Earnings Press Release, 29 July 2020

Arion Bank's Q2 2020 financial results

- Arion Bank's earnings improve substantially
- Net earnings of ISK 4,958 million from continuing operations, improvement of 76% from Q2 2019
- Return on equity 10.5%, compared with 4.3% in Q2 2019
- Net interest margin 2.9% and improves between years despite lowering interest environment
- Core revenues increase by 1.8% between years
- Operating expenses decreases by 3.5%, mainly due to organizational changes in 2019
- Impairments on loans decrease from the first quarter but uncertainty remains due to the pandemic
- Valitor's operations improve but volatility can be expected in discontinued operation at lower level

Arion Bank reported net earnings of ISK 4,958 million from continuing operations in the second quarter and ISK 3,676 million from continuing operations during the first six months of the year. Net earnings amounted to ISK 4,913 million for the quarter and ISK 2,742 million for the first six months. Return on equity was 10.5% for the quarter and 2.9% for the first six months of the year.

Total assets amounted to ISK 1,182 billion at the end of June 2020, compared with ISK 1,082 billion at the end of 2019. Liquid assets increased as the proposed ISK 10 billion dividend payment did not materialize, the Bank issued AT1 in February and deposits increased. Loans to customers increased slightly from year-end 2019, mainly due to mortgage lending. Deposits increased by 12.8% from year-end 2019. Total equity amounted to ISK 189 billion at the end of June, compared with ISK 190 billion at the end of 2019.

The Bank's capital ratio at the end of June 2020 was 28.1%, compared with 24.0% at the end of 2019. The CET 1 ratio was 22.9% at the end of June 2020, compared with 21.2% at the end of 2019. The Group's own funds increased by ISK 28.1 billion from year-end 2019, primarily due to the successful issuance of a USD 100 million Additional Tier 1 capital instrument in February 2020, and as a result of the Board of Directors' decision to propose that no dividends are paid in connection with operations in 2019 in light of the Covid-19 pandemic.

The Bank is committed to its medium-term targets, assuming the economy recovers in the medium term.

Highlights of the Income Statement and key income related performance indicators:

In ISK millions	Q2 2020	Q2 2019	% diff.
Net interest income	7,857	7,808	1%
Net commission income	2,688	2,478	8%
Net insurance income	761	823	(8%)
Net financial income	2,691	1,023	163%
Other operating income	66	88	(25%)
Operating income	**14,063**	**12,220**	**15%**
Salaries and related expenses	(3,577)	(3,805)	(6%)
Other operating expenses	(2,818)	(2,813)	0%
Operating expenses	**(6,395)**	**(6,618)**	**(3%)**
Bank levy	(324)	(912)	(64%)
Net impairment	(918)	(988)	(7%)
Net earnings before income tax	**6,426**	**3,702**	**74%**
Income tax expense	(1,468)	(891)	65%
Net earnings from cont. operations	**4,958**	**2,811**	**76%**
Discontinued operations, net of tax	(45)	(715)	(94%)
Net earnings	**4,913**	**2,096**	**134%**
KPI's			
Return on equity	10.5%	4.3%	
Earnings per share (in ISK)	2.86	1.16	
Cost to income ratio	45.5%	54.2%	

Highlights of the Balance Sheet and key performance indicators:

In ISK millions	**30.06.2020**	**31.12.2019**	**Diff.**	**% diff.**
Loans to customers	779,902	773,955	5,947	1%
Other assets	402,347	307,900	94,447	31%
Liabilities	993,422	892,030	101,392	11%
Equity	188,827	189,825	(998)	(1%)
Loans to Deposits ratio	140.3%	157.0%		
REA / Total assets	60.6%	66.5%		
CET1 ratio	22.9%	21.2%		
Capital adequacy ratio	28.1%	24.0%		

Benedikt Gíslason, CEO of Arion Bank

"Arion Bank's financial results for the second quarter are most satisfactory and we have achieved our target of 10% return on equity. This is particularly pleasing given that the Bank's capital ratio is exceptionally strong and far in excess of the requirements made by the regulators. Regular operations developed positively in the quarter, and unusually high financial income, both from equities and fixed income holdings, had a very positive impact on the results. Improving regular operations therefore remains a key priority. The subsidiaries Vörður and Stefnir are performing well and Valitor, which is for sale, has reduced its losses after undergoing restructuring at the beginning of the year. The aim is to strengthen Valitor's core business, and the company's operations in Denmark were sold during the quarter. Although there is still some way to go before the goals of restructuring are fully realized, excellent results have already been attained.

Despite the positive second quarter results, the Covid-19 pandemic is still causing considerable uncertainty in the Bank's operating environment. The impact of the pandemic on the domestic and international economy will continue to leave its mark on operations. The key area of uncertainty is the performance of the Bank's asset portfolio. Loan impairments decreased significantly during the second quarter compared with the first quarter, although it must be remembered that further impairments may be required in the present economic climate. However, the Bank's robust capital and liquidity positions mean that it is well placed to cope with the current conditions.

There was strong demand for mortgages during the quarter, both new loans and the refinancing of existing loans. Lower interest rates undoubtedly played their part in this, and the Bank lent ISK 17 billion in the form of new mortgages during the second quarter. Furthermore, business support loans which formed part of the raft of government measures and which are partly or entirely government-backed, are proving popular and straightforward to process to our customers.

Arion Bank recently launched green deposits which are aimed at anyone wishing to help contribute towards a greener future. Initially green deposits will be used to finance investments by customers in vehicles which are powered by green energy. Green vehicles are an appropriate place to start as nearly all electricity in Iceland comes from sustainable sources. Offering our customers the option of green deposits is an innovative step in Iceland and in keeping with the Bank's environment and climate policy according to which we aim to focus more strongly on financing projects which relate to sustainable development and green infrastructure.

In May we merged our corporate services in the Reykjavík area into a single unit located at the Bank's headquarters. It brings together a dedicated team of highly experienced specialists from our branches in the Reykjavik area whose focus is on SMEs. The goal of creating the Corporate Business Hub is to enhance our services to companies in the Reykjavík area and to make our specialist services and expert advice more easily available to our customers. It is also part of the continuing trend at the Bank to adapt our services to the new and evolving needs of our customers, with a greater emphasis on digital solutions and personal financial advice."

Income statement

In ISK millions	Q2 2020	Q2 2019	% diff.	Q1 2020	% diff.
Net interest income	7,857	7,808	1%	7,253	8%
Net commission income	2,688	2,478	8%	3,076	(13%)
Net insurance income	761	823	(8%)	501	52%
Net financial income	2,691	1,023	163%	(2,000)	-
Share of profit of associates	(5)	(7)	-	(25)	-
Other operating income	71	95	(25%)	169	(58%)
Operating income	**14,063**	**12,220**	**15%**	**8,974**	**57%**
Salaries and related expenses	(3,577)	(3,805)	(6%)	(3,130)	14%
Other operating expenses	(2,818)	(2,813)	0%	(3,078)	(8%)
Operating expenses	**(6,395)**	**(6,618)**	**(3%)**	**(6,208)**	**3%**
Bank levy	(324)	(912)	(64%)	(331)	(2%)
Net impairment	(918)	(988)	(7%)	(2,860)	(68%)
Net earnings / loss before income tax	**6,426**	**3,702**	**74%**	**(425)**	**-**
Income tax expense	(1,468)	(891)	65%	(860)	71%
Net earnings / loss from cont. operations	**4,958**	**2,811**	**76%**	**(1,285)**	**-**
Discontinued operations, net of tax	(45)	(715)	(94%)	(889)	(95%)
Net earnings / loss	**4,913**	**2,096**	**134%**	**(2,174)**	**-**

Operating income amounted to ISK 14.1 billion for the second quarter of 2020, compared with ISK 12.2 billion for the same period in 2019 and ISK 9.0 billion for the first quarter of 2020, an increase of 15% compared with the second quarter of 2019 and 57% compared with the first quarter of 2020. Net commission income developed positively and increased by 8% compared with the same period in 2019 but decreased by 13% compared with the first quarter of 2020, whereas net financial income improved significantly between years and quarters.

Net interest income increased by 1% compared with the same period in 2019 and 8% compared with the first quarter of 2020. The net interest margin (NIM) as a percentage of average interest-bearing assets was 2.9% during the second quarter of 2020, compared with 2.8% for the same period in 2019 and 2.8% for the first quarter of 2020. The main reasons for the increase in net interest income despite the lowering interest environment are slightly higher inflation and activities in the corporate loan book and in funding.

Net commission income increased by 8% in the second quarter of 2020 compared with the same period in 2019, but decreased by 13% from the first quarter of 2020. Income from lending and guarantees is exceptionally strong, mainly driven by the prepayment of loans and loan service agreements.

Net insurance income amounted to ISK 761 million, compared with ISK 823 million for the same period of 2019, and ISK 501 million for the first quarter of 2020. Insurance premiums earned at the insurance company Vördur have been increasing, but volatility in net insurance income is mainly due to seasonal fluctuations in the claim rate. The combined ratio for the second quarter of 2020 was 94.5%, compared with 89.0% for the second quarter of 2019 and 103.5% for the first quarter of 2020 and is highly competitive in the domestic market.

Net financial income was ISK 2,691 million in the second quarter of 2020, compared with ISK 1,023 million for the second quarter of 2019 and a net financial loss of ISK 2,000 million for the first quarter of 2020. Strong performances in the equity and bond markets are the main explanations for positive developments in the quarter following very difficult market conditions for equities during the first quarter.

Other operating income was ISK 71 million during the second quarter of 2020, compared with ISK 95 million during the same period in 2019 and ISK 169 million during the second quarter of 2020. Profit from sale of assets was the main source of income in all quarters.

Operating expenses amounted to ISK 6,395 million during the second quarter of 2020, compared with ISK 6,618 million in the same period in 2019 and ISK 6,208 million during the first quarter of 2020. The Bank's cost-to-income ratio was 45.5% for the second quarter of 2020, compared with 54.2% for the same period in 2019 and 69.2% for the first quarter of 2020. The cost-to-total assets ratio was 2.2% for the second quarter of 2020, the second quarter of 2019 and for the first quarter of 2020.

Salaries and related expenses amounted to ISK 3,577 million for the second quarter of 2020, a decrease of 6% compared with the same period of 2019, but a 14% increase compared with the first quarter of 2020, mainly due to redundancy expenses, wage contract increases and temporary summer employees. At the end of June 2020 the number of full-time equivalent positions (FTEs) was 783 at the Group and 655 at the Bank.

Other operating expenses amounted to ISK 2,818 million during the second quarter of 2020, compared with ISK 2,813 million during the same period in 2019 and ISK 3,078 million during the first quarter of 2020. There was a significant increase in IT expenses from the second quarter of 2019, partly Covid-19 related, but otherwise other operating expenses have been trending down.

Net impairment was negative by ISK 918 million during the second quarter of 2020, compared with ISK 988 million in the same period in 2019 and ISK 2,860 million in the first quarter of 2020. Calculated cost of risk was 13 bps of loans to customers, of which 6.7 bps (51% of net impairment) is due to changes in economic scenarios in IFRS 9 models, 3.0 bps (22% of net impairment) is due to specific impairment (Stage 3) and 3.6 bps (27% of net impairment) is due to other increases in credit risk. There is significant uncertainty regarding the valuation of assets due to the Covid-19 pandemic. The need for further impairments in 2020 due to Covid-19 depends on the development of the pandemic and its effect on the Icelandic economy, not least the tourism industry.

Income tax expense amounted to ISK 1,468 million during the second quarter of 2020, compared with ISK 891 million in the same period in 2019 and ISK 860 million during the first quarter of 2020. Income tax, as reported in the financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1 billion. The effective income tax rate was 22.8% for the second quarter of 2020, compared with 24.1% for the same period in 2019. In general, the combination of income is the main driver for the fluctuation in the effective tax rate.

Discontinued operations, net of tax, were negative by ISK 45 million during the second quarter of 2020, compared with a loss of ISK 715 million for the same period in 2019 and a loss of ISK 889 million in the first quarter of 2020. The reasons for the negative results of discontinued operations in past quarters are chiefly twofold: negative operational results of Valitor and valuation changes of Stakksberg and Sólbjarg. The operating results of the subsidiaries Valitor Holding hf., Stakksberg ehf. and Sólbjarg ehf. are presented as discontinued operations as they are all held for sale.

First six months of 2020

In ISK millions	**H1 2020**	**H1 2019**	**% diff.**
Net interest income	15,110	15,242	(1%)
Net commission income	5,764	4,696	23%
Net insurance income	1,262	1,076	17%
Net financial income	691	1,789	(61%)
Share of profit of associates	(29)	720	-
Other operating income	241	405	(40%)
Operating income	**23,039**	**23,928**	**(4%)**
Salaries and related expenses	(6,707)	(7,435)	(10%)
Other operating expenses	(5,895)	(6,045)	(2%)
Operating expenses	**(12,602)**	**(13,480)**	**(7%)**
Bank levy	(655)	(1,818)	(64%)
Net impairment	(3,778)	(2,069)	83%
Net earnings before income tax	**6,004**	**6,562**	**(9%)**
Income tax expense	(2,328)	(1,513)	54%
Net earnings from cont. operations	3,676	5,049	(27%)
Discontinued operations, net of tax	(934)	(1,935)	(52%)
Net earnings	**2,742**	**3,114**	**(12%)**
KPI's			
Return on equity	2.9%	3.2%	
Earnings per share (in ISK)	1.59	1.72	
Cost to income ratio	54.7%	56.3%	

Net earnings during the first six months of 2020 were 12% lower than during the same period in 2019, with return on equity 2.9%, compared with 3.2% for the first six months of 2019.

Net interest income for the first six months of 2020 decreased slightly compared with the first six months of 2019. *Net interest margin* was 2.9% for the first six months of 2020 and 2.8% for the same period in 2019. *Net financial income* decreased significantly compared with last year as net financial income for the first six months of 2020 was negatively affected by market changes in holdings of listed and unlisted equity in the first quarter. *Share of profit of associates* was positively affected by the sale of the associate Farice in 2019. Profit from sale of assets is the main source of income in *Other operating income*.

Operating expenses decreased by 7% compared with the first six months of 2019 and are greatly affected by the decreasing number of FTEs compared with the previous year. *Net impairment* was significant for the first six months of 2020, mostly due to more pessimistic assumptions in the Bank's IFRS 9 models, especially as regards to unemployment and the transfer of tourism related customers to Stage 2. *Income tax expense* was 54% higher during the first six months of 2020 compared with the same period in 2019, mainly due to the different combination of income during the period.

The loss from *discontinued operations* decreased significantly during the first six months of 2020, compared with the same period in 2019. Valitor's operations are improving but continued volatility can be expected in discontinued operations, however, at reduced levels.

Balance sheet

Arion Bank's ***total assets*** increased by 9% from year-end 2019.

In ISK millions	**30.06.2020**	**31.12.2019**	**Diff.**	**% diff.**	**31.03.2020**	**% diff.**
Cash & balances with CB	103,432	95,717	7,715	8%	118,174	(12%)
Loans to credit institutions	33,597	17,947	15,650	87%	33,797	(1%)
Loans to customers	779,902	773,955	5,947	1%	778,823	0%
Financial assets	197,141	117,406	79,735	68%	192,056	3%
Investment property	7,051	7,119	(68)	(1%)	7,129	(1%)
Investments in associates	861	852	9	1%	828	4%
Intangible assets	9,077	8,367	710	8%	8,826	3%
Assets and disposal groups held for sale	30,732	43,626	(12,894)	(30%)	28,038	10%
Other assets	20,456	16,866	3,590	21%	20,149	2%
Total assets	**1,182,249**	**1,081,855**	**100,394**	**9%**	**1,187,820**	**(0%)**

Cash and balances with the Central Bank and *Loans to credit institutions* increased in total by ISK 23,365 million or 21% from year-end 2019. The liquidity position has mainly increased due to the postponement of a dividend payment, the issuance of AT1 in February and an increase in deposits.

Loans to customers totalled ISK 779,902 million at the end of June 2020 and increased by 0.8% from year-end 2019. Loans to individuals increased by 3.9% during the quarter and 5.5% from year-end 2019, mainly due to strong mortgage lending. However, loans to corporates decreased by 3.4% during the second quarter and 3.5% from year-end 2019, mainly due to prepayments of large corporate loans in line with strategy. The loan book continues to be well balanced between individuals and corporates with a good distribution between sectors.

Financial assets amounted to ISK 197,141 million at the end of June 2020, compared with ISK 117,406 million at the end of 2019. The combination of securities held by the Bank, especially bond holdings, is closely related to the liquidity position at any given time.

In ISK millions	**30.06.2020**	**31.12.2019**	**Diff.**	**% diff.**	**31.03.2020**	**% diff.**
Bonds	140,576	65,874	74,702	113%	130,961	7%
Shares and instruments w. variable income	19,808	21,600	(1,792)	(8%)	20,878	(5%)
Derivatives	8,912	6,617	2,295	35%	9,935	(10%)
Securities used for economic hedging	27,845	23,315	4,530	19%	30,282	(8%)
Securities total	**197,141**	**117,406**	**79,735**	**68%**	**192,056**	**3%**

Assets and disposal groups held for sale amounted to ISK 30,732 million at the end of the period, compared with ISK 43,626 million at year-end 2019. The subsidiaries Valitor Holding ehf., Stakksberg ehf. and Sólbjarg ehf. are classified as held for sale. Valitor's contribution to the Group's assets was ISK 17,561 million at the end of June 2020.

Liabilities increased by 9% from year-end 2019. ***Equity*** decreased mainly due to the purchase of own shares, which offsets the net earnings for the period.

In ISK millions	30.06.2020	31.12.2019	Diff.	% diff.	31.03.2020	% diff.
Due to credit institutions & CB	7,661	5,984	1,677	28%	8,323	(8%)
Deposits from customers	555,855	492,916	62,939	13%	539,312	3%
Financial liabilities at fair value	3,118	2,570	548	21%	4,687	(33%)
Other liabilities	48,360	37,102	11,258	30%	70,455	(31%)
Borrowings	314,952	304,745	10,207	3%	322,470	(2%)
Subordinated liabilities	36,494	20,083	16,411	82%	35,837	2%
Liabilities associated w. disposal groups HFS	26,982	28,630	(1,648)	(6%)	22,857	18%
Total liabilities	**993,422**	**892,030**	**101,392**	**11%**	**1,003,941**	**(1%)**
Shareholders equity	188,656	189,644	(988)	(1%)	189,644	(1%)
Non-controlling interest	171	181	(10)	(6%)	181	(6%)
Total equity	**188,827**	**189,825**	**(998)**	**(1%)**	**189,825**	**(1%)**
Total liabilities and equity	**1,182,249**	**1,081,855**	**100,394**	**9%**	**1,193,766**	**(1%)**

Deposits from customers amounted to ISK 555,855 million at the end of June 2020 and increased by 13% from year-end 2019. The loan-to-deposit ratio was 140.3% at the end of June 2020, compared with 157.0% at the end of 2019. Deposits remain the most important source of funding for Arion Bank and the greater focus on deposit funding has resulted in a significant increase, especially in corporate deposits.

Borrowings amounted to ISK 314,952 million at the end of June 2020, a 3% increase from year-end 2019, primarily due to the depreciation of the ISK against foreign currencies. During Q2 the Bank bought back outstanding EUR notes for approximately ISK 3 billion (EUR 20 million). A comfortable liquidity position and limited refinancing needs mean that the Bank does not need to access the international wholesale funding markets in 2020.

Subordinated liabilities amounted to ISK 36,494 million at the end of June 2020, compared with ISK 20,083 million at the end of 2019. The Bank issued its first AT1 instrument during the first quarter of 2020 in the amount of approximately ISK 13 billion (USD 100 million). The Bank has previously issued a number of Tier 2 subordinated bonds in line with its capital strategy and has now issued the required subordinated bonds.

Shareholders' equity amounted to ISK 188,656 million at the end of June 2020, compared with ISK 189,644 million at the end of 2019. The slight decrease is explained by the purchase of own shares in the amount of ISK 4.4 billion, which is partly offset by the financial results for the period. The share buy-back program continued until the AGM in March 2020. The CET 1 ratio was 22.9% at the end of June 2020, compared with 21.2% at the end of 2019. The leverage ratio was 14.9% at the end of June 2020, compared with 14.1% at the end of 2019, which is very high in all comparisons in the international banking market.

For detailed information on the accounts please refer to Arion Bank's Consolidated Interim Financial Statements for the second quarter of 2020 on the Bank's website.

Key performance indicators

	Q2 2020	Q2 2019	H1 2020	H1 2019
Return on equity (ROE)	10.5%	4.3%	2.9%	3.2%
Return on equity from continuing operations	10.6%	5.8%	3.9%	5.1%
Return on equity assuming 17% CET 1	13.1%	4.4%	3.2%	3.2%
Return on total assets (ROA)	1.7%	0.7%	0.5%	0.5%
Net interest margin (int. bearing assets)	2.9%	2.8%	2.9%	2.8%
Net interest margin (total assets)	2.7%	2.5%	2.6%	2.5%
Operating income / REA	7.9%	6.2%	6.4%	6.1%
Cost-to-income ratio	45.5%	54.2%	54.7%	56.3%
Cost-to-Total assets ratio	2.2%	2.2%	2.2%	2.2%
Effective tax rate	22.8%	24.1%	38.8%	23.1%
CAD ratio	28.1%	22.8%	28.1%	22.8%
CET1 ratio	22.9%	21.4%	22.9%	21.4%
Share of stage 3 loans, gross	3.4%	2.4%	3.4%	2.4%
REA / Total assets	60.6%	63.1%	60.6%	63.1%
Loans to deposit ratio	140.3%	162.8%	140.3%	162.8%
The Group's employees at the end of the period	783	880	783	880
The Parent's employees at the end of the period	655	770	655	770

Investor meeting in English on 30 July at 10:30 CET (8:30 GMT)

Arion Bank will be hosting a meeting / webcast on Thursday 30 July at 10:30 CET (8:30 GMT) where CEO Benedikt Gíslason, CFO Stefán Pétursson, Deputy CFO Eggert Teitsson and Head of Investor Relations Theodór Fridbertsson will present the results and answer questions from participants. The meeting will take place in English at the Bank's headquarters, Borgartún 19, Reykjavík, and will be streamed live.

Those attending at Borgartún 19 need to register here. The webcast will be accessible live on *financialhearings.com* and a link will also be made available on the Bank's website under *Investor Relations*.

To participate in the webcast via telephone and to submit questions please call in using the relevant number indicated below before the start of the webcast:

SE: +46 850 558 369
UK: +44 333 300 9261
Iceland: +354 800 7520
United States: +1 833 823 0586

For further information please contact Theodór Fridbertsson, Head of Arion Bank's Investor Relations, at ir@arionbanki.is or tel.+354 856 6760.

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Financial calendar 2020-2021

The Bank's Financial Statements are scheduled for publication as stated below. The calendar may be subject to change.

Third quarter 2020	28 October 2020
Fourth quarter 2020 and full year 2020	10 February 2021
AGM 2021	16 March 2021
First quarter 2021	5 May 2021
Second quarter 2021	28 July 2021
Third quarter 2021	27 October 2021

This is information that Arion Bank hf. is obliged to make public pursuant to the EU Market Abuse Regulation. The information was submitted for publication through the agency of the contact persons set out above.

Forward-looking statements

This release contains forward-looking statements that reflect management's current views with respect to certain future events and potential financial performance. The information in the release is based on company data available at the time of the release. Although Arion Bank believes that the expectations reflected in such forward-looking statements are reasonable, no assurance can be given that such expectations will prove to have been correct. Accordingly, results could differ materially from those set out in the forward-looking statements as a result of various factors. The most important factors that may cause such a difference for Arion Bank include, but are not limited to: a) the macroeconomic development, b) change in inflation, interest rate and foreign exchange rate levels, c) change in the competitive environment and d) change in the regulatory environment and other government actions. This release does not imply that Arion Bank has undertaken to revise any forward-looking statements, beyond what is required by applicable law or applicable stock exchange regulations if and when circumstances arise that will lead to changes after the date when this release was made. Arion Bank assumes no responsibility or liability for any reliance on any of the information contained herein. It is prohibited to distribute or publish any information in this release without Arion Bank's prior written consent.