Earnings Press Release, 26 July 2023

Arion Bank's Q2 2023 financial results

- Arion Bank reports net earnings of ISK 7,091m in Q2, compared with ISK 10,050m in Q2 2022
- Return on equity in Q2 was 15.5%, compared with 22.6% in Q2 2022
- Earnings per share in ISK of 4.84 in Q2, compared with ISK of 6.70 in Q2 2022
- Net interest margin of 3.2%, compared with 3.1% in Q2 2022
- Solid quarter in all fee generating businesses in terms of fees and commission income, with total fees of ISK 4.2bn.
- Core operating income, defined as net interest income, net commission income and insurance service results (excluding opex of the insurance operation), increased by 8.0% compared with Q2 2022
- Other income positive due to ISK 1.6bn revaluation of the investment property Blikastadir
- Cost-to-core income ratio in Q2 was 39.4%, compared with 42.0% in Q2 2022
- The balance sheet increased by 3.6% from year-end 2022
- The Bank's capital ratio was 23.9% and the CET1 ratio was 18.9% at the end of June
- Pillar II capital requirements was reduced from 3.5% to 2.1% at the end of June
- The insurance subsidiary Vördur adopted IFRS 17 Insurance Contracts 1 January 2023 resulting in change in presentation of insurance results and restated comparative figures

Arion Bank reported net earnings of ISK 7,091m in the second quarter of 2023 and ISK 13,382m during the first six months of the year. Return on equity was 15.5% for the quarter and 14.5% for the first six months.

Total assets amounted to ISK 1,518bn at the end of June, compared with ISK 1,466bn at the end of 2022. Loans to customers increased by 4.6% in the first six months of 2023. The increase was 7.9% in corporate lending and 1.8% in loans to individuals, mainly mortgages. Deposits from customers increased by 3.4% during the first six months, especially from individuals and larger corporates. Total equity amounted to ISK 186bn at the end of June. Total equity decreased from year-end due to a capital release of ISK 15.6bn which was partly offset by net earnings for the first half of 2023.

The Group's capital ratio, as calculated under the Financial Undertakings Act No. 161/2002, was 23.9% and the CET1 ratio was 18.9%. The ratios take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank's dividend policy. These ratios comfortably exceed the requirements made by the FSA and Icelandic law.

Benedikt Gíslason, CEO of Arion Bank

"Arion Bank's second quarter financial results are line with our expectations and reflect the stability which has characterized the Bank's operations in recent quarters. Return on equity in the quarter continues to exceed the Bank's 13% target and all key financial targets were met. However, growth has slowed down in general, which is unsurprising given that economic growth in Iceland has also begun to slow down. Various positives can be found in the Icelandic economy at the moment. Inflation has finally begun to recede, while the international ratings agencies S&P Global Ratings and Moody's have both recently upgraded the sovereign outlook from stable to positive.

In June the Financial Supervisory Authority of the Central Bank of Iceland published the results of its annual assessment of risks in the operations of Arion Bank and concluded that the additional capital requirement would be reduced by 1.4 percentage points. The FSA's decision is positive for the Bank, and at the end of the second quarter the Bank's CET 1 ratio was 18.9%, which is four percentage points higher than the minimum requirement. Arion Bank's liquidity and funding positions also remain robust.

The partnership between Arion Bank and Vörður continues to go from strength to strength, and insurance premiums at Vörður increased in the second quarter by 14.4% compared with the same quarter last year. The highest growth rate was in corporate insurance which is due to the incorporation of Vördur's corporate services division into the Bank's Corporate & Investment Banking division. This move also helped to broaden Vördur's revenue basis and diversify its risk.

Earlier in the month it was announced that the Danish company Coloplast had acquired the Icelandic startup company Kerecis. Kerecis is an excellent example of an innovation success story in Iceland, where a previously discarded raw material is now being transformed into a valuable medical product. It is vital that we continue to nurture innovation in this country as the IP industry has become the fourth pillar of the nation's export revenue. The role of a bank is to take calculated risks alongside its retail and corporate customers, and this is something we do each and every day. We are delighted to have even been just a minor participant in this journey, and the Bank will recognize income of ISK 560 million in the third quarter from the sale of Kerecis. Several other Icelandic startups are doing amazing things today, companies such as Controlant and Amaroq Minerals, who we have worked closely with over the past few years, and we will watch how they perform over the next few years with great anticipation. In addition, various established companies which have made innovation integral to their business have been achieving excellent results, for example Hampidjan, which recently engaged Arion Bank to manage its IPO before making its return to the main market of Nasdaq Iceland.

During times of inflation, it has tended to be difficult to invest savings so that the investment retains its value with respect to inflation without it being tied up for three years. The situation changed in May when Arion Bank launched a new inflation-linked savings option for retail customers where the funds are subject to a notice period of only 90 days. Changes to legislation which came into effect on 1 June meant that inflation-linked savings were no longer subject to a minimum investment period of three years, and this enabled the Bank to offer a new type of account. The change in the law was great news for consumers and the new account has proven very popular among our customers.

In June Mosfellsbær municipality announced its new land use plan for the largest undeveloped piece of land in the capital city area, which is owned by Arion Bank. The 93-hectare area is set to undergo further development, and the secondary land use plan will be announced at a later stage. A total of 3,700 homes are planned to be built, a mixture of single family and multi-family residences, as well as 150 apartments for people aged 55 and over, schools, sports facilities and commercial property. After this important milestone was reached and uncertainty over the future of this key project has been reduced, the Bank has upgraded its valuation of the land and this had a positive impact on the quarterly results. We look forward to watching this area develop as it represents a much-needed addition to the housing market."

Income Statement

In ISK millions	Q2 2023	Q2 2022	Δ	Δ %	H1 2023	H1 2022	Δ	Δ %
Net interest income	11,426	9,745	1,681	17%	22,420	19,221	3,199	17%
Net commission income	4,187	4,582	(395)	(9%)	8,638	8,138	500	6%
Insurance service results	762	924	(162)	(18%)	41	360	(319)	(89%)
Net financial income	(617)	(2,878)	2,261	-	179	(1,758)	1,937	-
Other operating income	1,586	732	854	117%	1,605	1,164	441	38%
Operating income	**17,344**	**13,105**	**4,239**	**32%**	**32,883**	**27,125**	**5,758**	**21%**
Operating expenses	(6,009)	(6,056)	47	(1%)	(12,479)	(11,633)	(846)	7%
Bank levy	(457)	(416)	(41)	10%	(906)	(809)	(97)	12%
Net impairment	(568)	186	(754)	-	(620)	(309)	(311)	101%
Net earnings before income tax	**10,310**	**6,819**	**3,491**	**51%**	**18,878**	**14,374**	**4,504**	**31%**
Income tax expense	(3,226)	(3,588)	362	(10%)	(5,513)	(5,304)	(209)	4%
Net earnings from cont. operations	**7,084**	**3,231**	**3,853**	**119%**	**13,365**	**9,070**	**4,295**	**47%**
Discontinued operations, net of tax	7	6,819	(6,812)	-	17	6,915	(6,898)	-
Net earnings	**7,091**	**10,050**	**(2,959)**	**(29%)**	**13,382**	**15,985**	**(2,603)**	**(16%)**
KFI's								
Return on equity (ROE)	15.5%	22.6%			14.5%	17.5%		
Return on total assets (ROA)	1.9%	3.0%			1.8%	2.4%		
Earnings per share (in ISK)	4.84	6.70			9.17	10.65		
Cost to core income ratio	39.4%	42.0%			43.0%	44.4%		
Net interest margin (NIM)	3.2%	3.1%			3.1%	3.1%		
Core income / REA	7.5%	7.3%			7.2%	6.8%		

Net interest income increased by 17.2%, compared with the second quarter of 2022. The net interest margin (NIM) as a percentage of average interest-bearing assets was 3.2% for the quarter, compared with 3.1% for the second quarter of 2022. The policy rate increased from 2.75% at the beginning of the second quarter 2022 to 8.75% at the end of the second quarter 2023. Rate sensitivity is slowing as interest expense is increasing on both deposits and wholesale funding. Average interest-bearing assets increased by 9.2%, compared with the second quarter of 2022, mainly loans to customers.

Net commission income was ISK 4.2bn in the second quarter of 2023. The quarter was solid in all fee generating businesses, with strong and stable income from asset management, despite challenging market conditions. Lending fees are down from the second quarter of 2022, which was a record quarter in lending fees.

Insurance service results of the insurance company Vördur amounted to ISK 762m during the quarter. There has been strong growth of 14.4% in premiums written, compared with the second quarter 2022 and 12.6% increase in total insurance revenues. Claims are seasonally volatile but are showing signs of normalizing after some challenging quarters. Due to the adoption of IFRS 17 Insurance Contracts, the presentation of insurance results has been changed, the largest change being a shift of insurance service expenses from operating expenses to insurance service results. The combined ratio for the second quarter of 2023 was 79.3%, compared with 73.7% for the same period in 2022.

Net financial income was negative by ISK 617m for the quarter. The quarter was challenging, especially for equity positions, and affected by continued market volatility. The Bank partly prepaid an EMTN bond due in May 2024 with a premium of ISK 225m expensed.

Other income was positive during the quarter due to ISK 1.6bn revaluation of the investment property Blikastadir, one of the largest undeveloped plots of land in the capital area. With the publication by the municipality of the draft of a new master plan of Blikastadir in June the revaluation was prudent.

Operating expenses decreased by 0.8% in the second quarter, compared with the same period in 2022. When operating expenses of the insurance operation are included (post IFRS 17 cost related to insurance business is accounted for through insurance service results), the increase was 1.5%. There is an ongoing focus on operating expenses and efficiency within the Group. Cost-to-core income ratio was 39.4% in the second quarter, compared with 42.0% in the second quarter 2022, when including the operating expenses of the insurance operation. Salary expenses increased compared with the second quarter of 2022, mainly due to new labor agreements and an increase in the number of FTEs. At the end of June, the number of full-time equivalent positions (FTEs) was 781, an increase of 5% from the same period in 2022.

Net impairment was ISK 568m in the second quarter of 2023, mainly affected by prudent changes to IFRS 9 model assumptions. Impairments were slightly lower than through the cycle expectations, estimated at 25-30bps of the loan book on an annualized basis.

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 1bn. The effective income tax rate was 31.3% for the quarter. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate.

Balance sheet

The balance sheet increased by 3.6% from year-end 2022 and the liquidity position remains strong.

Assets

In ISK millions	30.06.2023	31.12.2022	Δ	Δ %	31.03.2023	Δ	Δ %
Cash & balances with CB	76,499	114,118	(37,619)	(33%)	80,272	(3,773)	(5%)
Loans to credit institutions	43,428	45,501	(2,073)	(5%)	62,899	(19,471)	(31%)
Loans to customers	1,134,621	1,084,757	49,864	5%	1,114,128	20,493	2%
Financial instruments	225,828	193,328	32,500	17%	204,997	20,831	10%
Intangible assets	8,486	8,783	(297)	(3%)	8,575	(89)	(1%)
Other assets	29,364	19,122	10,242	54%	29,773	(409)	(1%)
Total assets	**1,518,226**	**1,465,609**	**52,617**	**4%**	**1,500,644**	**17,582**	**1%**
KFI's							
REA / Total assets	60.1%	60.1%			60.4%		
Share of stage 3 loans, gross	1.6%	1.4%			1.4%		

Loans to customers increased by 4.6% or ISK 50bn from the end of 2022, with loans to corporates increasing by 7.9%, and loans to individuals growing by 1.8%. Part of this growth or ISK 9bn, is due to inflation and changes in currencies. This growth rate exceeded expectations but is expected to be slower for the second part of the year. The diversification of the corporate loan book continues to be good and in line with the Bank's credit strategy.

The Bank's liquidity position is strong with the total LCR ratio at 163% and the ISK LCR ratio at 106%. This is reflected in the strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments. The average duration of liquidity in the bond portfolio is less than one year and there is no HTM accounting.

Liabilities and equity

In ISK millions	30.06.2023	31.12.2022	Δ	Δ %	31.03.2023	Δ	Δ %
Due to credit institutions & CB	21,702	11,697	10,005	86%	24,188	(2,486)	(10%)
Deposits from customers	781,202	755,361	25,841	3%	775,023	6,179	1%
Other liabilities	76,956	70,702	6,254	9%	84,085	(7,129)	(8%)
Borrowings	405,572	392,563	13,009	3%	390,734	14,838	4%
Subordinated liabilities	46,478	47,330	(852)	(2%)	46,682	(204)	(0%)
Total liabilities	**1,331,910**	**1,277,653**	**54,257**	**4.2%**	**1,320,712**	**11,198**	**1%**
Shareholders equity	185,651	187,307	(1,656)	(1%)	179,276	6,375	4%
Non-controlling interest	665	649	16	2%	656	9	1%
Total equity	**186,316**	**187,956**	**(1,640)**	**(1%)**	**179,932**	**6,384**	**4%**
Total liabilities and equity	**1,518,226**	**1,465,609**	**52,617**	**4%**	**1,500,644**	**17,582**	**1%**
KFI's							
Loans to Deposits ratio	145.2%	143.6%			143.8%		
CET1 ratio	18.9%	18.8%			18.6%		
Capital adequacy ratio	23.9%	24.0%			23.7%		

Deposits from customers remain the most important source of funding for Arion Bank, with almost 60% of total liabilities in deposits. The 3.4% increase from year-end 2022 is mainly from individuals, SME's and corporates.

The maturity profile of *Borrowings* is balanced, and the Bank has broad funding options. During the quarter Arion Bank issued EUR 300m senior preferred notes, partly used to prepay 73.5% of a EUR 300m senior bond maturing in May 2024. The Bank has no significant FX maturities until December 2024.

Shareholders' equity decreased due to dividend payments and the purchase of own shares, in total ISK 15.6bn, which is partly offset by the net earnings of ISK 13.4bn for the period. The leverage ratio was 11.7% at the end of June, compared with 11.8% at the end of 2022, which is high by international standards. Taking into account the increase in the countercyclical buffer to 2.5%, the Bank has ISK 37bn of surplus capital over regulatory requirement. The management buffer range implies surplus capital in the range of ISK 15bn to ISK 24bn. Rating consideration may impact capital management in the near-term.

For further information on the accounts please visit Arion Bank's website.

Medium-term financial targets

Medium-term financial targets of Arion Bank

	Actuals Q2 2023	Actuals 6M 2023	Arion Bank's medium-term financial targets
Return on equity	15.5%	14.5%	Exceed 13%
Core operating income / REA	7.5%	7.2%	Exceed 6.7%
Insurance premium growth (YoY)	12.3%	10.1%	Premium growth (net of reinsurance) to exceed the growth of the domestic market by more than 3% (Premium growth in the domestic insurance market was 9.3% for Q1 2023 and 7.5% for 2022)
Cost-to-core income ratio	39.4%	43.0%	Below 48%
CET1 ratio	400 bps	400 bps	150-250 bps management buffer (~16.4 - 17.4% based on current capital requirements)
Dividend pay-out ratio	50%	50%	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

Arion Bank will host its Capital Markets Day in Q1 2024 to provide an update on strategy and direction of the Group as well as revised medium-term targets.

Investor meeting / webcast in English on 27 July at 10:30 CEST / 9:30 BST / 8:30 GMT

Arion Bank will be hosting a meeting at the Bank's headquarters in Borgartún 19, Reykjavík, on Thursday 27 July at 10:30 CEST / 8:30 GMT where CEO Benedikt Gíslason and CFO Ólafur Hrafn Höskuldsson will present the results and give an update on the economic environment. The meeting will take place in English and will also be streamed live.

The webcast will be accessible live on financialhearings and a link is also available on the Bank's website under Investor Relations.

Participants attending virtually will be able to ask questions during the meeting through a message board, located below the video feed. Answers will be provided by presenters at the end of the webcast.

For any further information please contact Theodór Fridbertsson, Head of IR, tel.+354 856 6760, or Haraldur Gudni Eidsson, Head of Corporate Communications, tel. +354 856 7108.

Financial calendar

Arion Bank's financial calendar is available on the Bank's website.

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.