Earnings Press Release, 6 May 2020

Arion Bank's Q1 2020 financial results

Arion Bank's results in Q1 affected by Covid-19 pandemic

Covid-19 had a substantial effect on the Icelandic economy and Arion Bank during the last month of the first quarter of 2020. Arion Bank reported a net loss of ISK 1,282 million from continuing operations and a net loss of ISK 2,171 million in the quarter. Return on equity was negative by 4.6% and 2.7% from continuing operations. The Bank reported net earnings of ISK 1,018 million for the same period in 2019, with return on equity of 2.1%. There were three main factors that contributed towards these negative earnings for the first quarter of 2020: Net financial income was negative by ISK 2,000 million, highly affected by fair value changes of equity holdings due to unfavorable market conditions; Net impairment was negative by ISK 2,860 million, mostly due to more pessimistic assumptions in the Bank's IFRS 9 models, especially as regards unemployment and the transfer of tourism related customers to Stage 2; and discontinued operations were negative by ISK 889 million, due to an operating loss at Valitor and value changes of Sólbjarg ehf. and Stakksberg ehf., all of which are classified as held for sale assets.

Total assets amounted to ISK 1,188 billion at the end of March 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 9.4% from year-end 2019 as a result of the continued focus on deposits. Total equity amounted to ISK 184 billion, compared with ISK 190 billion at the end of 2019, a decrease mainly related to the buy-back program in Q1.

The Bank's capital ratio at the end of March 2020 was 27.5%, compared with 24.0% at the end of 2019. The CET 1 ratio was 22.5% at the end of March 2020, compared with 21.2% at the end of 2019. The Group's own funds increased by ISK 23.3 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 and the recommendation of the Central Bank of Iceland to that effect. This effectively reintroduces the foreseeable ISK 10 billion dividend at year-end 2019 as loss absorbing capital.

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	**Q1 2020**	**Q1 2019**	**% diff.**
Net interest income	7,253	7,434	(2%)
Net commission income	3,076	2,218	39%
Net insurance income	501	253	98%
Net financial income	(2,000)	766	-
Share of profit of associates	(24)	727	-
Other operating income	170	310	(45%)
Operating income	**8,976**	**11,708**	**(23%)**
Salaries and related expenses	(3,130)	(3,630)	(14%)
Other operating expenses	(3,077)	(3,232)	(5%)
Operating expenses	**(6,207)**	**(6,862)**	**(10%)**
Bank levy	(331)	(906)	(63%)
Net impairment	(2,860)	(1,081)	165%
Net earnings / loss before income tax	**(422)**	**2,859**	**-**
Income tax expense	(860)	(622)	38%
Net earnings / loss from cont. operations	**(1,282)**	**2,237**	**-**
Discontinued operations, net of tax	(889)	(1,219)	(27%)
Net earnings / loss	**(2,171)**	**1,018**	**-**
KPI's			
Return on equity	(4.6%)	2.1%	
Earnings / loss per share (in ISK)	(1.25)	0.56	
Cost to income ratio	69.2%	58.6%	

Highlights of the Balance Sheet and key performance indicators:

In ISK millions	**31.03.2020**	**31.12.2019**	**Diff.**	**% diff.**
Loans to customers	778,823	773,955	4,868	1%
Other assets	408,996	307,900	101,096	33%
Liabilities	1,003,940	892,030	111,910	13%
Equity	183,879	189,825	(5,946)	(3%)
Loans to Deposits ratio	144.4%	157.0%		
REA / Total assets	60.0%	66.5%		
CET1 ratio	22.5%	21.2%		
Capital adequacy ratio	27.5%	24.0%		

Benedikt Gíslason, CEO of Arion Bank

"Arion Bank's financial results for the first quarter of 2020 were significantly impacted by the Covid-19 pandemic. The Bank reported an operating loss of approximately ISK 2 billion for the first quarter, which can largely be attributed to the effect of Covid-19 and the performance of the securities markets and the economy in general. The market value of the Bank's equity holdings decreased by ISK 2 billion, net impairment amounted to approximately ISK 3 billion, or 0.38% of the Bank's loan portfolio, and the negative impact of held for sale assets was approximately ISK 1 billion. Net impairment is mostly due to the more negative economic outlook and the increased probability of default as a result. The Bank's loan portfolio remains well distributed between retail and corporate customers and approximately 91% of loans are secured with collateral, of which 70% are secured with collateral in real estate. Core operations developed positively in the quarter compared with Q1 2019, despite the challenging conditions. The Bank's net interest margin increased, core revenues were up 9% and operating expenses decreased by 10%. The Bank continues to focus on its core revenues, and the financial targets have not changed even though it may now take longer to achieve them.

In recent weeks and months we have done whatever we can to help our customers adapt to the unique circumstances created by the Covid-19 pandemic. Almost two thousand of our retail customers have taken advantage of the mortgage payment holiday offered by the Bank. There is currently a payment freeze on more than 11% of the Bank's loans to individuals. We have also been working closely with our corporate customers to analyze the current situation and outlook and many companies have requested a payment freeze on their loans. We have done our utmost to accommodate their requests and there is currently a payment freeze on approximately 9% of corporate loans. The Bank has therefore frozen approximately 10% of its loan portfolio.

Excellent results have been achieved in the battle against Covid-19 in Iceland and cases are on the decline. The economic consequences have yet to fully materialize but they will undoubtedly be some of the most severe witnessed in recent times. It seems likely that it will be some time before the tourist industry regains its former shape, with the positive impact it had on the Icelandic business sector and economy. Arion Bank will continue to strive to supports its customers. The Bank's issue of Additional Tier 1 capital and the Board's decision to cancel the share buy-back program and dividend mean that the Bank's capital and liquidity positions are unusually robust and the Bank's capital adequacy ratio is higher than ever at 27.5%. One third of the Bank's capital, or ISK 63 billion, is in excess of the regulatory minimum and the Bank is therefore well placed to tackle the conditions we currently face."

Income statement

In ISK millions	Q1 2020	Q1 2019	% diff.	Q4 2019	% diff.
Net interest income	7,253	7,434	(2%)	7,693	(6%)
Net commission income	3,076	2,218	39%	2,615	18%
Net insurance income	501	253	98%	723	(31%)
Net financial income	(2,000)	766	-	489	-
Share of profit of associates	(24)	727	-	5	-
Other operating income	170	310	(45%)	199	(15%)
Operating income	**8,976**	**11,708**	**(23%)**	**11,724**	**(23%)**
Salaries and related expenses	(3,130)	(3,630)	(14%)	(3,076)	2%
Other operating expenses	(3,077)	(3,232)	(5%)	(3,368)	(9%)
Operating expenses	**(6,207)**	**(6,862)**	**(10%)**	**(6,444)**	**(4%)**
Bank levy	(331)	(906)	(63%)	(357)	(7%)
Net impairment	(2,860)	(1,081)	165%	1,203	(338%)
Net earnings / loss before income tax	**(422)**	**2,859**	**-**	**6,126**	**-**
Income tax expense	(860)	(622)	38%	(923)	(7%)
Net earnings / loss from cont. operations	**(1,282)**	**2,237**	**-**	**5,203**	**-**
Discontinued operations, net of tax	(889)	(1,219)	(27%)	(7,981)	(89%)
Net earnings / loss	**(2,171)**	**1,018**	**-**	**(2,778)**	**-**

Operating income amounted to ISK 9.0 billion for the first quarter of 2020, compared with ISK 11.7 billion for the same period in 2019 and the fourth quarter of 2019, a decrease of 23%. Net commission income developed positively and increased by 39% compared with the same period in 2019 and 18% compared with the fourth quarter of 2019, whereas net financial income was negative by ISK 2,000 million, compared with ISK 766 million income for the same period in 2019 and ISK 489 million for the fourth quarter of 2019.

Net interest income decreased by 2% compared with the same period in 2019 and 6% compared with the fourth quarter of 2019. The net interest margin (NIM) as a percentage of average interest-bearing assets was 2.8% during the first quarter of 2020, compared with 2.7% for the same period in 2019 and 3.0% for the fourth quarter of 2019. The main reason for the decrease in net interest income is lower inflation and a 5% decrease in interest-bearing assets during the quarter and a 6% decrease from the same period last year.

Net commission income increased by 39% in the first quarter of 2020 compared with the same period in 2019 and 18% from the fourth quarter of 2019. Income from lending and guarantees is exceptionally strong in the first quarter of 2020, mainly driven by the prepayment of loans and the service agreement with Housing Financing Fund (HFF).

Net insurance income amounted to ISK 501 million, compared with ISK 253 million for the same period of 2019, and ISK 723 million during the fourth quarter of 2019. 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 first quarter of 2020 was 103.5%, compared with 109.6% for the first quarter of 2019 and 94.4% for the fourth quarter of 2019 and is highly competitive in the domestic market.

Net financial income was negative by ISK 2,000 million, compared with ISK 766 million positive net income for the first quarter of 2019 and ISK 489 million for the fourth quarter of 2019. Net financial income was negatively affected by equity holdings of ISK 2,403 million measured at fair value as markets were negative from the start of the Covid-19 pandemic, and FX loss of ISK 153 million, although ISK 413 million of FX earnings are classified in discontinued operation. Net financial income was positively affected by fair value developments in bond holdings and derivatives.

Other operating income was ISK 170 million during the first quarter of 2020, compared with ISK 310 million during the same period in 2019 and ISK 199 million during the fourth quarter of 2019. Profit from sale of assets was the main source of income in all quarters.

Operating expenses amounted to ISK 6,207 million during the first quarter of 2020, compared with ISK 6,862 million in the same period in 2019 and ISK 6,444 million during the fourth quarter of 2019. The Bank’s cost-to-income ratio was 69.2% for the first quarter of 2020, compared with 58.6% for the same period in 2019 and 54.9% for the fourth quarter of 2019, the higher ratio highly affected by negative net financial income. The cost-to-total assets ratio was 2.2% for the first quarter, compared with 2.3% during the first quarter of 2019 and 2.2% for the fourth quarter of 2019.

Salaries and related expenses amounted to ISK 3,130 million for the first quarter of 2020, a decrease of 14% compared with the same period of 2019, but a 2% increase compared with the fourth quarter of 2019. Full-time equivalent positions (FTE's) at the end of March 2020 totalled 814 for the Group and 687 at the Bank.

Other operating expenses amounted to ISK 3,077 million during the first quarter of 2020, compared with ISK 3,232 million during the same period in 2019 and ISK 3,368 million during the fourth quarter of 2019. The decrease between the first quarter in 2020 and 2019 is most notably marketing expense.

Net impairment was negative by ISK 2,860 million during the first quarter of 2020, compared with a negative net impairment of ISK 1,081 million in the same period in 2019 and ISK 1,203 million positive net impairment in the fourth quarter of 2019. Calculated impairment was 0.38% of loans to customers, of which 0.11% (27.4% of net impairment) is due to specific impairment (Stage 3), 0.06% (15.9% of net impairment) due to an increased impairment in tourism exposure, 0.05% (12.7% of net impairment) is due to other increase in credit risk and 0.16% (44.0% of net impairment) is due to a change in economic scenarios in IFRS 9 models. 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. Positive net impairment in the fourth quarter of 2019 was mainly due to the realization of discounts when the Bank sold a mortgage loan portfolio amounting to ISK 48 billion to the HFF. The sale of the loan portfolio initiated the discount realization of ISK 1.6 billion that would otherwise have been recognized following a prepayment of the mortgages or during their time until maturity.

Income tax expense amounted to ISK 860 million during the first quarter of 2020, compared with ISK 622 million in the same period in 2019 and ISK 923 million during the fourth quarter of 2019. 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 negative for the first quarter of 2020, mainly due to loss from equity holdings, which is not tax-deductible, compared with 21.8% 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 889 million during the first quarter of 2020, compared with a loss of ISK 1,219 million for the same period in 2019 and a loss of ISK 7,981 million in the fourth quarter of 2019. The main reasons for the negative results of discontinued operations are chiefly twofold: negative operational results of Valitor and valuation changes of Stakksberg and Sólbjarg. Additionally an impairment of Valitor's intangible assets of ISK 4.0 billion had significant negative impacts on the fourth quarter of 2019.

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.

Balance sheet

Arion Bank's ***total assets*** increased by 10% from year-end 2019.

In ISK millions	**31.03.2020**	**31.12.2019**	**Diff.**	**% diff.**
Cash & balances with CB	118,174	95,717	22,457	23%
Loans to credit institutions	33,797	17,947	15,850	88%
Loans to customers	778,823	773,955	4,868	1%
Financial assets	192,056	117,406	74,650	64%
Investment property	7,129	7,119	10	0%
Investments in associates	828	852	(24)	(3%)
Intangible assets	8,826	8,367	459	5%
Assets and disposal groups held for sale	28,038	43,626	(15,588)	(36%)
Other assets	20,149	16,866	3,283	19%
Total assets	**1,187,820**	**1,081,855**	**105,965**	**10%**

Cash and balances with the Central Bank and *Loans to credit institutions* increased in total by ISK 38,307 million or 34% 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 778,823 million at the end of March 2020 and increased by 0.6% from year-end 2019. Loans to individuals increased by 1.5% during the quarter, mainly due to strong mortgage lending. However, loans to corporates were rather stable during the quarter, mainly due to the depreciation of the Icelandic krona. With year-end 2019 FX rates constant, the loan book would have reduced by 2.5% during the period. The loan book continues to be well balanced between individuals and corporates with a good distribution between sectors.

Financial assets amounted to ISK 192,056 million at the end of March 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	**31.03.2020**	**31.12.2019**	**Diff.**	**% diff.**
Bonds	130,961	65,874	65,087	99%
Shares and instruments w. variable income	20,878	21,600	(722)	(3%)
Derivatives	9,935	6,617	3,318	50%
Securities used for hedging	30,282	23,315	6,967	30%
Securities total	**192,056**	**117,406**	**74,650**	**64%**

Assets and disposal groups held for sale amounted to ISK 28,038 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 16,664 million at the end of March 2020.

Liabilities increased by 13% from year-end 2019. ***Equity*** decreased due to the purchase of own shares and loss for the period.

In ISK millions	**31.03.2020**	**31.12.2019**	**Diff.**	**% diff.**
Due to credit institutions & CB	8,323	5,984	2,339	39%
Deposits from customers	539,312	492,916	46,396	9%
Financial liabilities at fair value	4,687	2,570	2,117	82%
Other liabilities	70,455	37,102	33,353	90%
Borrowings	322,470	304,745	17,725	6%
Subordinated liabilities	35,837	20,083	15,754	78%
Liabilities associated w. disposal groups HFS	22,857	28,630	(5,773)	(20%)
Total liabilities	**1,003,941**	**892,030**	**111,911**	**13%**
Shareholders equity	183,702	189,644	(5,942)	(3%)
Non-controlling interest	177	181	(4)	(2%)
Total equity	**183,879**	**189,825**	**(5,946)**	**(3%)**
Total liabilities and equity	**1,187,820**	**1,081,855**	**105,965**	**10%**

Deposits from customers amounted to ISK 539,312 million at the end of March 2020 and had increased by 9% from year-end 2019. The loan-to-deposit ratio was 144.4% at the end of March 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.

Borrowings amounted to ISK 322,470 million at the end of March 2020, a 6% increase from year-end 2019, primarily due to the depreciation of the ISK against foreign currencies. 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 35,837 million at the end of March 2020, compared with ISK 20,083 million at the end of 2019. The Bank issued its first AT1 instrument during the quarter 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.

Shareholders' equity amounted to ISK 183,702 million at the end of March 2020, compared with ISK 189,644 million at the end of 2019. The decrease is explained by the purchase of own shares in the amount of ISK 4.4 billion and the negative financial results for the period. The share buy-back program continued until the AGM in March 2020. The CET 1 ratio was 22.5% at the end of March 2020, compared with 21.2% at the end of 2019. The leverage ratio was 14.5% at the end of March 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 first quarter of 2020 on the Bank's website.

Key performance indicators

	Q1 2020	Q1 2019
Return on equity (ROE)	(4.6%)	2.1%
Return on equity from continuing operations	(2.7%)	4.5%
Return on total assets (ROA)	(0.8%)	0.3%
Net interest margin (int. bearing assets)	2.8%	2.7%
Net interest margin (total assets)	2.6%	2.5%
Cost-to-income ratio	69.2%	58.6%
Cost-to-Total assets ratio	2.2%	2.3%
Effective tax rate	(203.8%)	21.8%
CAD ratio	27.5%	22.3%
CET1 ratio	22.5%	21.3%
Share of stage 3 loans, gross	2.9%	2.5%
REA/Total assets	60.0%	64.4%
Loans to deposit ratio	144.4%	169.1%
The Group's employees at the end of the period	814	917
The Parent's employees at the end of the period	687	811

Investor webcast in English on 7 May at 10:30 CET (8:30 GMT)

Arion Bank will be hosting a webcast on Thursday 7 May 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 webcast will take place in English.

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: +46 850 558 351
UK: +44 333 300 9030
Iceland: +354 800 7520
United States: +1 833 526 8396

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

For media enquiries please contact Haraldur Gudni Eidsson, Head of Corporate Communications, at haraldur.eidsson@arionbanki.is or tel. +354 856 7108.

Financial calendar 2020

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

Extended AGM	14 May 2020
Second quarter 2020	29 July 2020
Third quarter 2020	28 October 2020

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.