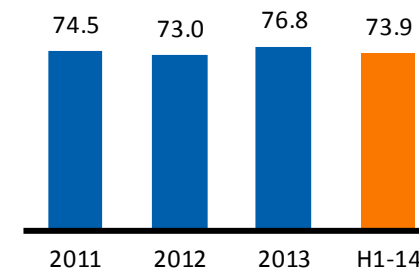
**CPI Imbalance – ISK bn.**



**FX Imbalance – ISK bn.**



**Risk weighted assets/Total assets (%)**



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