



# First quarter results 2019

Investor presentation 8 May 2019



Q1 2019

# Highlights during the quarter



Core earnings improved compared with Q1 2018



Irregular items such as WOW air bankruptcy and the Valitor legal case verdict affect net earnings negatively. Sale of the Banks share in Farice has a positive effect



Digital journey continues with the launch of the biggest update of the Arion app to date. The app is now open also to non-customers



Valitor sales process is on track



CEO Höskuldur H. Ólafsson stepped down 30 April. CFO Stefán Pétursson was appointed acting CEO as of 1 May until a new CEO has been appointed



# CEO of Arion Bank steps down after nine years in the job

New Chairman of the Board and two new Directors elected at the 2019 AGM

## Stefán Pétursson, CFO, appointed as acting CEO

- Höskuldur H. Ólafsson, CEO of Arion Bank since 2010, decided to step down in April 2019
- The Board of Directors is in the process of hiring a new CEO and is expected to announce its decision in the next few weeks
- Stefán Pétursson, CFO, has taken over the position of CEO on a temporary basis until a new CEO is announced

## Key decisions made at 2019 AGM

- Brynjólfur Bjarnason elected Chairman of Board and Herdís Dröfn Fjeldsted Vice Chairman
- Liv Fiksdahl and Renier Lemmens elected as new Directors on six member Board
- ISK 10 billion dividend approved and reduction of share capital by cancelling own shares
- Approval of acquisition of up to 10% of Bank's share capital and issue of additional Tier 1 notes



FY 2018

# Digital journey has produced outstanding results



Total number  
of customer touchpoints  
**34 million**



Percentage of  
digital service touchpoint  
**97%**



Video conference  
meetings with customers  
**20,000**



Digital car loans – YoY  
increase  
**20%**



Percentage of digital credit  
appraisals  
**92%**



Mortgages applied for  
digitally  
**72%**



Digital consumer loans  
– YoY increase  
**62%**



Percentage of digital  
applications for cards  
**66%**

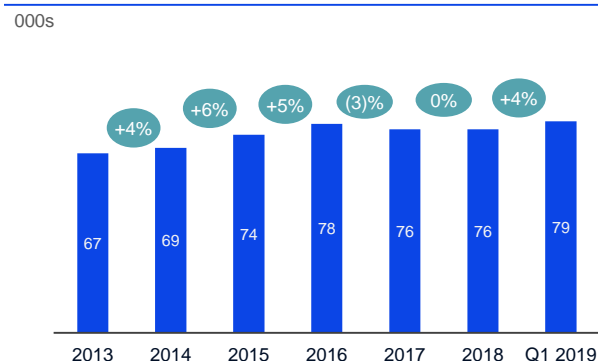


# Digital services and the change in customer behavior

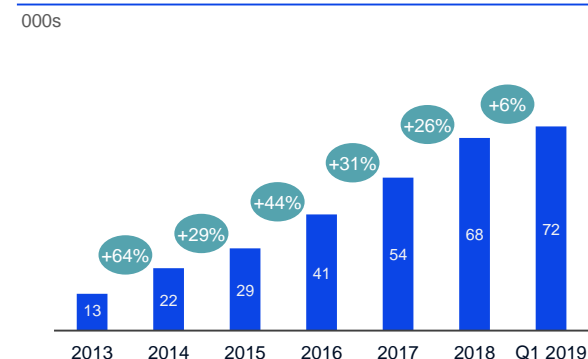
Number of Arion app users increasing at steady pace and new digital branches are very popular

- The growth in active Arion Bank app users continues to grow at a steady pace (6% in Q1)
- New digital branches drive increased customer usage in Q1
- Our digital journey focuses on reshaping end-to-end customer journeys into fully digital flows, accessible online 24/7
- In 2019 the journey continues with three new digital solutions launching before end of H1.

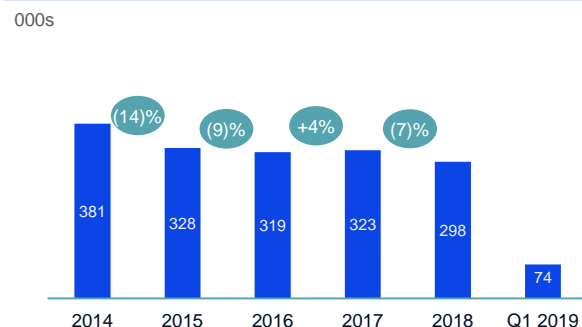
Active online bank users<sup>1</sup>



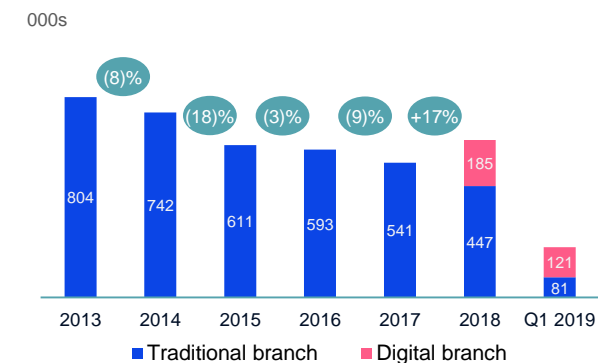
Active Arion App users<sup>1</sup>



Number of calls to the call centre

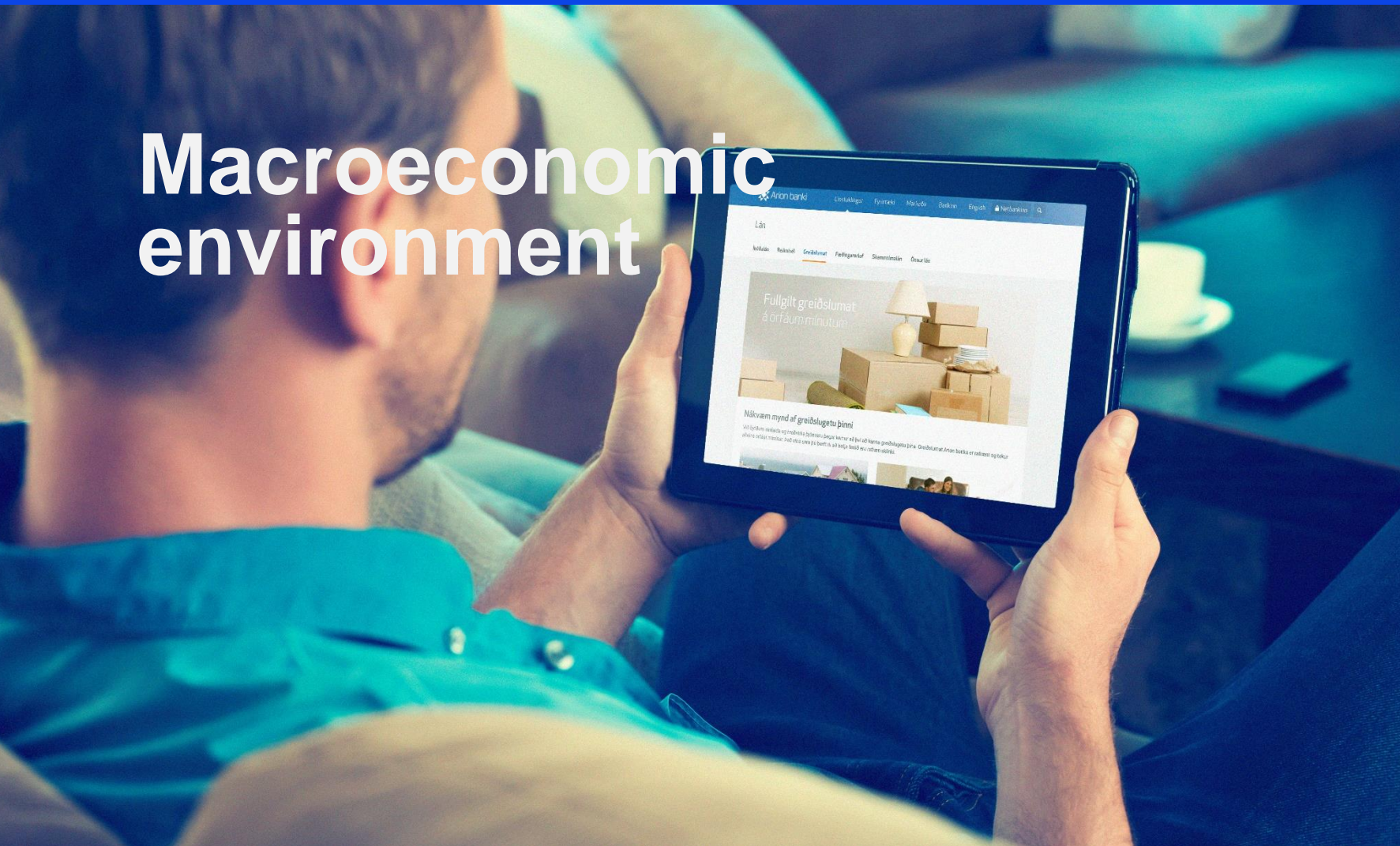


Number of visits to branches<sup>2</sup>





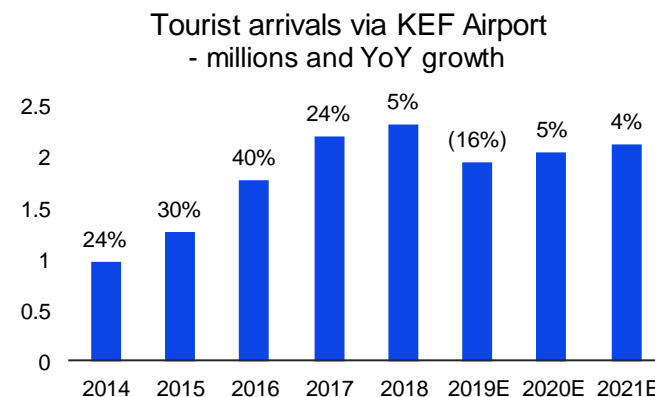
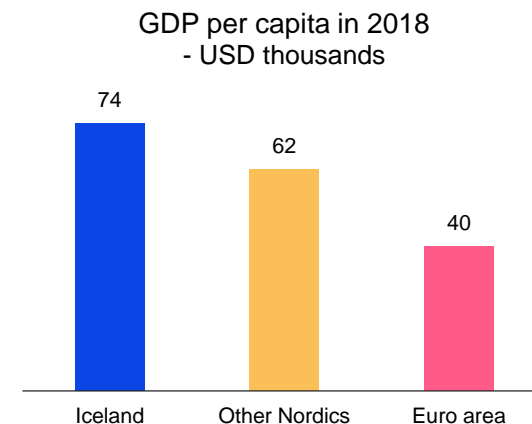
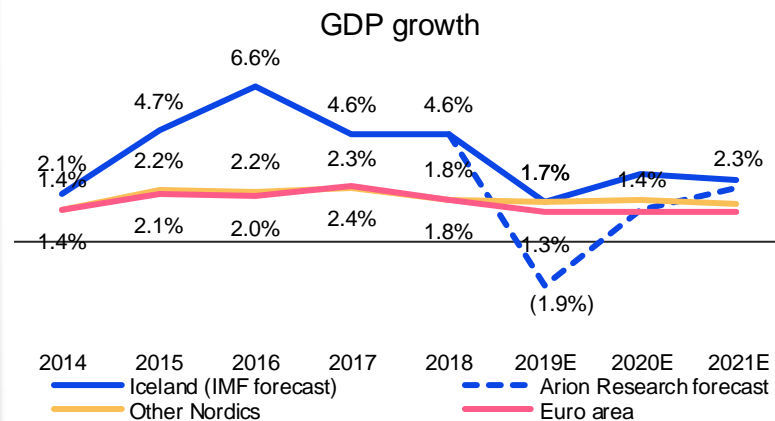
# Macroeconomic environment



# Temporary contraction in GDP expected

After strong 4.6% GDP growth in 2018, economic activity looks set to slow down in the short term

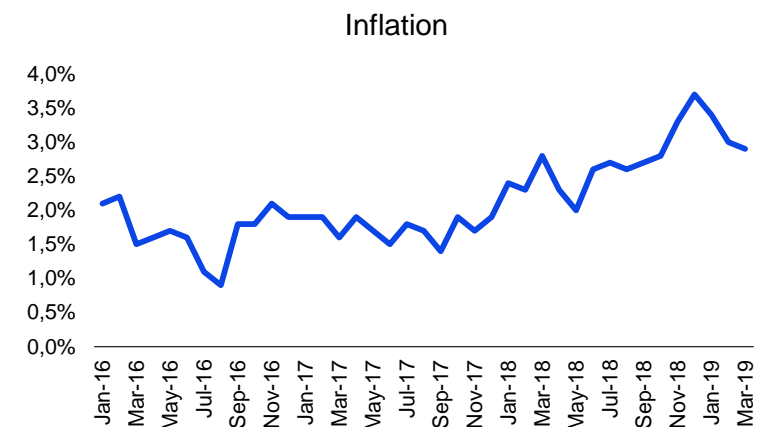
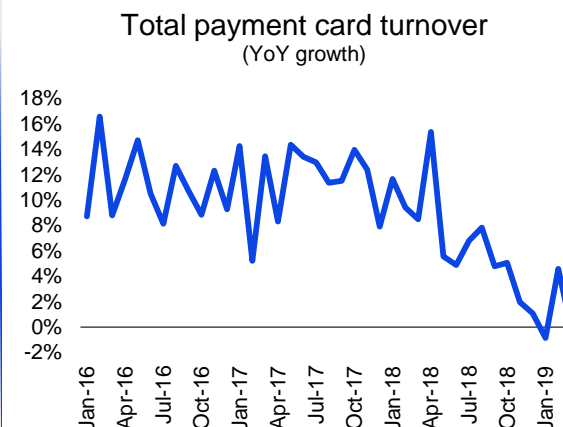
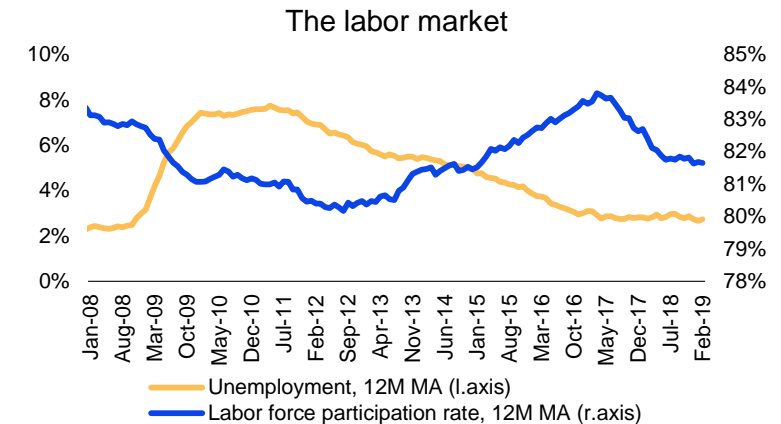
- Falling exports are expected to bring an end to one of the longest growth periods the Icelandic economy has experienced
- Despite a possible contraction, GDP per capita will remain high
- The tourism industry has boomed since 2011. Growth is however slowing down temporarily but is expected to pick up again from 2020
- The economy is well equipped to handle a short recession, with a positive net external position and historically low debt levels, both in the private and public sector



# New wage agreements reduce uncertainty

Inflation is expected to pick up again and household consumption is wavering

- Wage agreement partly concluded in March at reasonable levels
- WOW air's bankruptcy and the signing of the wage agreements have reduced uncertainty in the FX market
- Foreign investment of pension funds has put pressure on the ISK
- Inflation slowed down in Q1, but is trending upwards due to higher import prices in relation to the weakening of ISK and wage increases
- Unemployment remains very low, but expectations of an increase are emerging, especially in tourist related sectors
- Consumer confidence has been sliding, which has been reflected in slower payment card turnover growth





Q1 2019

## Positive core earnings, but impact from weaker macro



Growing NII compared with Q1 2018, but NIM stable as inflation temporarily slowed down and positive effects of liability management have not materialized yet



Slowing economy puts pressure on revenue growth and impairments



Stable commission income and insurance performance



Net financial income improved significantly compared with Q4 2018



Operating expenses relatively stable compared with Q1 2018. Ongoing focus on cost efficiencies supported by digital solutions



Q1 2019

# Headline Figures



Net earnings

**ISK 1.0 bn.**

Q1 2018:  
ISK 1.9 bn.



CET 1

**21.3%**

31.12.2018:  
21.2%



Cost-to-income ratio

**58.6%**

Q1 2018:  
62.5%



Share of stage 3 loans, gross\*

**2.5%**

31.12.2018:  
2.6%



Return on equity

**2.1%**

Q1 2018:  
3.6%



Leverage ratio

**13.5%**

31.12.2018:  
14.2%



Number of employees

**917**

31.12.2018:  
904



Mortgages/Total loans

**41.2%**

31.12.2018:  
41.1%



# Income statement



# Income statement Q1 2019

Core earnings improve, but increased impairments and Valitor legal case have negative effects

- Top line development strong compared with both Q1 and Q4 2018
  - Operating income up 8% vs Q1 2018
- Cost development stable
  - Salaries flat vs Q1 2018
- Net impairments increase both single name and stage 1 and 2 according to IFRS 9, partly due to more cautious macro expectations
- WOW air bankruptcy affects financial income by ISK 0.2 billion and net impairments by ISK 1.1 billion, in total ISK 1.3 billion (ISK 1.0 billion net of tax)
- Sale of the associate Farice resulted in a profit of ISK 732 million
- The Valitor legal case affects discontinued operations negatively by ISK 600 million, net of tax

	Q1 2019	Q1 2018	Diff%	Q4 2018	Diff%
Net interest income	7,434	6,827	9%	7,969	(7%)
Net commission income	2,218	2,205	1%	2,746	(19%)
Net financial income	766	1,387	(45%)	(774)	-
Net insurance income	253	143	77%	704	(64%)
Share of profit of associates	727	(20)	-	11	-
Other operating income	310	268	16%	294	5%
<b>Operating income</b>	<b>11,708</b>	<b>10,810</b>	<b>8%</b>	<b>10,950</b>	<b>7%</b>
Salaries and related expenses	(3,630)	(3,616)	0%	(3,584)	1%
Other operating expenses	(3,232)	(3,143)	3%	(3,015)	7%
<b>Operating expenses</b>	<b>(6,862)</b>	<b>(6,759)</b>	<b>2%</b>	<b>(6,599)</b>	<b>4%</b>
Bank levy	(906)	(804)	13%	(765)	18%
Net impairment	(1,081)	(135)	-	(573)	89%
<b>Net earnings before income tax</b>	<b>2,859</b>	<b>3,112</b>	<b>(8%)</b>	<b>3,013</b>	<b>(5%)</b>
Income tax expense	(622)	(890)	(30%)	(881)	(29%)
Discontinued operations, net of tax	(1,219)	(273)	347%	(516)	136%
<b>Net earnings</b>	<b>1,018</b>	<b>1,949</b>	<b>(48%)</b>	<b>1,616</b>	<b>(37%)</b>

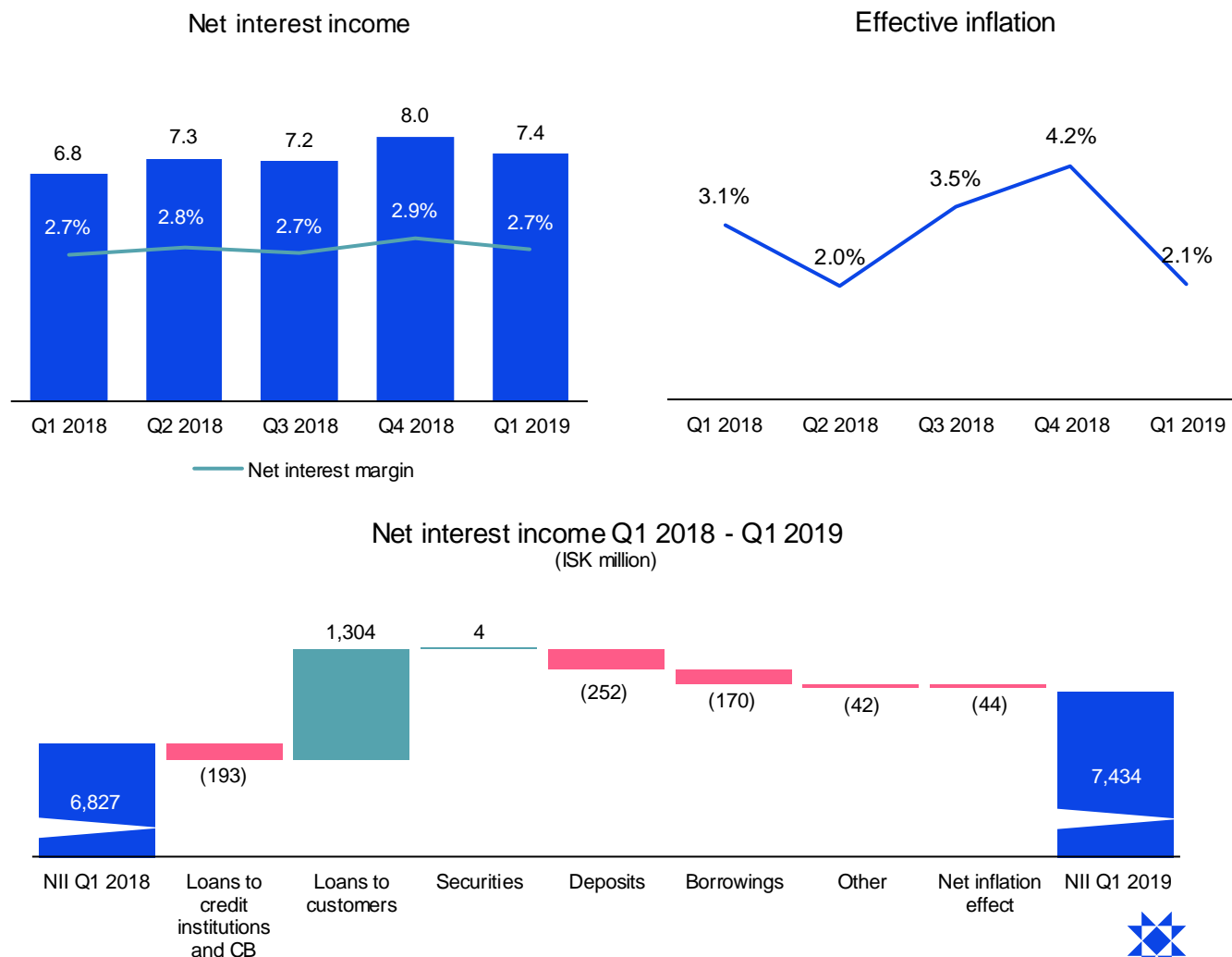




# Net interest income

Net interest income increased compared with Q1 last year in line with strategy

- Net interest income increased from Q1 2018 due to loan growth (6% YOY), increased focus on return and management of liabilities. Decrease from Q4 2018 mainly due to lower inflation
- NIM stabilized as inflation tailwind is temporarily reduced
- NIM was also negatively affected by increase in interest bearing assets in connection with funding activities during the period, mostly in low yielding FX
  - High LCR at the end of Q1, 213% compared with 164% at YE 2018, due to upcoming payments of borrowings in Q2 2019
- Improved liquidity management
  - Liability management is yielding positive results

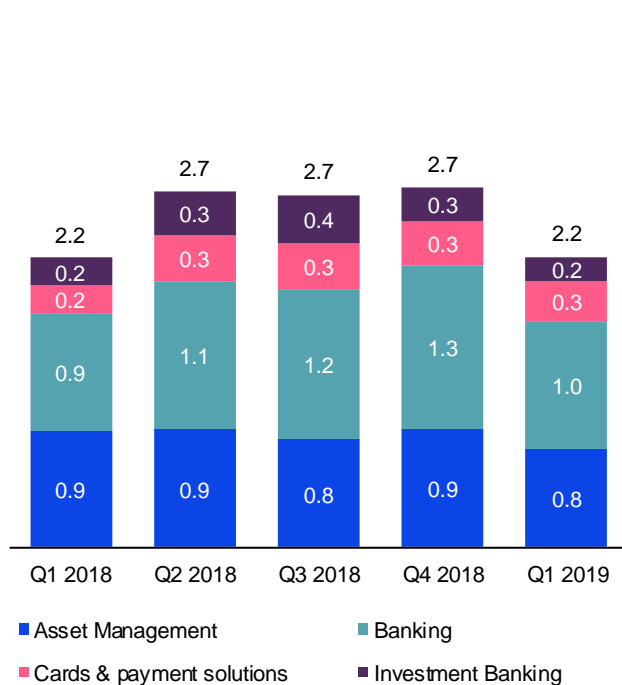




# Net commission and net insurance income

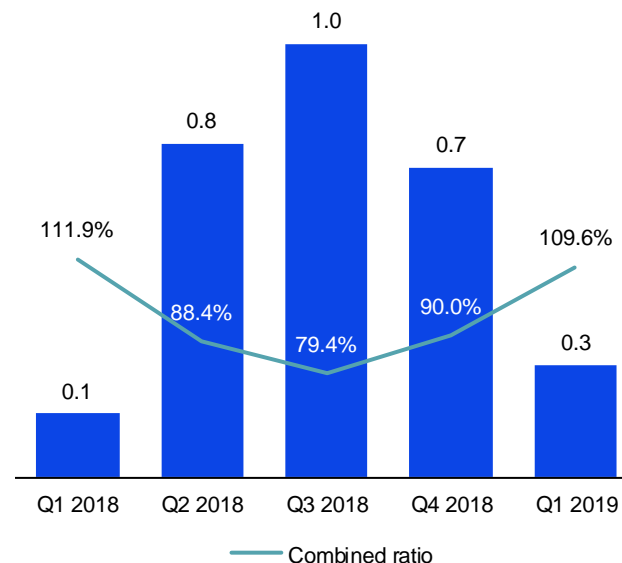
## Seasonality in net commission income and net insurance income

Net commission income



- Net commission income in Q1 stable between years but there is seasonality in Banking, mainly due to tourism
- Corporate Advisory arm of Investment Banking continues to be volatile but Capital Markets holds a strong position in the market

Net insurance income



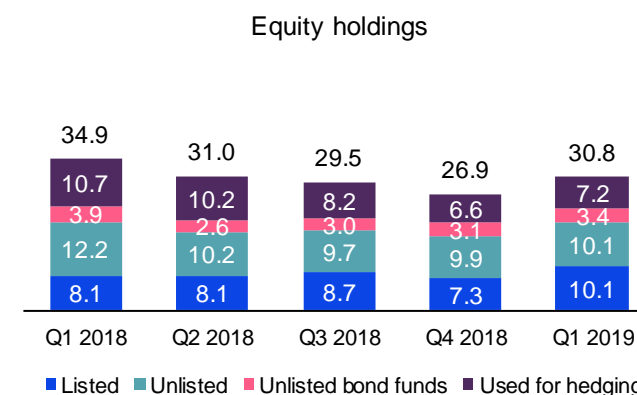
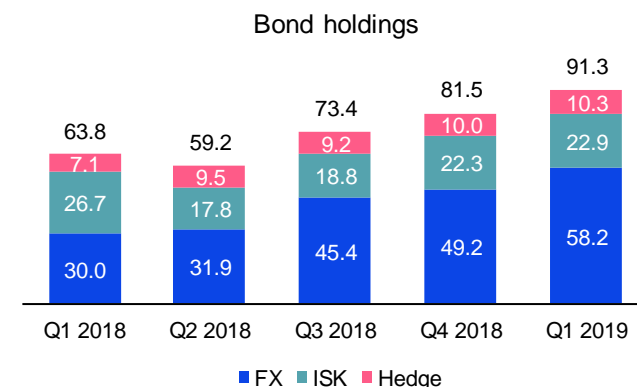
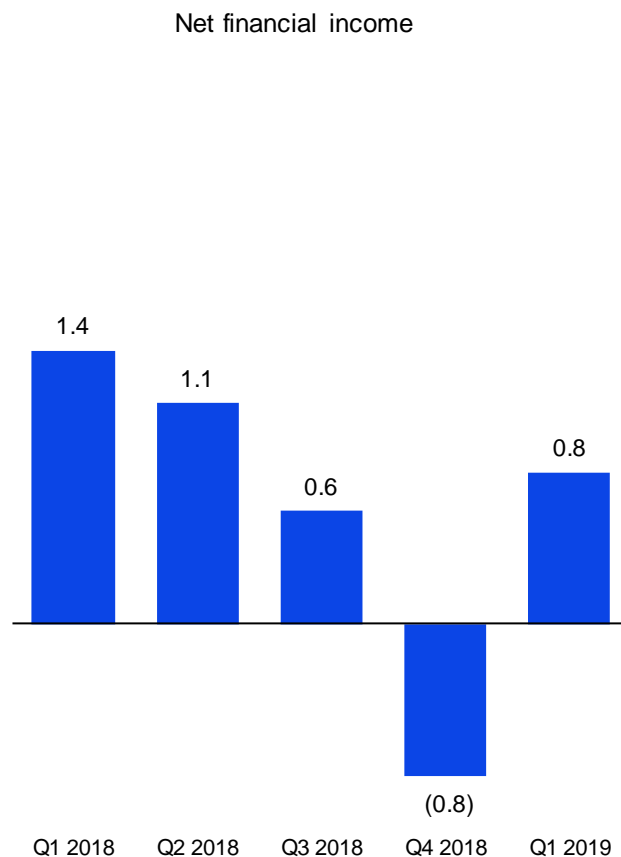
- Decrease in net insurance income from Q4 2018 due to seasonality in non-life insurance but significant improvement from Q1 last year
- Volatility in non-life, often affected by weather conditions in Q1
- Income from life insurance is stable
- Earned premiums increased by 8% in Q1 YoY



# Net financial income

## NFI back to normal levels in Q1 compared with Q4 2018

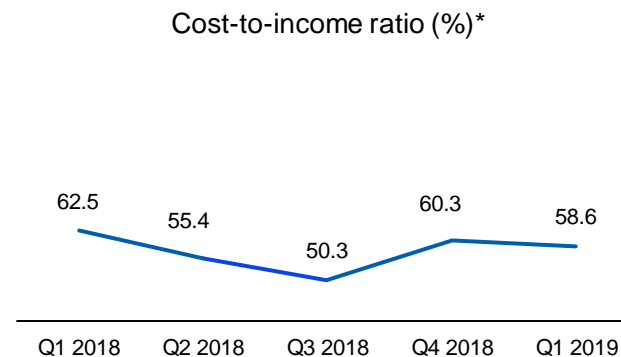
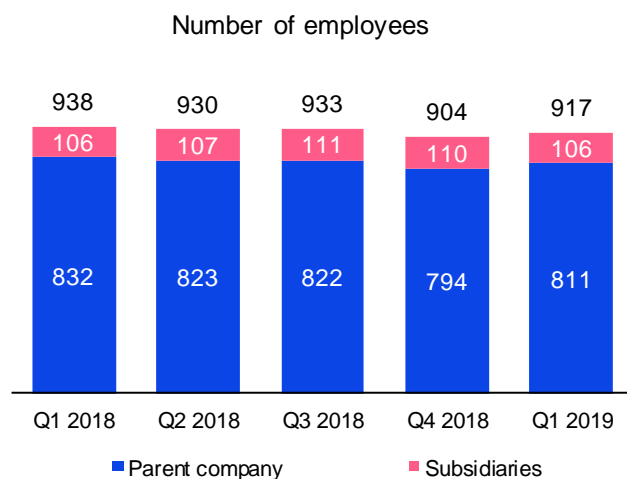
- Bond holdings are mainly part of liquidity management
- Equity holdings are mainly strategic positions, largely legacy holdings
- Market conditions were rather favorable in Q1 2019 reversing losses from Q4 2018
  - Preference shares in Visa International up ISK 0.6 billion during the quarter (down ISK 0.3 billion during Q4 2018)
  - ISK 0.2 billion loss from WOW air bonds was the single largest negative contributor during the quarter
- Total portfolio of Vördur is ISK 15 billion, ISK 10.3 billion of bonds and ISK 4.7 billion in equity instruments
- Returns on the bond and equity portfolio have been largely positive in the past



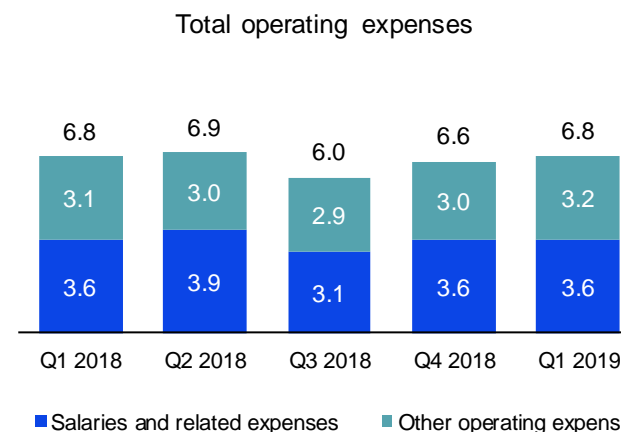
# Total operating expenses

## Cost-to-income ratio improved compared with Q1 and Q4 2018

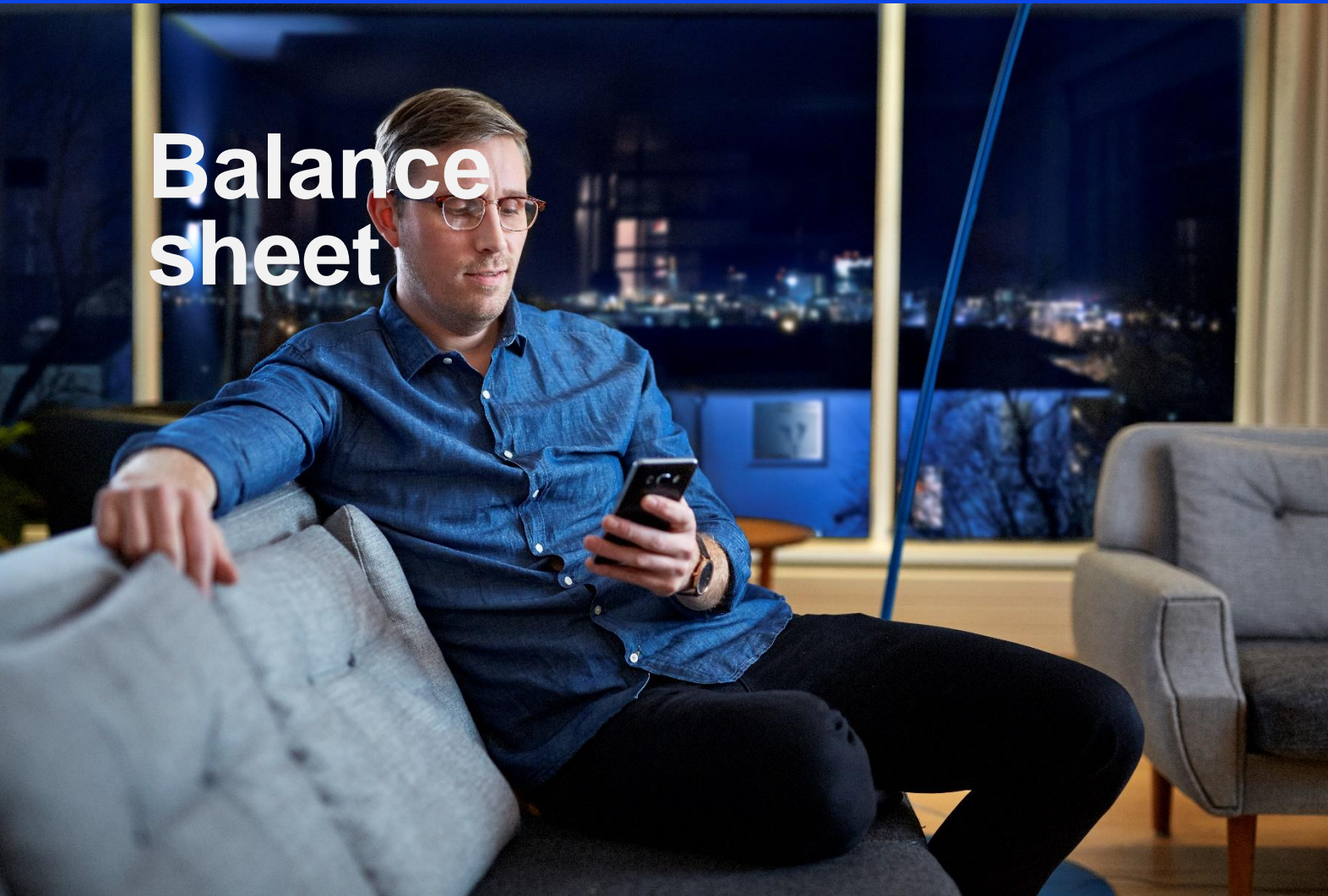
- FTE decreased by 2.2% from Q1 2018
- Wage inflation continues to put pressure on salary expenses, but salary expenses are stable due to reduction in FTE
- Other operating expenses remain stable and the increase from Q1 2018 was mainly in IT due to the digital journey of the Bank



\* Cost-to-income ratio (salaries and related expenses + other operating expenses/operating income)



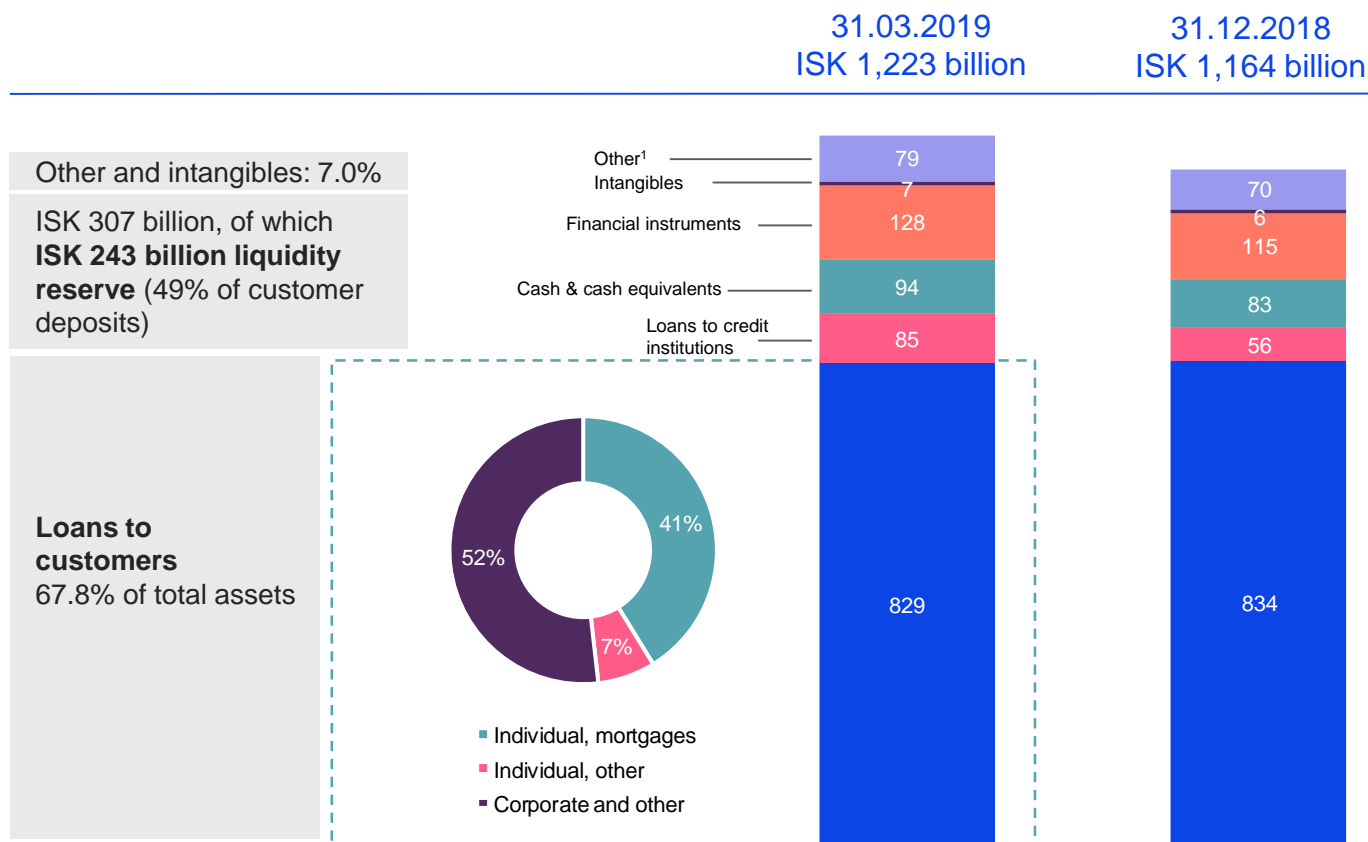
# Balance sheet



# Balance sheet - Assets

## Stable loan book – other interest bearing assets increasing

- The balance sheet has grown by 6.4% compared with year-end 2018, mostly due to surplus liquidity
- Loans to customers decreased by 0.5% from year-end 2018
  - Focus on quality lending and increased NIM, both in mortgage and corporate lending
- Stronger liquidity position despite dividend payment during Q1 2019
  - Temporary position due to upcoming payments of borrowings in Q2 2019



<sup>1</sup>Other includes investment property, investment in associates, tax assets, assets and disposal groups held for sale and other assets

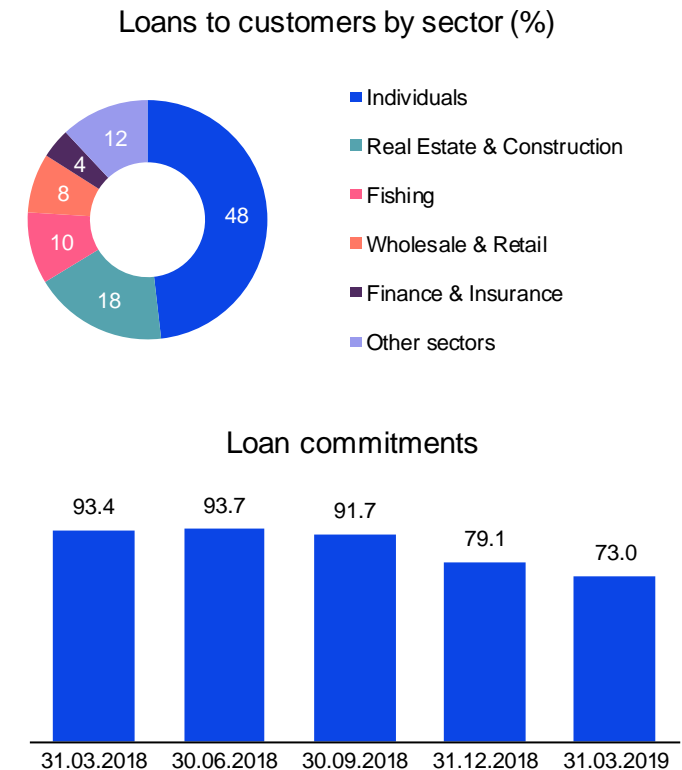
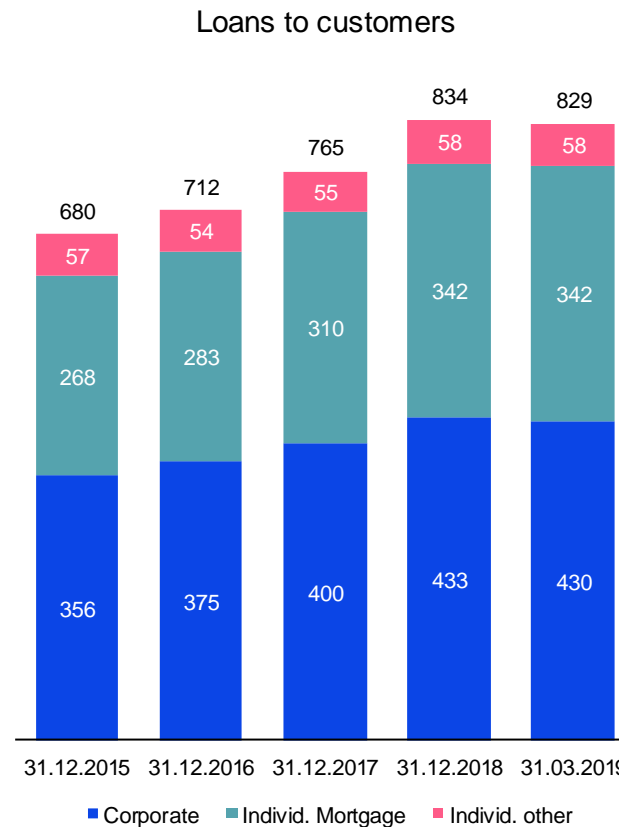




# Loans to customers

## Returns prioritized over loan growth

- Loans to customers relatively stable
  - Slight reduction in loans to individuals
  - Good diversification in the corporate loan book
- Demand for new lending affected by increased economic uncertainty
- Shortage of ISK liquidity in the market is likely to affect loan growth and pricing
- The loan book is collateralized 90.6%, as it was at YE 2018
- Loan commitments reduce in line with strategy and economic conditions



# Balance sheet – Liabilities and equity

## Strong equity position and well balanced funding

- Net dividend payment in Q1 totalling ISK 9.1 billion reduced the equity of the Bank
  - Strong equity position and a very high leverage ratio despite capital release
  - Leverage ratio still 2-3 times higher than Scandinavian peers
- Active wholesale funding both in Iceland and in the international markets. Activities in Q1 and early Q2 will show effect from Q2 2019
- Deposits increased by 5.2% from YE 2018 and 8.3% YoY – continued focus on deposits going forward

### Equity

CET1 ratio 21.3%  
Leverage ratio 13.5%

### Borrowings (in ISK)

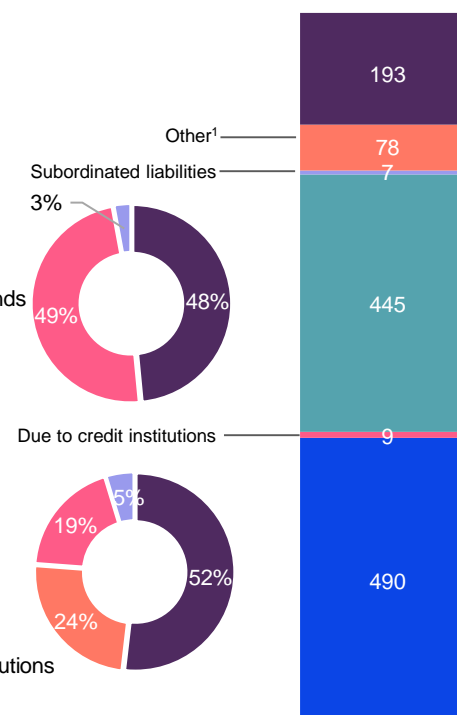
ISK 229 billion  
EUR 174 billion  
Other currencies 43 billion

### Deposits

On demand 71%  
Up to 3M 15%  
More than 3M 14%  
  
5.2% increase from YE2018

- Covered bonds
- Senior unsec. bonds
- Other

- Individuals
- Corporates
- Pension funds & domestic fin. institutions
- Other



<sup>1</sup> Other includes Financial liabilities at fair value, tax liabilities, Liabilities associated with disposal groups held for sale and Other liabilities

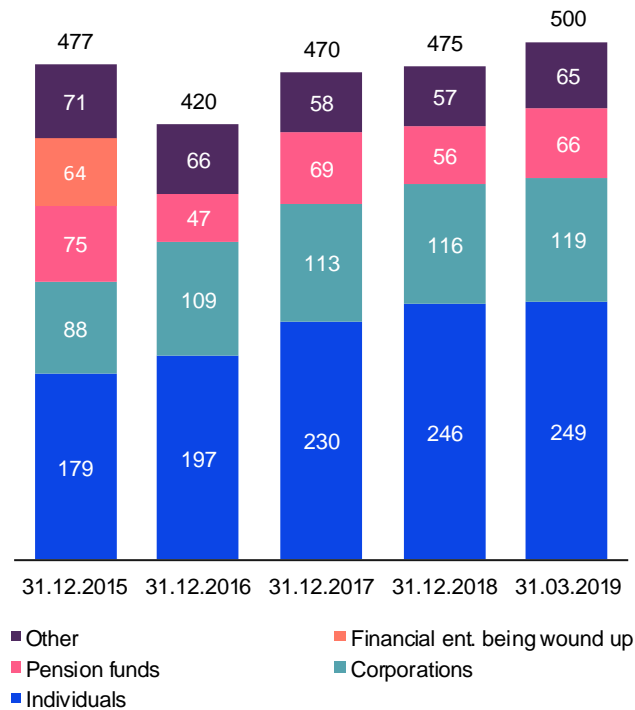


# Deposits

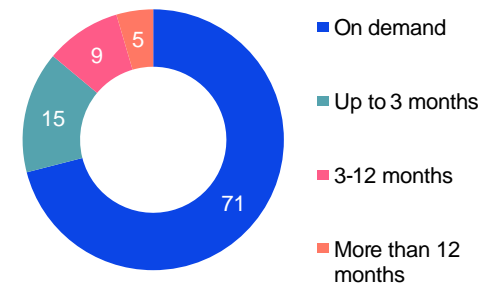
## Continued focus on deposits both from individuals and corporates

- Deposits represent 42% of the Bank's funding
- Deposits from individuals have grown significantly in the last few years
- More challenging macro economic conditions may affect growth in deposits from individuals
- Focus on deposits from individuals and corporates going forward

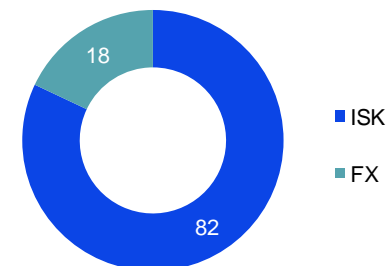
Deposits and due to credit institutions and Central Bank



Maturity of deposits (%)



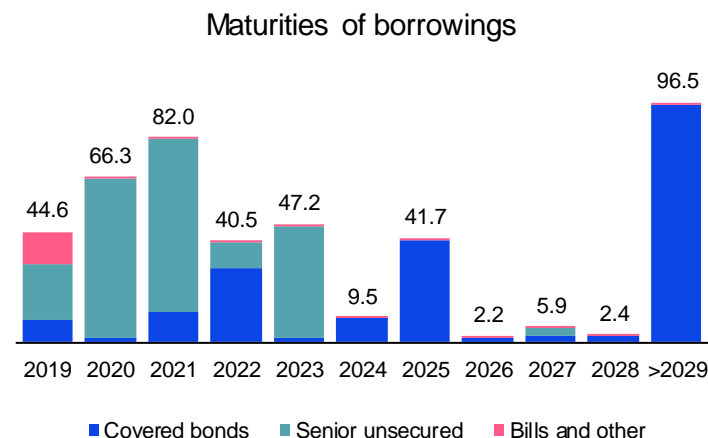
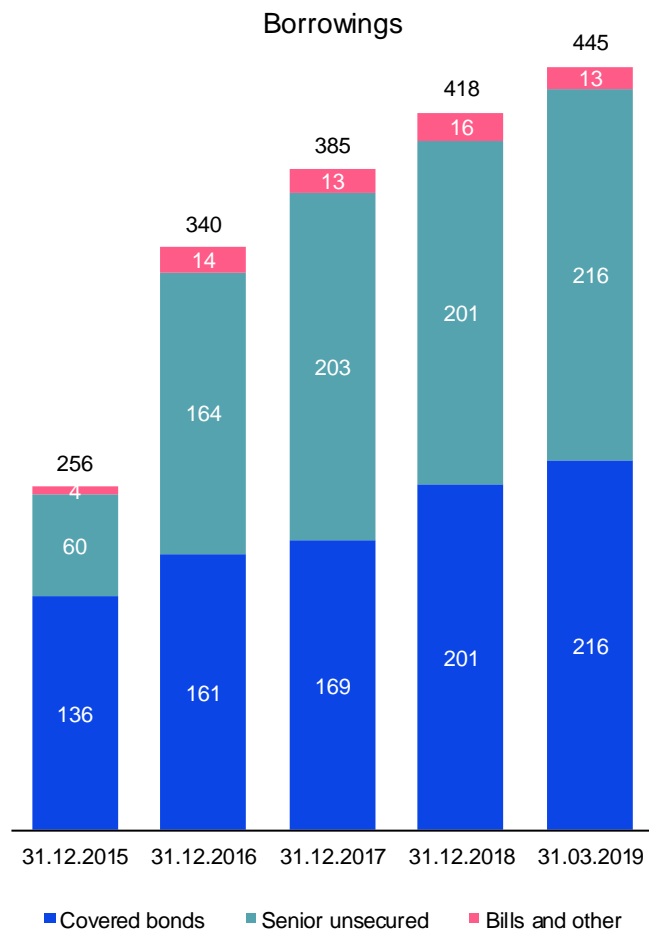
Deposits by currency (%)





# Borrowings

## Strong credit rating and well balanced maturity schedule

- The Bank did several EMTN private placements in Q1 including NOK 750 million 3 year bond
- The Bank issued covered bonds to finance mortgages in the Icelandic market, total of ISK 14.1 billion during Q1
- Commercial paper issued in Q1 amounted to ISK 7.3 billion



### Ratings - S&P (July 2018)

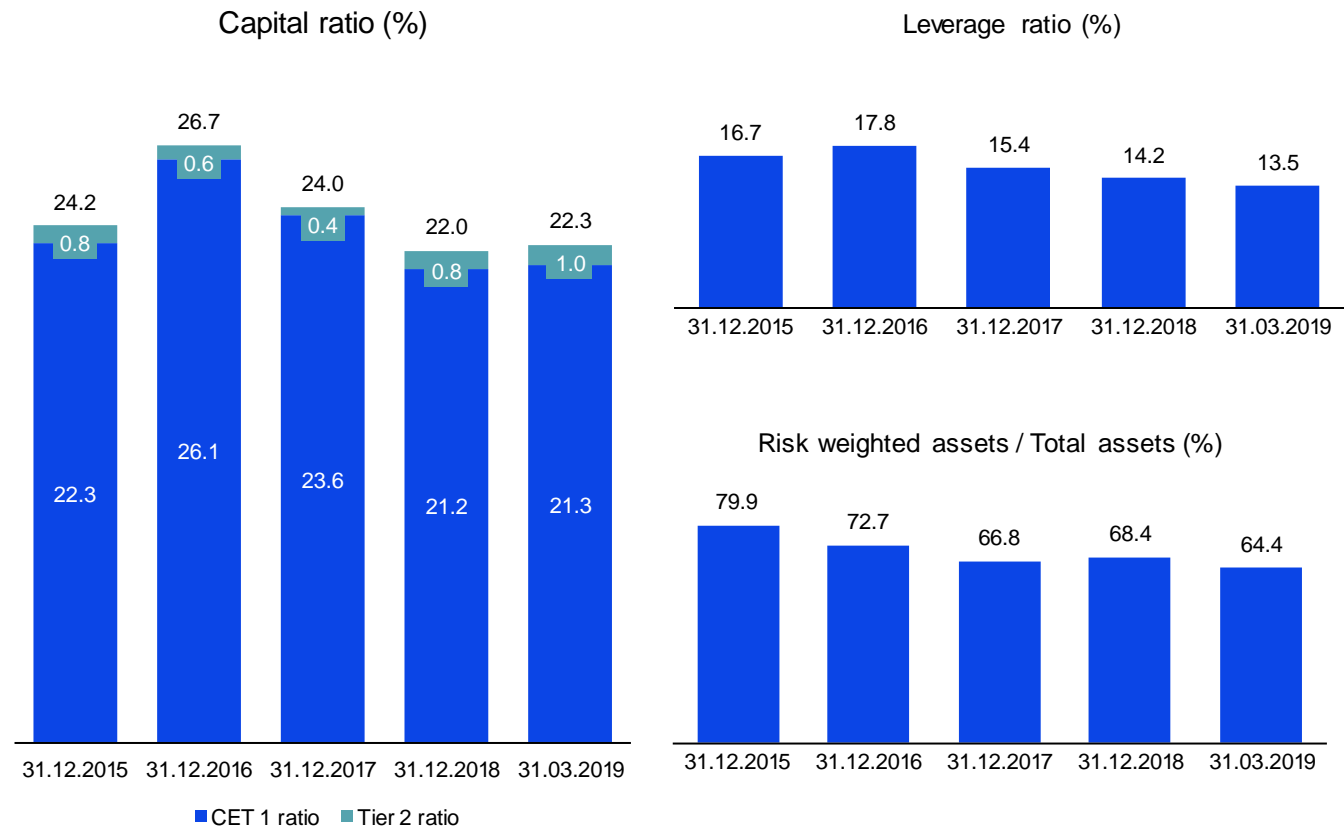
		
Senior unsecured	BBB+	A
Short term debt	A-2	A-1
Outlook	Stable	Stable



# Own funds

## Release of surplus capital continued in Q1 with a dividend payment

- Capital ratio remains stable, increased Tier 2 with due to issue of Subordinated loan of EUR 5 million (ISK 681 million) during Q1
- Arion Bank monitors the debt capital markets to identify the right timing for issuance of Additional Tier 1 (AT1) or further Tier 2 capital instrument in order to optimize the Bank's capital.
- Risk weighted assets/Total assets decreases due to decrease in loan book



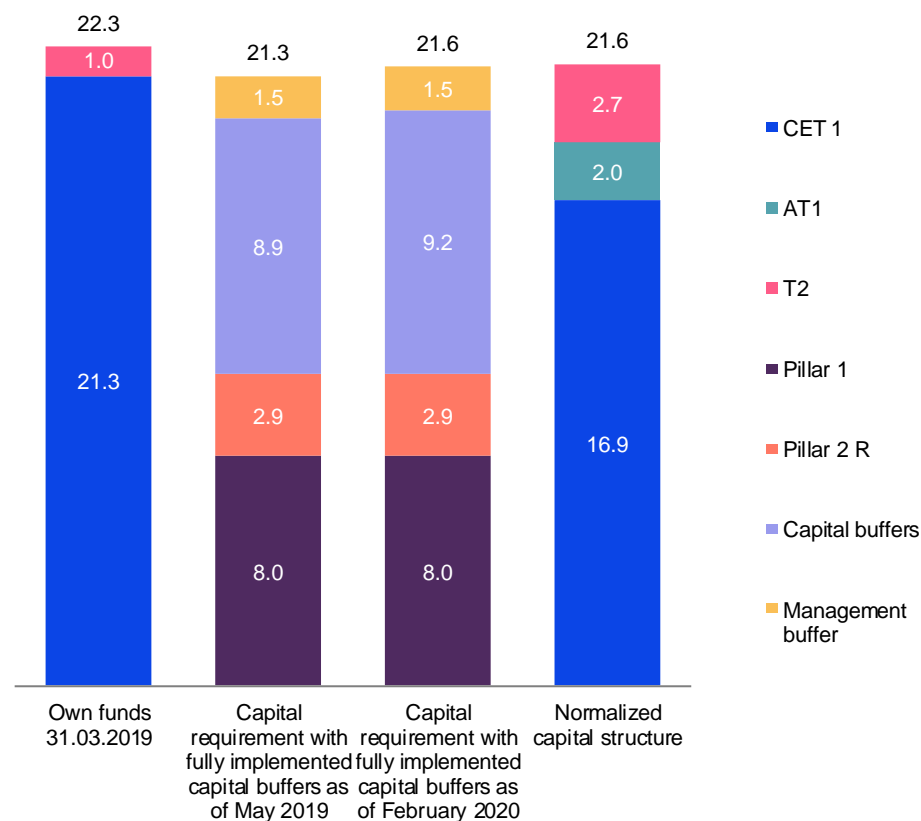


# Capital adequacy

## Own funds and capital requirements

- The Bank's total capital adequacy ratio is 22.3% as at 31 March 2019. The ratio increased by 30 bps in the first quarter, partly due to a reduction of the Bank's loan book.
- In October 2018, FME's concluded the annual Supervisory Review and Evaluation Process (SREP) for the Bank. The Pillar 2 additional requirement is 2.9% of risk-weighted assets based on the Group's financial statement as at 31 December 2017.
- In accordance with FME's decisions the countercyclical capital buffer in Iceland increases by 50 bps in May 2019 and a further increase of 25 bps comes into effect in February 2020
- Based on fully implemented capital buffers as at May 2019, the Group's total regulatory capital requirement is 19.8% of risk-weighted assets
- Taking into account the Bank's internal management buffer of 1.5%, the Bank's near-term total capital requirement is 21.6%. Accordingly, the Bank's surplus capital was ISK 5.2 billion on 31 March 2019, which is in excess of foreseeable dividend payment according to the Bank's dividend policy.

Own funds and capital requirements (%)



Q1 2019

# Going forward



Continued focus on Net interest income and Net interest margin. The Bank will seek ways to reduce capital employed in its operations



Cost control continues to be one of the key focus points supported by cost cutting initiatives and the digital strategy



The intended divestment of Valitor is on track and the marketing of the company to potential investors will start in the coming weeks



Arion Bank will continue to explore further options for optimizing capital and will look to issue AT1 or further T2 subject to market conditions. The Bank has prepared a share buy-back program



The Bank continues its digital journey and the focus will also be on the integration of a new core banking system for deposits and payments



# Arion Bank is committed to its medium term targets



## Return on Equity

Exceed **10%**



## Loan Growth

Prudent lending in  
line with economic  
growth



## CET 1 Ratio

(Subject to regulatory requirements)

Decrease to circa **17%**



## Cost to Income Ratio

Decrease to circa **50%**



## Dividend Policy / Share buy-back

Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above the minimum requirements set by the regulators in addition to the Bank's management buffer

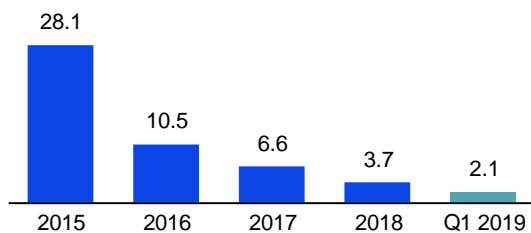


# KFI's and other information

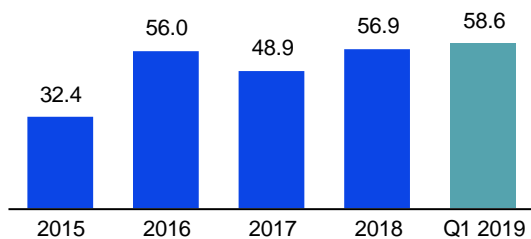


# Key financial indicators - annual

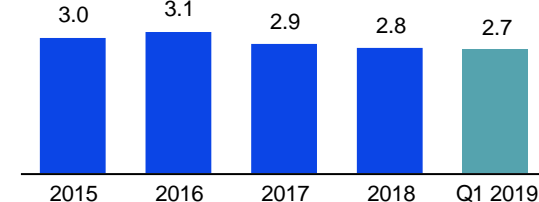
Return on equity (%)



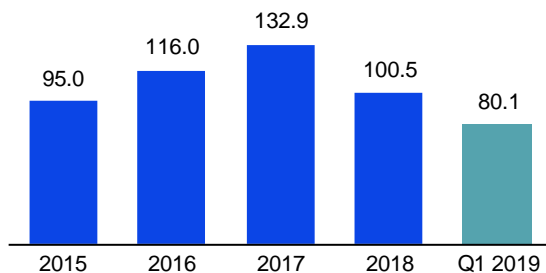
Cost-to-income ratio (%)



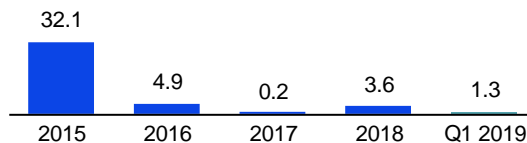
Net interest margin (%)



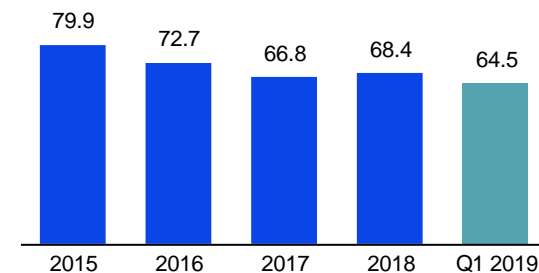
CPI Imbalance – ISK bn.



FX Imbalance – ISK bn.



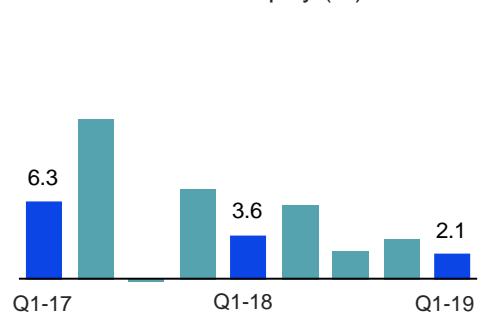
Risk weighted assets / Total assets (%)



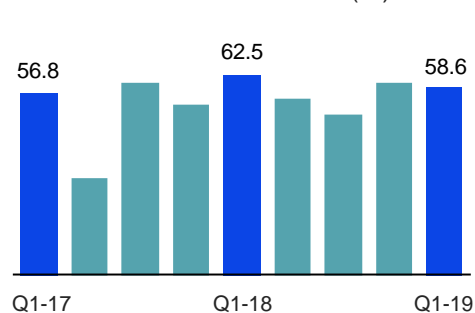


# Key financial indicators - quarterly

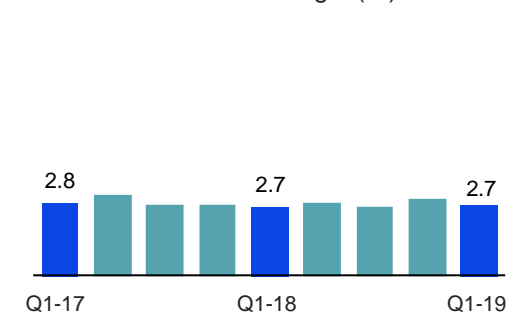
Return on equity (%)



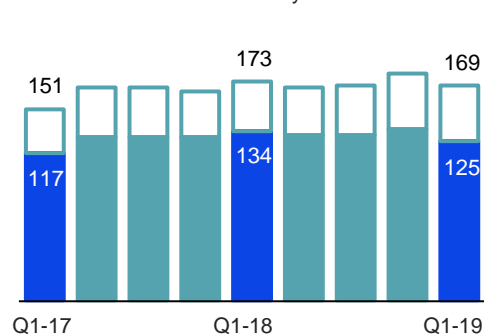
Cost-to-income ratio (%)



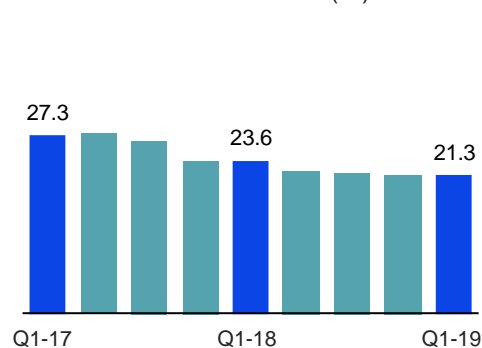
Net interest margin (%)



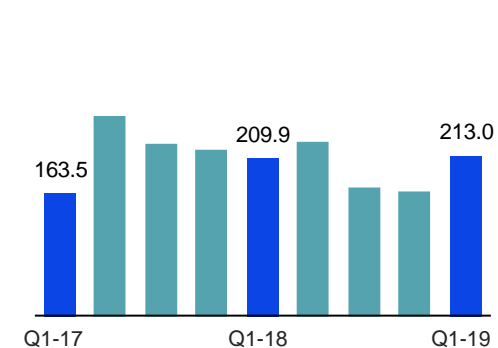
Loans-to-deposits ratio (%)  
without loans financed by covered bonds



Tier 1 ratio (%)



Liquidity coverage ratio (LCR) (%)



# Key figures

Operations	Q1 2019	Q1 2018	Q1 2017	Q1 2016	Q1 2015	Q1 2019	Q4 2018	Q3 2018	Q2 2018	Q1 2018
Net interest income	7,434	6,827	6,904	7,273	5,783	7,434	7,969	7,209	7,314	6,827
Net commission income	2,218	2,205	2,198	3,219	3,757	2,218	2,746	2,687	2,712	2,205
Operating income	11,708	10,810	11,404	12,090	22,019	11,708	10,950	11,906	12,505	10,810
Operating expenses	6,862	6,759	6,478	7,198	6,399	6,862	6,599	5,993	6,927	6,759
Net earnings	1,018	1,949	3,355	2,883	14,906	1,018	1,616	1,150	3,062	1,949
Return on equity	2.1%	3.6%	6.3%	5.7%	35.1%	2.1%	3.2%	2.3%	5.9%	3.6%
Net interest margin	2.7%	2.7%	2.8%	3.1%	2.6%	2.7%	2.9%	2.7%	2.8%	2.7%
Return on assets	0.3%	0.7%	1.2%	1.1%	6.2%	0.3%	0.5%	0.4%	1.1%	0.7%
Cost-to-income ratio	58.6%	62.5%	56.8%	59.5%	29.1%	58.6%	60.3%	50.3%	55.4%	62.5%
Cost-to-total assets	2.3%	2.4%	2.4%	2.8%	2.6%	2.3%	2.2%	2.0%	2.4%	2.4%
<b>Balance Sheet</b>										
Total assets	1,222,695	1,131,768	1,119,648	1,028,606	1,004,324	1,222,695	1,164,326	1,219,529	1,174,844	1,131,768
Loans to customers	829,246	782,255	720,198	694,004	649,089	829,246	833,826	819,965	803,694	782,255
Mortgages	366,381	340,202	302,679	285,886	190,008	366,381	365,820	359,960	348,434	340,202
Share of stage 3 loans, gross	2.5%	3.3%	-	-	-	2.5%	2.6%	2.9%	3.0%	3.3%
Problem loans	-	-	1.5%	2.1%	3.2%	-	-	-	-	-
RWA/ Total assets	64.4%	68.8%	66.4%	71.5%	72.5%	64.4%	68.4%	66.2%	67.8%	68.8%
Tier 1 ratio	21.3%	23.6%	27.3%	26.2%	21.2%	21.3%	21.2%	21.7%	21.9%	23.6%
Leverage ratio	13.5%	15.4%	17.0%	0.0%	0.0%	13.5%	14.2%	13.8%	14.3%	15.4%
Liquidity coverage ratio	213.0%	209.9%	163.5%	153.4%	192.0%	213.0%	164.4%	169.1%	231.7%	209.9%
Loans to deposits ratio	169.1%	172.7%	151.4%	160.2%	137.7%	169.1%	178.9%	169.2%	168.8%	172.7%



# Balance sheet

<b>Assets</b>	<b>31.03.2019</b>	<b>2018</b>	<b>2017</b>	<b>2016</b>	<b>2015</b>
Cash & balances with CB	94	83	140	88	48
Loans to credit institutions	85	56	87	80	87
Loans to customers	829	834	765	712	680
Financial assets	128	115	109	117	133
Investment property	7	7	7	5	8
Investments in associates	1	1	1	1	27
Other assets	78	69	39	32	27
<b>Total Assets</b>	<b>1,223</b>	<b>1,164</b>	<b>1,148</b>	<b>1,036</b>	<b>1,011</b>
<b>Liabilities and Equity</b>					
Due to credit institutions & CB	9	9	7	8	11
Deposits from customers	490	466	462	412	469
Other liabilities	78	64	67	65	62
Borrowings	445	418	385	339	256
Subordinated loans	7	7	-	-	10
Shareholders Equity	193	201	226	211	193
Non-controlling interest	0	0	0	0	9
<b>Total Liabilities and Equity</b>	<b>1,223</b>	<b>1,164</b>	<b>1,148</b>	<b>1,036</b>	<b>1,011</b>



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