

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 surrounding environment. The structure is angular and contemporary.

# FINANCIAL STATEMENTS FOR Q1 2014

INVESTOR PRESENTATION  
21 MAY 2014

# HIGHLIGHTS OF Q1 2014

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- Acceptable results
- Challenge to increase net interest income
- Very good progress in commission income
- Ongoing focus on operating expenses
- Special income tax and bank levy a major burden
- Irregular items still have large effect
- Stable lending in a low demand environment
- Balance sheet largely unchanged
- Strong capital and liquidity



# HIGHLIGHTS OF Q1 2014

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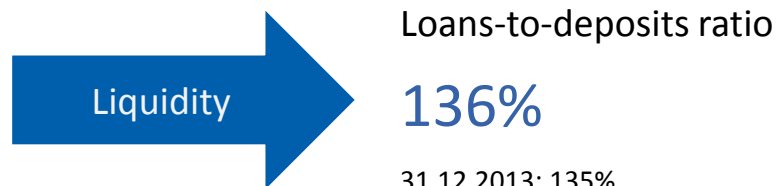
## FINANCIALLY ROBUST BANK WITH STABLE OPERATIONS

- Stable operations
  - ROE of 7.8%
  - Irregular items still have an effect
- Credit rating assigned by Standard & Poor's (S&P) at the beginning of 2014 – BB+
- Equal opportunities action plan published
- Arion Bank intranet nominated for Icelandic web awards 2013
- New Director elected to the Board
  - Kirstín Th. Flygenring
- The Bank agreed to extend partnership with Icelandair to issue frequent flyer credit cards
  - Cardholders at Arion Bank now collect frequent flyer points on all domestic transactions
- The Bank participated in a financial literacy week. The Bank is one of the main sponsors of the Institute for Financial Literacy
- The Bank was one of the main sponsors of the Men and Cancer or Moustache March campaign which was organized by the Icelandic Cancer Society
- Number of meetings, courses, conferences and lectures held in Borgartún

# HIGHLIGHTS Q1 2014



# FINANCIAL HIGHLIGHTS





# INCOME STATEMENT



# INCOME STATEMENT

BETTER PERFORMANCE COMPARED TO SAME PERIOD LAST YEAR

Decrease in net interest income related to low inflation in January and March and deflation in February

Higher commission income primarily driven by the card business

Positive net valuation change mainly related to restructuring

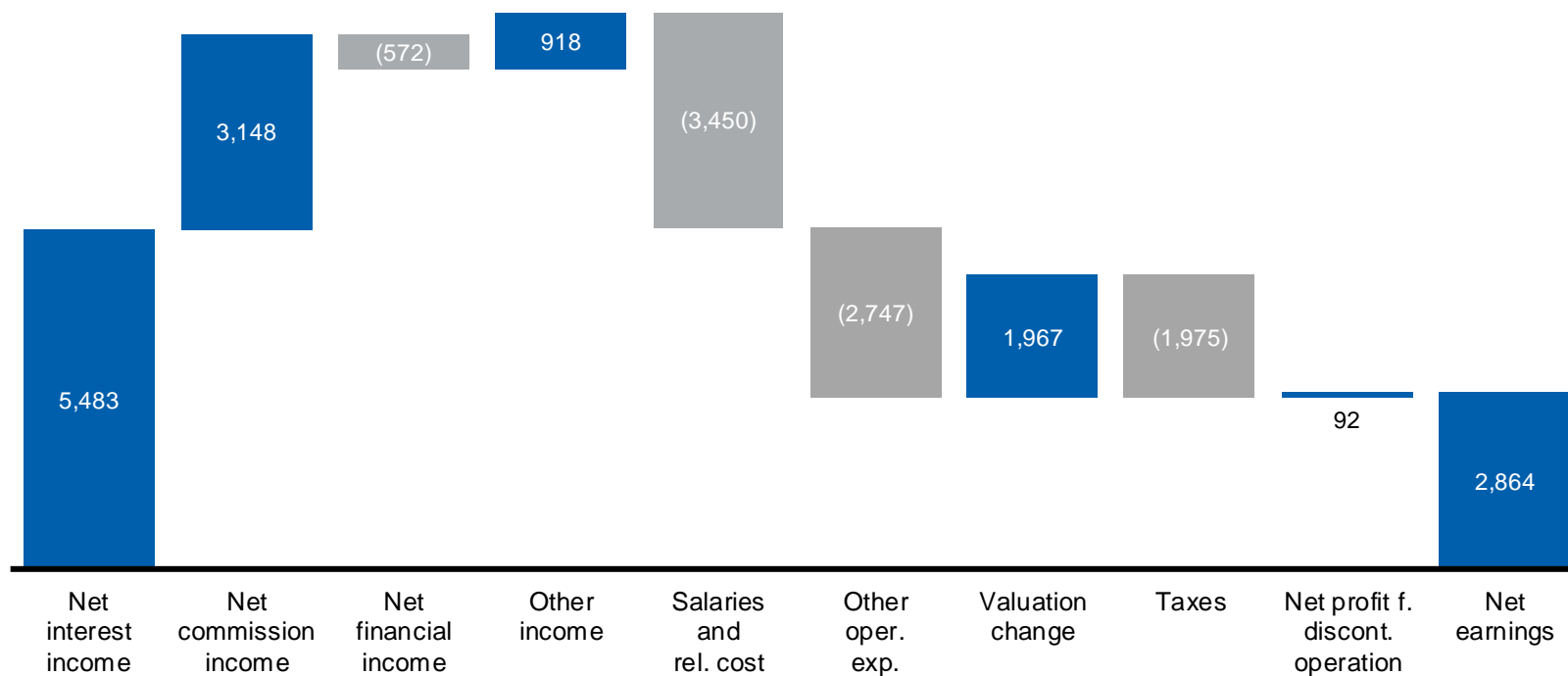
Effective income tax rate is 27%, mainly because of non-deductible loss from shares

Bank levy was raised at the end of the year 2013 and was not reflected in Q1 2013

Million ISK	Q1 2014	Q1 2013	Diff	%
Net interest income	5,483	6,288	(805)	(13%)
Net commission income	3,148	2,449	699	29%
Net financial income	(572)	(827)	255	(31%)
Other income	918	1,176	(258)	(22%)
<b>Operating income</b>	<b>8,977</b>	<b>9,086</b>	<b>(109)</b>	<b>(1%)</b>
Salaries and related cost	(3,450)	(3,322)	(128)	4%
Other operating expenses	(2,747)	(3,277)	530	(16%)
Net change in valuation	1,967	(322)	2,289	(711%)
<b>Net earnings before taxes</b>	<b>4,747</b>	<b>2,165</b>	<b>2,582</b>	<b>119%</b>
Income tax	(1,315)	(586)	(729)	124%
Bank levy	(660)	(91)	(569)	625%
Net gain from discontinued operations, net of tax	92	(79)	171	(216%)
<b>Net earnings</b>	<b>2,864</b>	<b>1,409</b>	<b>1,455</b>	<b>103%</b>
Shareholders of Arion Bank	2,808	1,697	1,111	65%
Minority interest	56	(288)	344	(119%)

# INCOME STATEMENT

## BREAKDOWN OF NET EARNINGS IN Q1 2014



In ISK million



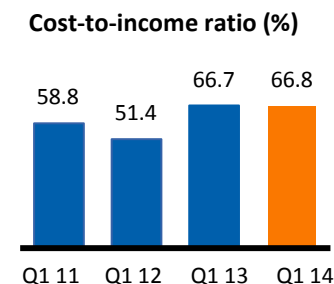
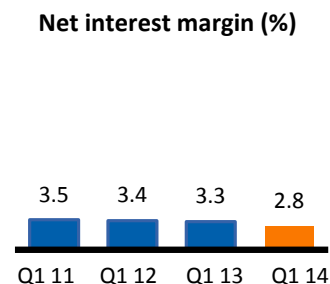
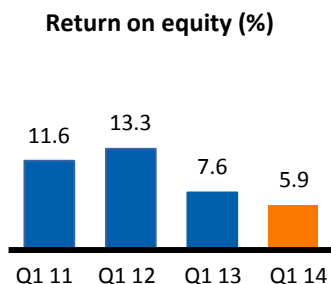
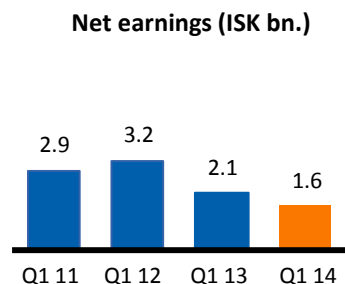
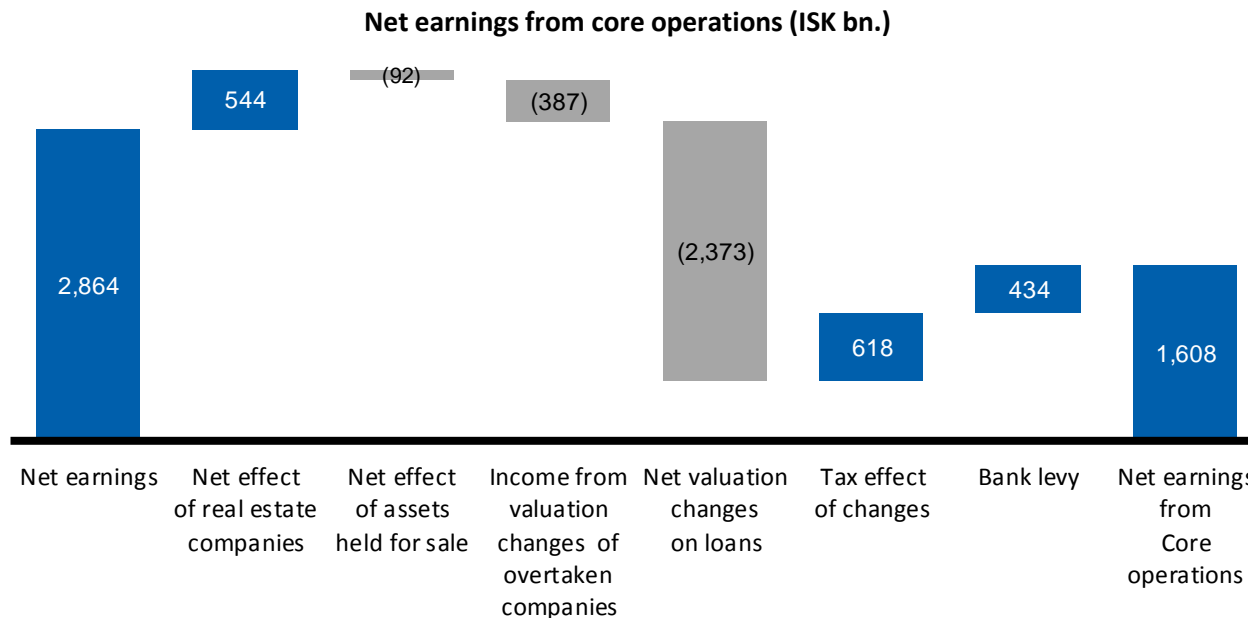
# CORE INCOME

## LOW NET INTEREST INCOME AND FX LOSS HAVE A NEGATIVE EFFECT ON CORE EARNINGS

FX loss included in core operating income

- Has a negative effect on performance

Decrease in net interest margin has the most single negative effect on core operations



# NET INTEREST INCOME

LOWER BUSINESS RISK IS AN IMPORTANT FACTOR IN LOWER NET INTEREST INCOME

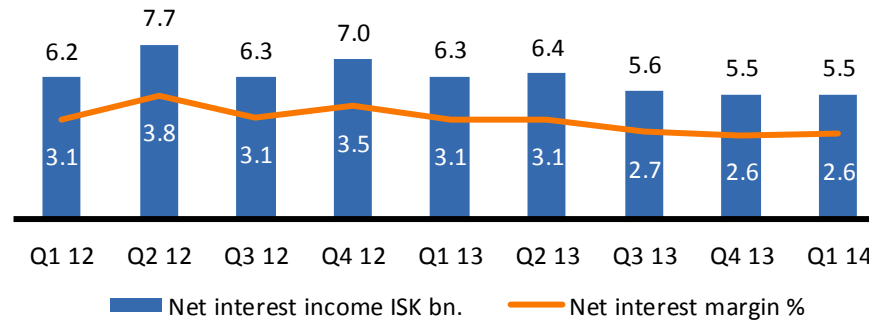
Net interest income is stable in spite of external pressures

Increased inflation imbalance has a negative effect on net interest margin

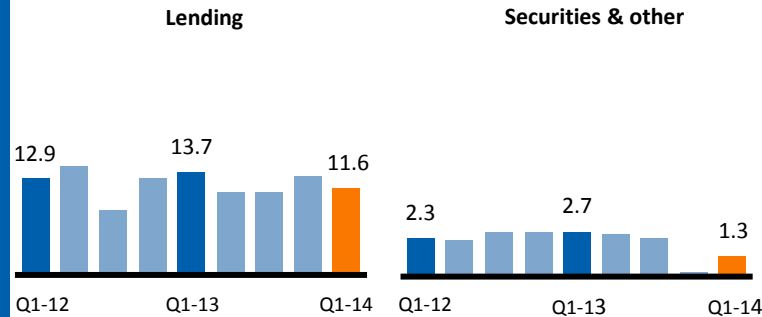
Continued pressure on interest margin due to more competition in corporate lending

Focus on maturity of deposits and wholesale funding has effect on interest expense

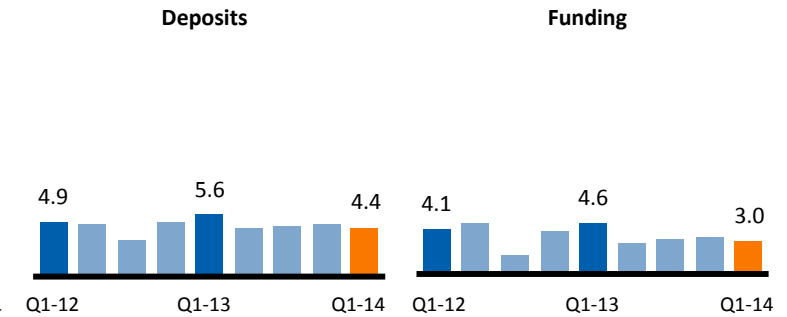
By quarters from Q1 2012 – Q1 2014



Interest income by type (ISK bn.)



Interest expense by type (ISK bn.)



# NET COMMISSION INCOME

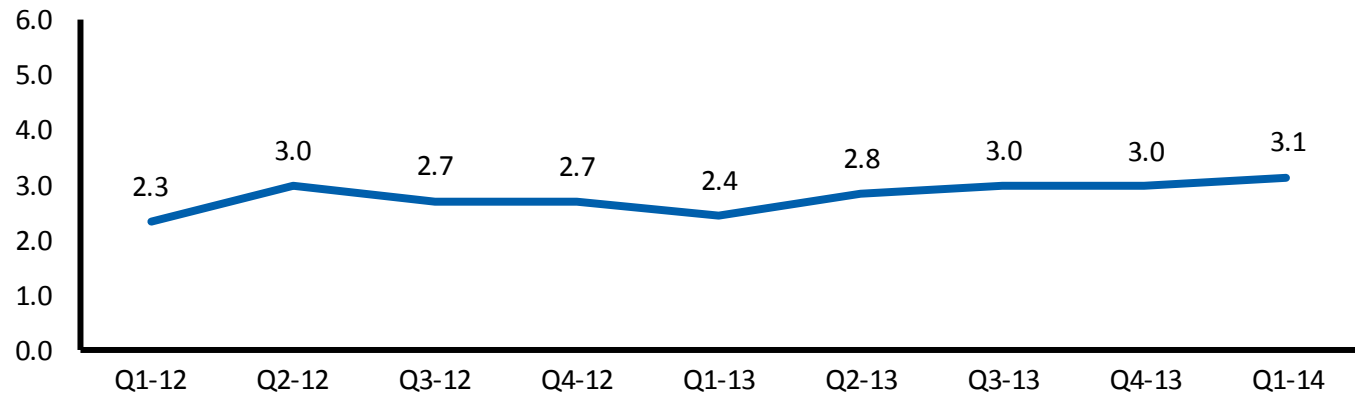
## STRONG PLATFORM FOR FUTURE GROWTH

Good progress in net commission income, increase by 29% from Q1 2013

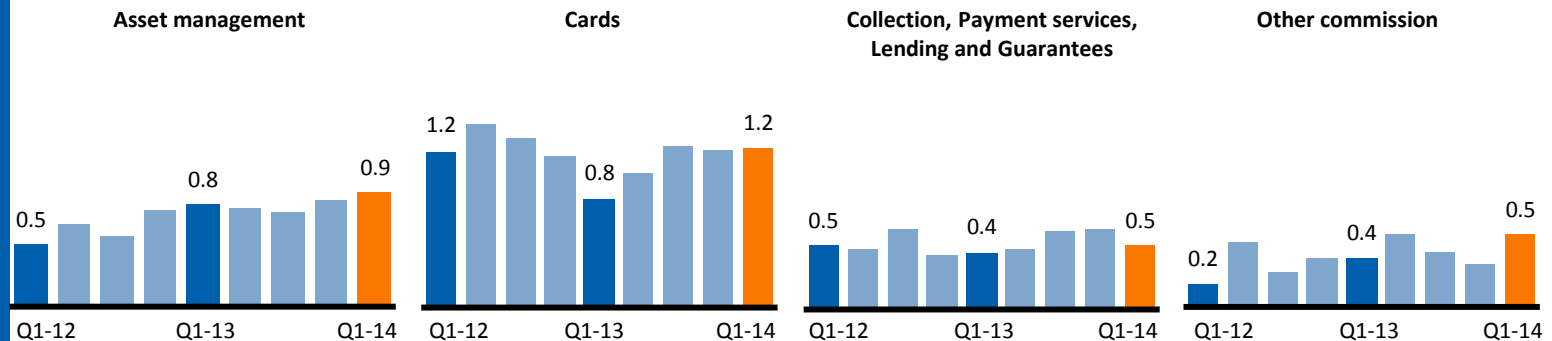
Gradual increase in commission from asset management and cards

Other commission mainly from investment banking activities

Net commission income from Q1 2012 – Q1 2014 (ISK bn.)



By type from Q1 2012 – Q1 2014 (ISK bn.)



# NET FINANCIAL INCOME

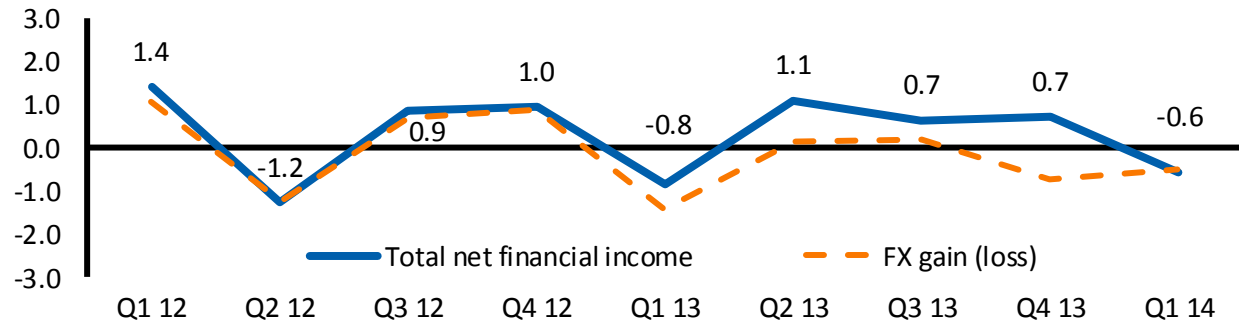
## REDUCED FX IMBALANCE RESULTING FROM DIRECT MEASURES TAKEN BY THE BANK

FX loss continues due to further appreciation of the Icelandic Króna

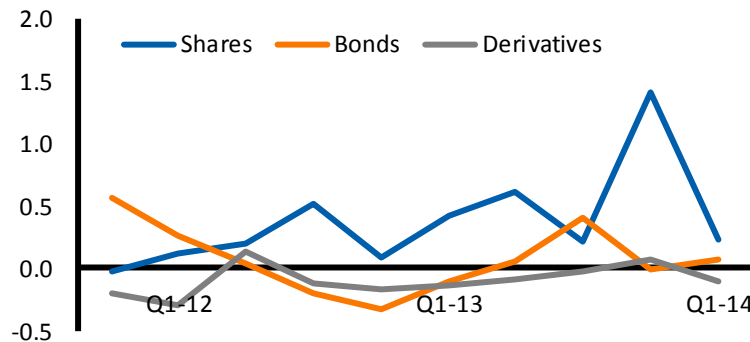
Volatility in income from shares and bonds

FX imbalance has been decreasing by the Bank from year-end by ISK 11 billion

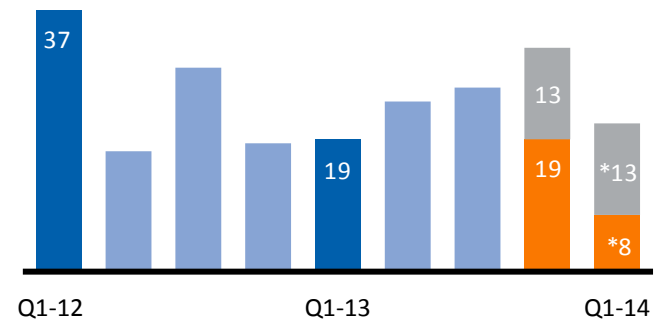
By quarters from Q1 2012 – Q1 2014 (ISK bn)



Other financial income from Q1 2012 – Q1 2014 (ISK bn.)



FX imbalance from Q1 2012 – Q1 2014 (ISK bn.)



\*Arion Bank has ISK 8 bn. and subsidiaries ISK 13 bn. in FX imbalance

# OTHER INCOME

## VALUATION CHANGES HAVE A STRONG IMPACT

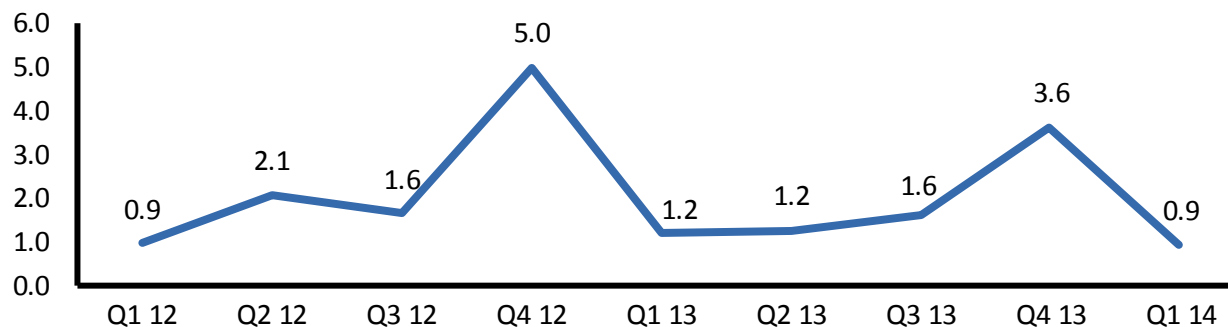
Stable income from investment properties aside from valuation changes and individual sales

No valuation changes in Q1

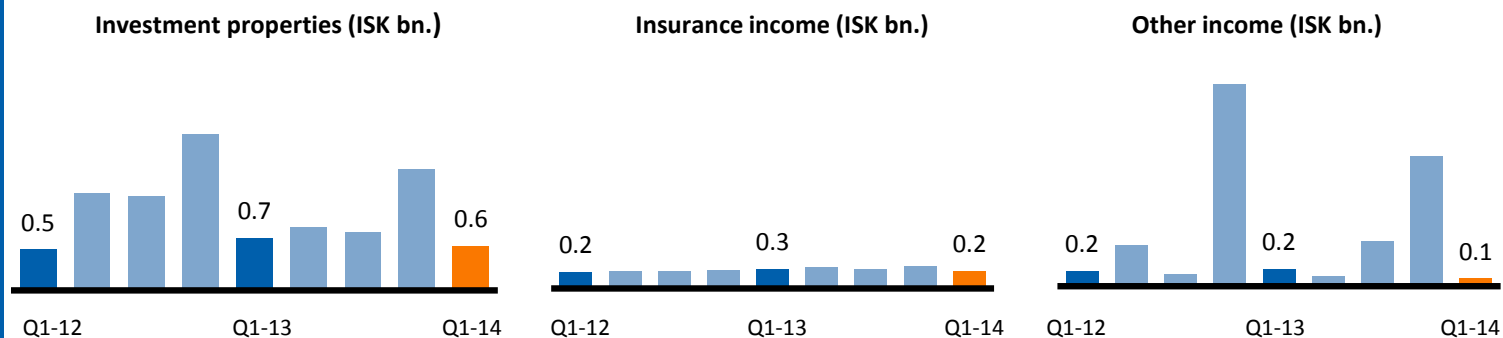
Stable insurance income from Okkar líf which is a life insurance subsidiary

Other income is irregular due to valuation of associates

By quarters from Q1 2012 – Q1 2014



Other income by type from Q1 2012 – Q1 2014





# TOTAL OPERATING EXPENSE

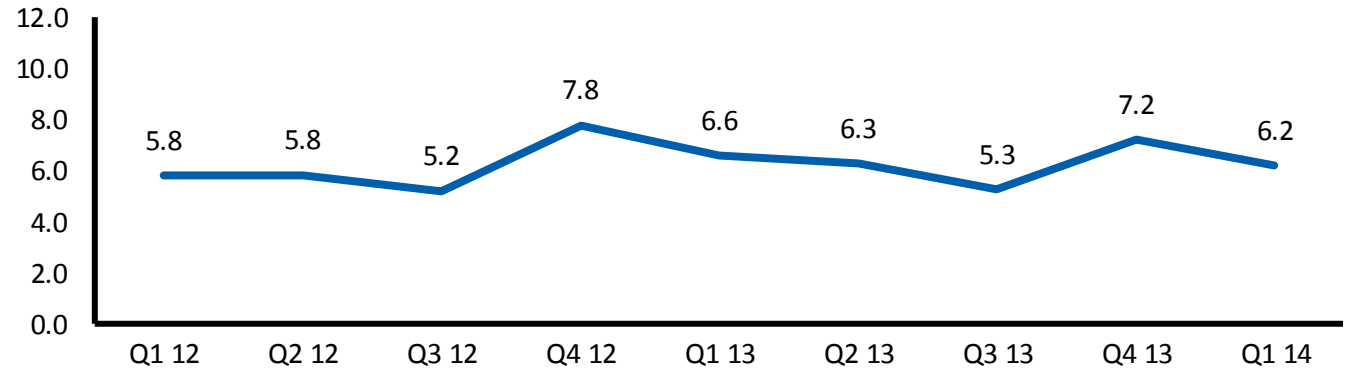
TRENDS IN OPERATING EXPENSE ARE IN THE RIGHT DIRECTION

Operating expense has decreased by 6% from Q1 2013

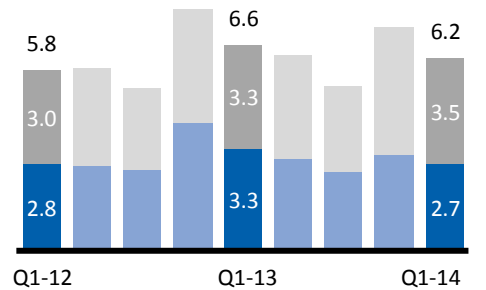
Number of employees gradually reducing

Operating efficiency will be a focus for the Bank in the near term

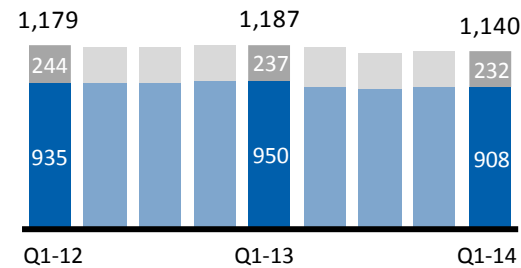
By quarters from Q1 2012 – Q1 2014 (ISK bn.)



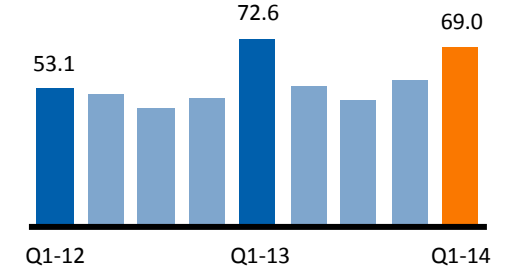
By type (ISK bn.)



Total employees



Cost-to-income ratio (%)



■ Salaries & relat. exp. ■ Other oper.exp. ■ Parent company ■ Subsidiaries

# BALANCE SHEET



# BALANCE SHEET

## STABILITY IN THE BALANCE SHEET

Changes mainly related to liquidity management

Funding profile is strong

<b>Assets</b>					
<b>Billion ISK</b>	<b>31.03.2014</b>	<b>31.12.2013</b>	<b>Diff%</b>	<b>31.03.2013</b>	<b>Diff%</b>
Cash & balances with CB	19	38	(51%)	28	(33%)
Loans to credit institutions	95	102	(7%)	103	(8%)
Loans to customers	642	636	1%	566	14%
Financial assets	100	87	15%	146	(31%)
Investments properties	29	29	(0%)	28	1%
Other assets	49	48	2%	37	32%
<b>Total assets</b>	<b>933</b>	<b>939</b>	<b>(1%)</b>	<b>907</b>	<b>3%</b>

<b>Liabilities and Equity</b>					
<b>Billion ISK</b>	<b>31.03.2014</b>	<b>31.12.2013</b>	<b>Diff%</b>	<b>31.03.2013</b>	<b>Diff%</b>
Due to credit institutions & CB	26	28	(7%)	22	20%
Deposits from customers	471	472	(0%)	462	2%
Other liabilities	54	58	(6%)	55	(1%)
Borrowings	203	205	(1%)	204	(1%)
Subordinated loans	31	32	(2%)	32	(2%)
Equity	148	145	2%	132	12%
<b>Total liabilities and equity</b>	<b>933</b>	<b>939</b>	<b>(1%)</b>	<b>907</b>	<b>3%</b>

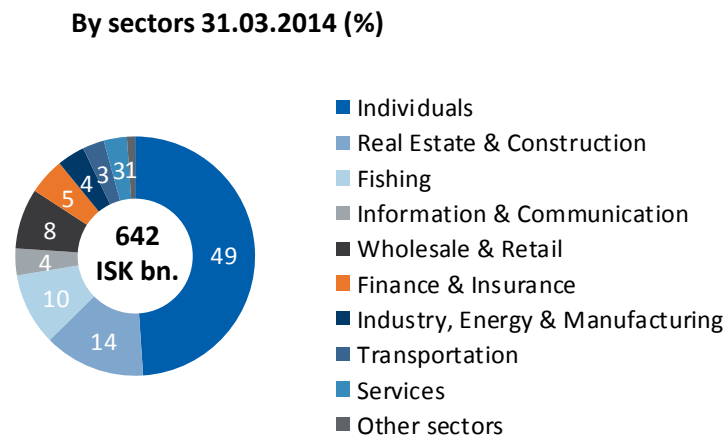
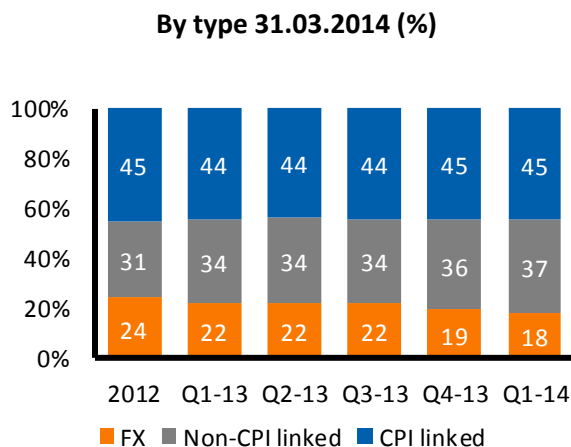
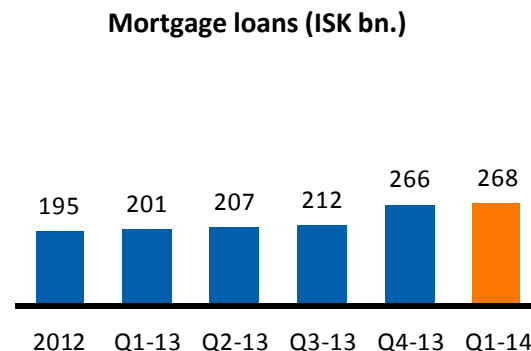
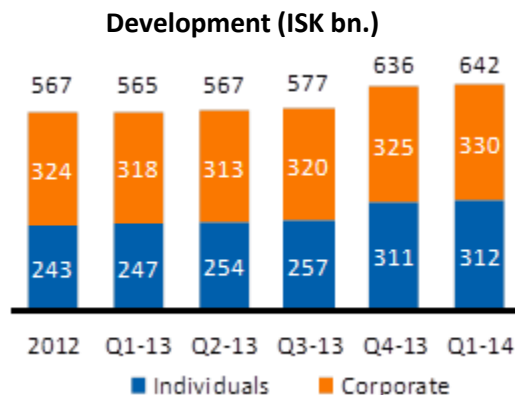
# LOANS TO CUSTOMERS ARE WELL DIVERSIFIED

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

Slow growth in the corporate portfolio is in line with moderate economic growth and modest investment climate

Arion Bank continues to have a strong position on the mortgage loan market

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



# IMPROVING ASSET QUALITY

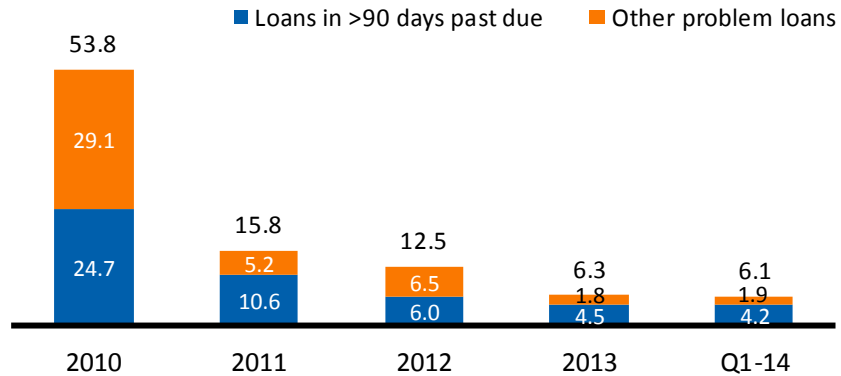
## THE BANK CONTINUES TO FOCUS ON REDUCING PROBLEM LOANS

Problem loans have continued to decrease since their peak in 2010

Loans in over 90 days default have also been decreasing

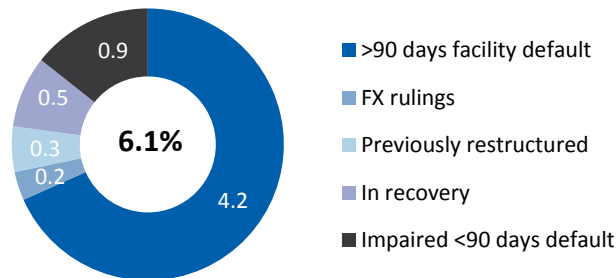
The focus on problem loans is ongoing and the objective is to be well below 5% at year end 2014

Development of problem loans (%)

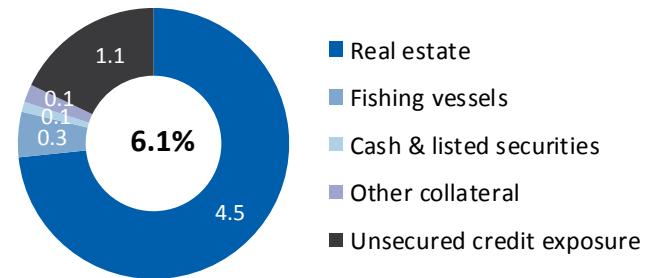


The Bank defines problem loans as book value of loans ( i.e. net of impairment) that are either individually impaired or are in over 90 days past due and not impaired as % of total book value of loans to customers

Problem loans by status (%)



Collateral behind problem loans (%)





# STRONG FUNDING PROFILE

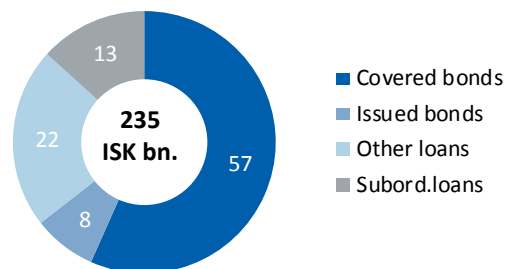
NO SIGNIFICANT REDEMPTION OF LONG-TERM FUNDING IN THE MEDIUM TERM

Limited need for refinancing

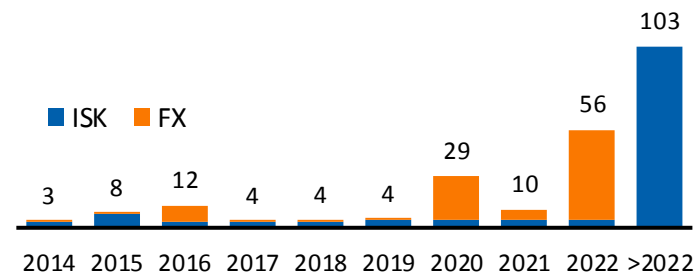
Term deposits now stable at acceptable level

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

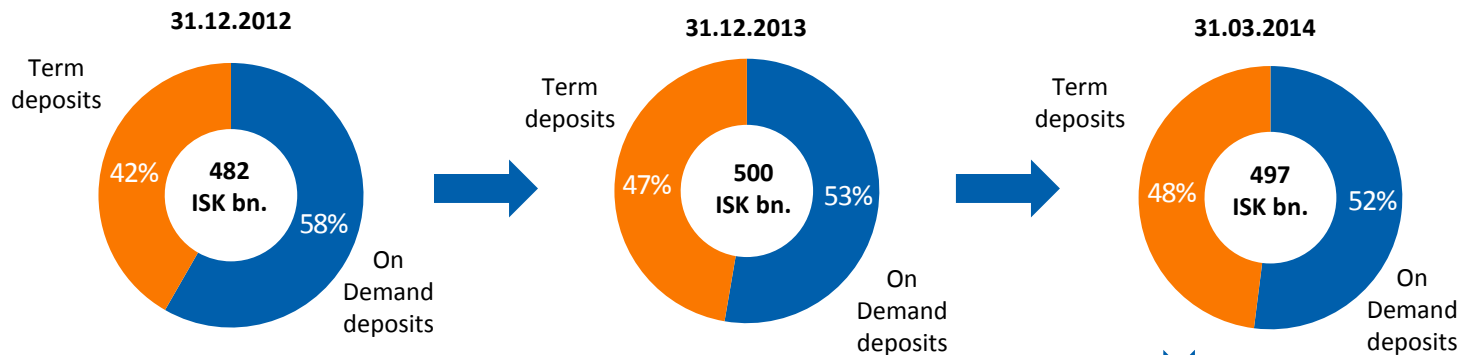
Funding mix (%)



Maturity of long-term funding 31.03.2014 (ISK bn.)



Development of total deposits by maturity



# VERY SOLID CAPITAL BASE

WITH HIGH QUALITY CAPITAL WITH NO RELIANCE ON HYBRID INSTRUMENTS

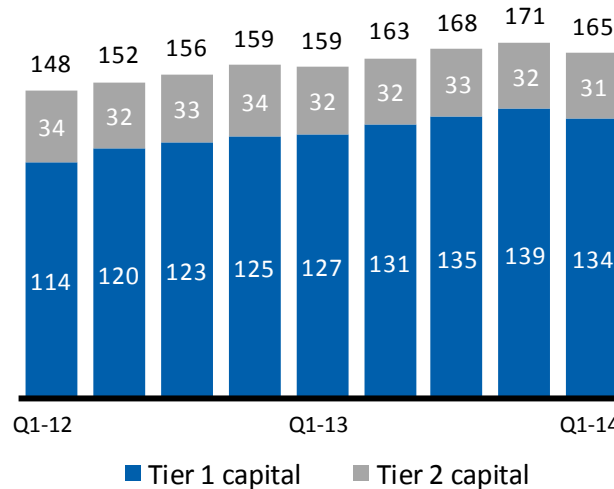
Arion Bank has maintained very solid levels of capitalization due to strong profit generation

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

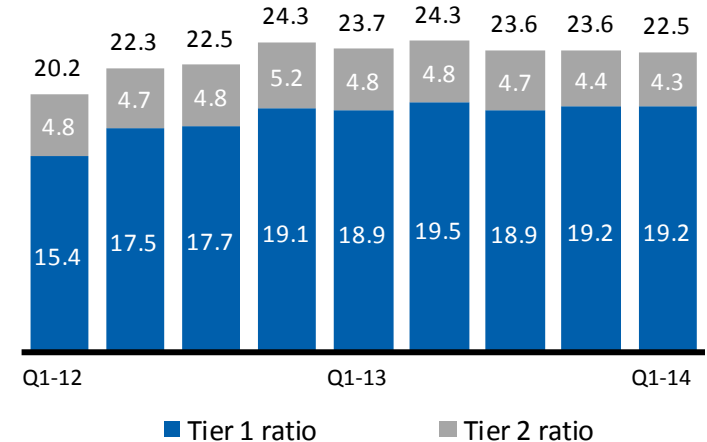
The decrease in CAD from year-end 2013 is mainly because of approved dividend payment, which was made in May 2014

Official capital ratio is in every Q1 and Q3 based on audited retained earnings at 31 December or 30 June each year

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



**Total capital ratio (%)**



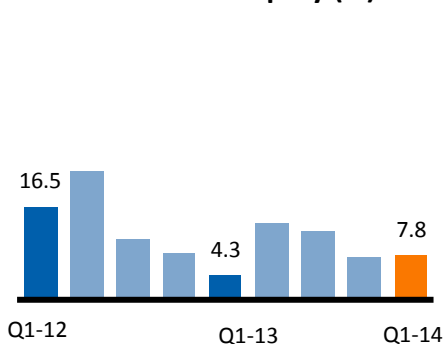
# KEY FINANCIAL INDICATORS



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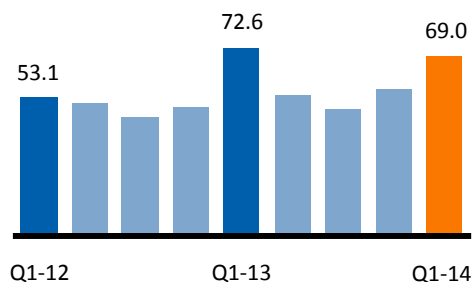
STILL TOO MUCH VOLATILITY IN PROFITABILITY FOR MANY REASONS

**Return on equity (%)**

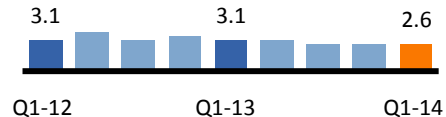


**Cost-to-income ratio (%)**

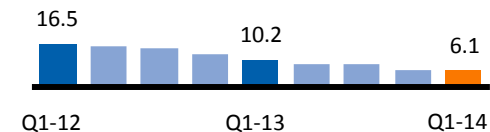
without net valuation change



**Net interest margin (%)**

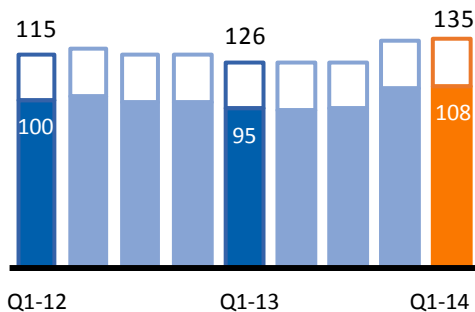


**Problem loans\* (%)**

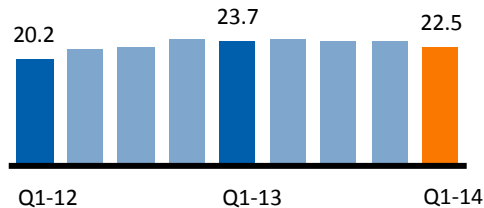


**Loans-to-deposits ratio (%)**

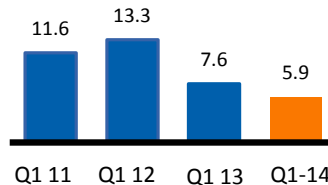
without loans financed with covered bonds



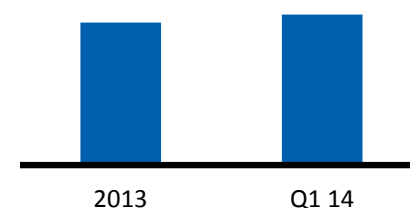
**Total capital ratio (%)**



**Core return on equity (%)**



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



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

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