Press release, 28 November 2013

ARION BANK'S 9 MONTH 2013 FINANCIAL RESULTS

Arion Bank reported net earnings of ISK 10.1 billion for the first nine months of 2013, compared with ISK 14.5 billion for the same period in 2012. Return on equity was 10.0%, compared with 15.9% in the same period in 2012. Return on equity based on regular operations was 9.2%, compared with 11.9% in the same period in 2012. Total assets amounted to ISK 936.9 billion, compared with ISK 900.7 billion at the end of 2012.

Net earnings for the third quarter of 2013 amounted to ISK 4.2 billion, compared with ISK 3.3 billion in the same period in 2012. Return on equity in the third quarter was 12.2%, compared with 10.7% in the same period in 2012. Return on equity based on regular operations in the third quarter was 11.2%, compared with 12.4% in the same period in 2012.

The Bank's capital ratio at the end of the period was 23.6%, but was 24.3% at the end of 2012.

Highlights of the interim financial statement:

- Net earnings of ISK 10.1 billion, compared with ISK 14.5 billion during the same period in 2012.
- Earnings during the third quarter of 2013 of ISK 4.2 billion, compared with ISK 3.3 billion during the same period in 2012.
- Earnings from regular operations of ISK 9.3 billion, compared with ISK 10.9 billion during the same period in 2012.
- Operating income decreased between years to ISK 31.5 billion from ISK 34.4 billion in the same period in 2012. The main reason for this is the decrease in the interest-rate differential following an increase in term deposits and bond issues. Other income is also lower due to smaller changes in the value of assets.
- Net interest income of ISK 18.3 billion, lower than the same period in 2012 as a result of higher funding cost and lower inflation.
- Net negative valuation change on loans of ISK 0.1 billion, mostly as a result of write-downs relating to court judgments on currency-linked loans and written off loans totalling ISK 7.8 billion and an increase in the valuation of loans, primarily to corporate clients, of ISK 7.6 billion.
- Return on equity was 10.0%, compared with 15.9% in the same period in 2012. Return on equity based on regular operations was 9.2%, compared with 11.9% in the same period in 2012.
- The interest-rate differential as a percentage of average interest-bearing assets was 2.9% during the period, compared with 3.3% during the same period in 2012.
- The cost-to-income ratio was 57.6%, compared with 49.8% during the same period in 2012. The high ratio is partly explained by provisions relating to the fine imposed on Valitor by the Competition Authority and lower operating income than in the same period in 2012. The cost-to-income ratio on regular operations was 56.3%, compared with 51.3% during the same period in 2012.
- Loans to customers of ISK 576.2 billion at the end of the period, and has increased slightly from year end 2012.
- Total assets of ISK 936.9 billion, compared with ISK 900.7 billion at the end of 2012.
- Shareholders' equity at the end of the period of ISK 140.9 billion, compared with ISK 130.9 billion at the end of 2012.

Höskuldur H. Ólafsson, CEO of Arion Bank:

The Bank's third quarter figures were good and in line with our expectations. Overall we are pleased with the Bank's performance over the first nine months of the year, especially since uncertainties remain in our external environment. The Bank's core activities are stable and the financial results are to a far greater extent built on traditional banking activities rather than irregular items such as valuation changes.

We are glad to report that Arion Bank will complete the recalculation of currency-linked loans next week, when 70 customers will be informed of the results of the recalculation of their loans. The process of recalculating 3,700 currency-linked loans, which has been ongoing for the past year, is now nearing an end. There only remain a few currency-linked loans to companies where we are awaiting a decision from the Supreme Court.

The quarter also marked the fifth anniversary of the founding of Arion Bank. During this time our objective has been to develop a good bank which provides its customers with excellent service and sound advice, a bank which takes responsible decisions but is bold when needed. We hope that these aims have come across in the last few years.

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Income statement – highlights

Income Statement				
In ISK million	**9M '13**	**9M '12**	**Diff.**	**Diff. %**
Net interest income	18,313	20,134	-1,821	-9%
Net change in valuation on loans	-119	479	-598	-125%
Net interest income less val. on loans	18,194	20,613	-2,419	-12%
Net commission income	8,284	8,053	231	3%
Net financial income	1,989	491	1,498	305%
Net gain/ -loss on foreign exchange	-1,035	559	-1,594	-285%
Other income	4,035	4,643	-608	-13%
Operating income	**31,467**	**34,359**	**-2,892**	**-8%**
Salaries and related expense	-9,439	-8,813	-626	7%
Other operating expense	-8,744	-8,061	-683	8%
Net earnings before taxes	**13,284**	**17,485**	**-4,201**	**-24%**
Income tax	-2,851	-3,375	524	-16%
Bank Levy	-300	-771	471	-61%
Net earnings from continuing operation	**10,133**	**13,339**	**-3,206**	**-24%**
Net gain/ -loss from discont. operation net of tax	-3	1,198	-1,201	-
Net earnings	**10,130**	**14,537**	**-4,407**	**-30%**

Operating income

Operating income during the first nine months of 2013 amounted to ISK 31,467 million, a decrease of ISK 2,892 million from the same period in 2012. This decrease is primarily a result of the lower interest-rate differential and a decrease in other operating income from the same period in 2012.

Net interest income amounted to ISK 18,194 million during the period, compared with ISK 20,613 million during the same period in 2012. This represents a decrease between years of almost ISK 2 billion and is largely explained by lower inflation and higher interest expenses on funding, both term deposits and new borrowings in Iceland and abroad. The interest-rate differential as a percentage of average interest-bearing assets was 2.9% during the period, compared with 3.3% during the same period in 2012.

Net valuation changes on loans and receivables resulted in an expense of ISK 119 million, compared with income of ISK 479 million in the same period in 2012. There was an increase in the value of loans of ISK 7,632 million, particularly in respect of loans to larger companies. Loan impairment totalled ISK 7,751 million, which is largely a result of loans being deemed illegally linked to a foreign currency.

Net commission income remained almost unchanged between years at ISK 8,284 million, compared with ISK 8,053 million in the same period in 2012. There was a sharp increase in commission income in Investment Banking, while income from card transactions and loans has decreased.

Net financial income amounted to ISK 1,989 million, compared with ISK 491 million in the same period in 2012. Income is largely derived from the Bank's equity holdings while bond holdings also generate returns. The positive conditions on the Icelandic securities market so far this year explain the increase between years.

Net exchange rate loss amounted to ISK 1,035 million, compared with gains of ISK 559 million in the same period in 2012. The Bank's net foreign exchange balance was ISK 26.3 billion at the end of the period which meant that volatility in the exchange rate had a significant impact on operating income. The foreign exchange balance is within the 15% limit imposed by the Central Bank of Iceland. It is the Bank's policy to have a strong liquidity in foreign currency. However, the exchange rate in the first nine months of the year meant this policy generated an exchange rate loss during the period.

Other operating income amounted to ISK 4,035 million, compared with ISK 4,643 million in the same period in 2012. The main types of income included in other operating income are lease income from commercial property owned by Landfestar and Landey and income from insurance premiums at OKKAR Life Insurance, all of which are subsidiaries of the Bank. It also includes valuation changes and profits on investment properties owned by the Bank's real estate companies, and this largely accounts for the decrease between years – valuation changes and profits on the sale of investment properties were higher in the same period in 2012.

Operating expenses

Operating expenses amounted to ISK 18,183 million, an increase of ISK 1,309 million or 7.8% from the same period in 2012. Operating expenses include a fine of ISK 500 million imposed on Valitor by the Competition Authority, which has been ratified by the Competition Authority Appeals Committee. Excluding the fine, operating expenses increased by ISK 809 million or 4.8%. The cost-to-income ratio was 57.6% during the period, compared with 49.8% during the same period in 2012. The cost-to-assets ratio was 2.6% during the period, compared with 2.5% in the same period in 2012. The cost-to-income ratio is heavily influenced by the decrease in operating income relating to lower net interest income and the aforementioned fine imposed on Valitor.

Salaries and related expenses amounted to ISK 9,439 million, compared with ISK 8,813 million in the same period in 2012. There were on average 1,164 full-time equivalent positions at Arion Bank during the period, compared with 1,160 in the same period in 2012. The average salary has increased by 5.0% which is less than the 5.5% increase in the salary index between periods.

Other operating expenses amounted to ISK 8,744 million, compared with ISK 8,061 million in the same period in 2012. This increase of ISK 683 million is largely related to the fine imposed on Valitor by the Competition Authority. In other respects other operating expenses were as expected.

Taxes

Income tax amounted to ISK 2,851 million, compared with ISK 3,375 million in the same period in 2012. The effective income tax rate is slightly higher than in the same period in 2012, 21.5% during the first nine months of 2013 and 19.3% in 2012.

Special tax on financial companies amounted to ISK 300 million, compared with ISK 771 million in the same period in 2012. The decrease is due to a lower tax rate in 2013 than in the previous two years.

Discontinued operations

Net expenses from discontinued operations amounted to ISK 3 million, compared with net income of ISK 1,198 million in the same period in 2012. In 2012 the Bank generated capital gains from the sale of a major shareholding in Hagar and the sale of the Bank's share in N1. The sale of assets during the first nine months of this year had an insignificant effect and there was a loss on other discontinued operations and foreclosure assets owned by the Bank.

Third quarter of 2013

The financial results for the third quarter of 2013 were most satisfactory. Return on equity was 12.2%, compared with 10.7% in the same period in 2012.

Income Statement

In ISK million	Q3 '13	Q3 '12	Diff.	Diff. %
Net interest income	5,646	6,254	-608	-10%
Net change in valuation on loans	-253	-2,053	1,800	-88%
Net interest income less val. on loans	5,393	4,201	1,192	28%
Net commission income	2,986	2,715	271	10%
Net financial income	445	161	284	176%
Net gain/ -loss on foreign exchange	213	708	-495	-70%
Other income	1,610	1,637	-27	-2%
Operating income	**10,647**	**9,422**	**1,225**	**13%**
Salaries and related expense	-2,760	-2,644	-116	4%
Other operating expense	-2,516	-2,586	70	-3%
Net earnings before taxes	**5,371**	**4,192**	**1,179**	**28%**
Income tax	-1,102	-462	-640	139%
Bank Levy	-112	-261	149	-57%
Net earnings from continuing operation	**4,157**	**3,469**	**688**	**20%**
Net gain/ -loss from discont. operation net of tax	62	-181	243	-
Net earnings	**4,219**	**3,288**	**931**	**28%**

Operating income during the third quarter of 2013 increased by 13% compared to the same period last year. Interest income and exchange rate gains decreased slightly between years. The increase in operating income between years is explained by commission income, financial income on securities holdings and the decrease in write-downs on loans.

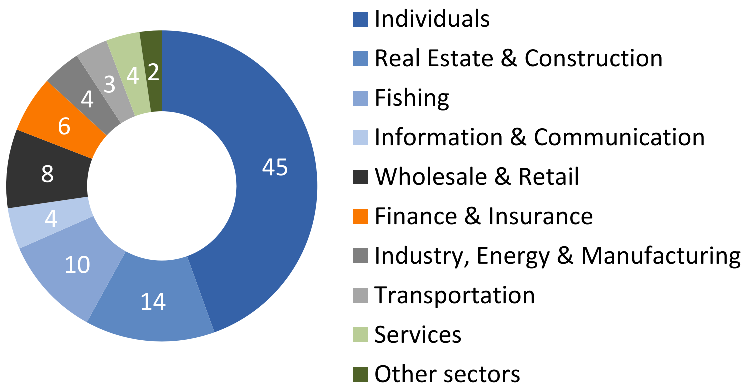
Operating expenses during the third quarter of 2013 increased slightly from the same period in 2012 and this almost solely relates to an increase in salary expenses, both contractual increases and the 1.3% rise in the financial sector tax rate in 2013.

Balance sheet – highlights

Assets					
In ISK million	**30.09.2013**	**31.12.2012**	**Diff.%**	**30.09.2012**	**Diff.%**
Cash & balances with CB	20,116	29,746	-32%	16,026	26%
Loans to credit institutions	113,202	101,011	12%	88,007	29%
Loans to customers	576,204	566,610	2%	572,484	1%
Financial assets	154,387	137,800	12%	137,924	12%
Investment properties	29,382	28,919	2%	28,171	4%
Non-current assets & disp.groups HFS	9,931	11,923	-17%	13,711	-28%
Other assets	33,722	24,666	37%	19,922	69%
Total assets	**936,944**	**900,675**	**4%**	**876,245**	**7%**

Arion Bank had *total assets* of ISK 936,944 million at the end of the period, compared with ISK 900,675 million at the end of 2012. Changes during the period are insignificant and can largely be attributed to increased liquidity and securities holdings. The Bank remains financially robust and the liquidity ratio is 35.5% and the cash ratio is 28.9%, compared with 32.9% and 30.8% respectively at the end of 2012. The statutory minimums for these ratios are 20% and 5%.

Loans to customers



Loans to customers amounted to ISK 576,204 million at the end of September 2013, compared with ISK 566,610 million at the end of 2012. A substantial amount of new loans were issued in the first nine months of 2013 and a substantial amount was paid off, meaning that the loan portfolio remained virtually unchanged. The ratio of loans to individuals has increased significantly in recent years. At the end of 2010 loans to individuals represented 24.7% of the total portfolio but the figure had reached 45% by the end of September 2013. The Bank believes that this figure will continue to rise in the medium term and ratio will be similar at Arion Bank to that at the major Nordic banks, where loans to individuals constitute approximately 50% of the total portfolio.

Securities

Securities holdings amounted to ISK 154,387 million at the end of the period, compared with ISK 137,800 million at the end of 2012.

Securities					
In ISK million	**30.09.2013**	**31.12.2012**	**Diff.%**	**30.09.2012**	**Diff.%**
Bonds	131,511	117,730	12%	119,697	10%
Shares and instruments w. variable income	17,748	16,844	5%	15,860	12%
Derivatives	1,080	788	37%	969	11%
Securities used for hedging	4,048	2,438	66%	1,398	190%
Securities total	**154,387**	**137,800**	**12%**	**137,924**	**12%**

Changes in this asset class are mainly linked to the management of the Bank’s liquidity, i.e. buying bonds.

Non-current assets and disposal groups held for sale

Non-current assets and disposal groups held for sale amounted to ISK 9,931 million at the end of September 2013, compared with ISK 11,923 million at the end of 2012. The decrease is largely due to the sale of Fram Foods Ísland hf. and some large real estate properties have also been sold. The main assets in this category are real estate and shareholdings in companies which have been acquired by the Bank in connection with the settlement of customers’ loans.

Liabilities and equity

Liabilities and equity

In ISK million	30.09.2013	31.12.2012	Diff.%	30.09.2012	Diff.%
Due to credit institutions & CB	28,548	32,990	-13%	16,459	73%
Deposits from customers	471,768	448,683	5%	454,405	4%
Non current liab. & disp.groups HFS	591	1,769	-67%	2,683	-78%
Financial liabilities at fair value	9,834	13,465	-27%	11,122	-12%
Other liabilities	46,442	43,585	7%	37,689	23%
Borrowings	206,065	195,085	6%	192,953	7%
Subordinated loans	32,809	34,220	-4%	32,502	1%
Equity	140,887	130,878	8%	128,432	10%
Total liabilities and equity	**936,944**	**900,675**	**4%**	**876,245**	**7%**

Total liabilities amounted to ISK 796,057 million at the end of September, compared with ISK 769,797 million at the end of 2012. The increase is primarily attributable to bond issues in Iceland and abroad during the period, while deposits have also increased.

Deposits

Total deposits amounted to ISK 500,316 million at the end of the period, compared with ISK 481,673 million at the end of 2012. Investment options have been limited in recent years and deposits have remained at a similar level. The Bank has made systematic efforts in recent years to increase its term deposits in order to make its funding more secure.

Borrowings

Borrowings amounted to ISK 206,065 million at the end of September 2013, compared with ISK 195,085 million at the end of 2012. This increase is explained by the Bank's issue of ISK 4.8 billion in indexed and non-indexed covered bonds, which are listed on NASDAQ OMX Iceland, and NOK 500 million (approx. ISK 11 billion) in bonds which were sold to international investors and are listed on the Oslo Stock Exchange. The total increase has been reduced by the appreciation of the Icelandic króna and repayments of long-term liabilities. The Bank will continue to work on diversifying its funding base, both in Iceland and internationally.

Subordinated liabilities

Subordinated liabilities amounted to ISK 32,809 million at the end of the period, compared with ISK 34,220 million at the end of 2012. The change is solely related to changes in the exchange rate of foreign currencies linked to the loans.

Shareholders’ equity

Shareholders' equity amounted to ISK 140,887 million at the end of September 2013, compared with ISK 130,878 million at the end of 2012. The change relates entirely to the 9 month 2013 financial results. The capital ratio calculated in accordance with the rules of the FME was 23.6% at the end of the period, compared with the statutory minimum of 8%.

Key performance indicators

	9M 2013	2012	9M 2012
Return on equity (ROE)	10.0%	13.8%	15.9%
Return on total assets (ROA)	1.5%	1.9%	2.2%
Net interest margin (int.bearing assets)	2.9%	3.4%	3.3%
Net interest margin (total assets)	2.7%	3.1%	3.0%
Cost-to-income ratio	57.6%	49.8%	49.8%
Cost-to-Total assets ratio	2.6%	2.8%	2.5%
Effective tax rate	21.5%	18.0%	21.0%
CAD-ratio	23.6%	24.3%	22.5%
Tier 1 ratio	18.9%	19.1%	17.7%
Problem loans	8.2%	12.5%	16.5%
RWA/Total Assets	73.7%	73.0%	78.7%
Loans to deposit ratio	122.1%	126.3%	126.0%
Secured liquidity ratio	35.5%	32.9%	30.6%
Cash ratio	28.9%	30.8%	17.7%
The Group's average number of employees	1,164	1,166	1,160
The Group's employees at the end of the period	1,139	1,190	1,177
The parent's average number of employees	927	927	921
The parent's empl. at the end of the period	906	949	936

Financial calendar

The Bank's interim financial statements are scheduled for publication on the dates stated below.

Annual financial statement for 2013	26 February 2014
Annual General Meeting 2014	20 March 2014
First quarter 2014	21 May 2014
Second quarter 2014	27 August 2014
Third quarter 2014	20 November 2014

This calendar may be subject to change.