Arion Bank

Earnings Press Release, 13 February 2019

ARION BANK'S FINANCIAL RESULTS FOR 2018

CORE BANKING TRENDS CONTINUE TO BE POSITIVE

Arion Bank reported net earnings of ISK 1.6 billion for the fourth quarter of 2018, compared with ISK 4.1 billion for the same period of 2017. Return on equity was 3.2% for the fourth quarter of 2018, compared with 7.3% for the same period in 2017. Net earnings in 2018 were ISK 7.8 billion and return on equity 3.7% compared with ISK 14.4 billion net earnings and 6.6% return on equity in 2017. The Board proposes a dividend payment of ISK 10 billion or ISK 5.00 per share. The dividend payment is a continuation of the optimization of the Bank's capital structure.

Total assets amounted to ISK 1,164.3 billion at the end of 2018, compared with ISK 1,147.8 billion at the end of 2017. Total equity amounted to ISK 200.9 billion, compared with ISK 225.7 billion at the end of 2017. In 2018 Arion Bank paid dividend of ISK 16.2 billion and purchased treasury stock for ISK 17.1 billion.

The Bank's capital ratio at the end of 2018 was 22.0%, compared with 24.0% at the end of 2017. The CET1 ratio was 21.2% at the end of 2018, compared with 23.6% at the end of 2017.

Arion Bank is in the process of divesting the Bank's subsidiary Valitor Holding hf. Valitor has been classified as a disposal group held for sale in the Financial Statements. The comparative figures for the year 2017 have been restated in the Income Statement for the year 2018.

Highlights of the income statement and key income related performance indicators:

In ISK millions	Q4 2018	Q4 2017	% diff.	2018	2017	% diff.
Net interest income	7,969	7,063	13%	29,319	28,920	1%
Net commission income	2,746	3,124	(12%)	10,350	10,211	1%
Net financial income	(774)	1,555	-	2,302	4,045	-
Net insurance income	704	324	117%	2,589	2,093	24%
Share of profit of associates and impairment	11	(10)	-	27	(927)	-
Other operating income	294	90	227%	1,584	2,521	(37%)
Operating income	**10,950**	**12,146**	**(10%)**	**46,171**	**46,863**	**(1%)**
Salaries and related expenses	(3,584)	(3,461)	4%	(14,278)	(13,602)	5%
Other operating expenses	(3,015)	(2,982)	1%	(12,000)	(9,291)	29%
Operating expenses	**(6,599)**	**(6,443)**	**2%**	**(26,278)**	**(22,893)**	**15%**
Bank levy	(765)	(784)	(2%)	(3,386)	(3,172)	7%
Net impairment	(573)	1,504	(138%)	(3,525)	312	-
Net earnings before income tax	**3,013**	**6,423**	**(53%)**	**12,982**	**21,110**	**(39%)**
Income tax expense	(881)	(1,957)	(55%)	(4,046)	(5,966)	(32%)
Discontinued operations, net of tax	(516)	(401)	29%	(1,159)	(725)	60%
Net earnings	**1,616**	**4,065**	**(60%)**	**7,777**	**14,419**	**(46%)**
KPI's						
Return on equity	3.2%	7.3%		3.7%	6.6%	
Earnings per share (in ISK)	4.29	2.02		3.86	7.20	
Cost to income ratio	60.3%	53.0%		56.9%	48.9%	

Highlights of the balance sheet and key performance indicators:

In ISK millions	31.12.2018	31.12.2017	Diff.	% diff.
Loans to customers	833,826	765,101	68,725	9%
Other assets	330,500	382,653	(52,154)	(14%)
Liabilities	963,467	922,021	41,446	4%
Equity	200,859	225,734	(24,875)	(11%)
Loans to Deposits ratio	178.9%	165.5%		
RWA / Total assets	68.4%	66.8%		
CET 1 ratio	21.2%	23.6%		

For detailed information on the accounts please refer to Arion Bank's Consolidated Financial Statements for the year 2018 on the Bank's website, www.arionbanki.is.

HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK

"Arion Bank's financial results for the fourth quarter were below expectations, as indeed they were for 2018 as a whole. However, we can see positive developments in the Bank's core operations and are pleased to see the improvement in the Bank's net interest margin during the fourth quarter in line with our objectives. Challenging conditions on the equity and bond markets, not least a volatile airline industry in Iceland, have left their mark on operations, both during the quarter and 2018 as a whole. One of our main tasks this year will be to increase profitability and a number of projects have been launched in this respect. It is nevertheless obvious that generating a satisfactory return on equity will be challenging without an increase in lending rates when the government continues to burden the banking system with extremely high taxes and the regulators increase capital requirements and other public levies.

An important milestone was reached in 2018 when the Bank was listed on Nasdaq Iceland and Nasdaq Stockholm following a successful IPO in which approximately 30% of the Bank's share capital was sold. The offering was heavily oversubscribed with investors from the United Kingdom, the United States, Scandinavia and continental Europe purchasing around 70% of the offering. The Bank had approximately 6,000 shareholders at year-end.

In November the Bank issued its first subordinated bonds which are eligible as Tier 2 capital. This issuance as well as the dividends and share buybacks in 2018 are a part of the strategy to optimize the Bank's capital structure. The capital ratio at year-end is strong and well above the required minimum, or 22.0%, taking into account the dividend proposal of ISK 10 billion. The payment exceeds the Bank's dividend policy and further shows its intention to optimize the capital structure in the medium term.

In November the Bank announced that it had appointed Citi to advice on the planned sale of the Bank's subsidiary Valitor. The sales process is currently being prepared and further developments can be expected this year.

At the end of the year Arion Bank was named the marketing company of 2018 by the Icelandic marketing association, Ímark, for the successful digital journey the Bank has been on. Our digital solutions have also begun to make an impression internationally and the Bank won two awards for its digital products in December. In a little over two years we have launched around 20 digital products and our branch network has evolved in response to the popularity of these solutions. During the fourth quarter two new micro-branches were opened. These micro-branches focus on digital services and occupy substantially less space than the older traditional branches. In fact we were able to reduce the total size of our branches in the Reykjavík area by close to 40% during last year. This trend clearly has an impact on how we work and it also influences how our customers obtain their financial services from us. Today 97% of interaction between the Bank and our customers is through digital channels, such as the App, Arion Online Banking and our website, and digital sales grew 125% during the year.

In 2018 Arion Bank became the first Icelandic bank to be given permission to use the Ministry of Welfare's equal pay symbol. Equality has been a key priority in recent years and the Bank first received equal pay certification from the union VR in 2015. The Bank has retained this certification ever since, and the focus on equal rights and the knowledge that employees receive the same salary for equally valuable jobs has had an extremely positive effect on the Bank's culture. The Bank is also outperforming most listed companies in Sweden by being 17th out of 329 on AllBright's list of companies in Sweden in terms of the gender ratio in management teams."

INCOME STATEMENT

In ISK millions	Q4 2018	Q3 2018	% diff.	Q4 2017	% diff.
Net interest income	7,969	7,209	11%	7,063	13%
Net commission income	2,746	2,687	2%	3,124	(12%)
Net financial income	(774)	570	-	1,555	-
Net insurance income	704	984	(28%)	324	117%
Share of profit of associates and impairment	11	34	(68%)	(10)	(210%)
Other operating income	294	422	(30%)	90	227%
Operating income	**10,950**	**11,906**	**(8%)**	**12,146**	**(10%)**
Salaries and related expenses	(3,584)	(3,129)	15%	(3,461)	4%
Other operating expenses	(3,015)	(2,864)	5%	(2,982)	1%
Operating expenses	**(6,599)**	**(5,993)**	**10%**	**(6,443)**	**2%**
Bank levy	(765)	(938)	(18%)	(784)	(2%)
Net impairment	(573)	(2,651)	(78%)	1,504	(138%)
Net earnings before taxes	**3,013**	**2,324**	**30%**	**6,423**	**(53%)**
Income tax expense	(881)	(973)	(9%)	(1,957)	(55%)
Discontinued operations, net of tax	(516)	(201)	157%	(401)	29%
Net earnings	**1,616**	**1,150**	**41%**	**4,065**	**(60%)**

Operating income amounted to ISK 11.0 billion for the fourth quarter of 2018, compared with ISK 12.1 billion for the same period in 2017. Net interest income, net insurance income and other operating income increase between years, whereas net commission income and net financial income decreased. Operating income decreased by 8% compared with the third quarter of 2018, in particular net financial income.

Net interest income increased by 13% compared with the fourth quarter of 2017. The net interest margin as a percentage of average interest-bearing assets was 2.9% during the fourth quarter of 2018 compared with 2.7% for the fourth quarter of 2017. The margin was 2.7% during the third quarter of 2018. Average interest-bearing assets increased by 3.6% in 2018 but decreased by 2.8% from the third quarter of 2018. Increase in the net interest margin from third quarter is the result of management emphasis on return on lending rather than loan growth and improved liquidity management.

Net commission income decreased by 12% during the fourth quarter of 2018 compared with the same period in 2017 but increased slightly from the third quarter 2018. The decrease is primarily due to lower performance fees, partly due to market conditions, in Asset Management in Q4 2018 compared with the same period in 2017.

Net financial income is negative by ISK 774 million, compared with positive net financial income of ISK 1,555 million for the fourth quarter of 2017 and ISK 570 million for the third quarter of 2018. The markets were weak generally in Q4 2018, both equity markets and bond markets. The Group holds preference shares in Visa international which performed weakly during the quarter although the performance was acceptable through the whole year. Repricing of bonds relating to the airline industry and fair value changes of legacy lending position was marked down by total of ISK 720 million during the quarter. In general returns on bonds and equity holdings have been positive through the years.

Net insurance income amounted to ISK 704 million, compared with ISK 324 million for the fourth quarter of 2017, and ISK 984 million during the third quarter of 2018. The increase from 2017 is primarily due to increasing premiums earned at the insurance company Vördur and a relatively low claim rate. Combined ratio in Q4 was 90.0% compared to 105.4% for the same period in 2017.

Other operating income was ISK 294 million during the fourth quarter, compared with ISK 90 million during the same period in 2017 and ISK 422 million during the third quarter of 2018. Fair value changes on investment property are the main reason for the fluctuations between quarters.

Operating expenses amounted to ISK 6,599 million during the fourth quarter, compared with ISK 6,443 million in the same period in 2017 and ISK 5,993 million during the third quarter of 2018. The Bank's cost-to-income ratio was 60.3% for the fourth quarter, compared with 53.0% for the same period in 2017 and 58.2% during the third quarter of 2018. The cost-to-total assets ratio was 2.2% for the fourth quarter, the same as in the fourth quarter of 2017 and 2.7% during the third quarter of 2018.

Salaries and related expenses amounted to ISK 3,584 million for the fourth quarter of 2018, an increase of 4% from the same period in 2017 but increased by 15% from the third quarter of 2018, mainly due to seasonal fluctuations. The increase from last year is mainly due to a general rise in salaries under labor agreements which came into effect in May 2018. The average salary per employee increased by 5.9% between years 2018, but at the same time the general salary index in Iceland rose by 6.3%. Full-time equivalent positions at the end of the year totalled 904 at the Group, 45 down from the year end 2017 and decrease by 29 from the end of third quarter 2018. The decrease is mainly due to the outsourcing of projects, e.g. the cash center and increased emphasis on process automation.

Other operating expenses amounted to ISK 3,015 million during the fourth quarter of 2018, compared with ISK 2,982 million during the same period in 2017 and ISK 2,864 million during the third quarter of 2018. There are minor changes between years but increase of 5% from third quarter is mainly due to seasonal fluctuations.

Net impairment was negative by ISK 573 million during the fourth quarter of 2018, compared with a positive net impairment of ISK 1,504 million in the same period in 2017 and a negative of ISK 2,651 million in the third quarter of 2018. In general the net impairment is unsatisfactory, partly due to slightly more cautious macro expectations. The total exposure to the airline industry was ISK 4.0 billion at year-end, down from ISK 4.3 billion at the end of Q3.

Income tax amounted to ISK 881 million during the fourth quarter of 2018, compared with ISK 1,957 million in the same period in 2017 and ISK 973 million during the third quarter of 2018. 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 high, or 29.2% for the fourth quarter of 2018, compared with 30.5% during the fourth quarter of 2018. This high tax rate is mainly due to the fact that the bank levy is not deductible from the tax base and therefore taxes weighs high as net earnings are low.

Discontinued operations, net of tax was negative of ISK 516 million during the fourth quarter, compared with loss of ISK 401 million for the same period in 2017 and loss of ISK 201 million in the third quarter of 2018. This is mainly due to result from operation of the subsidiary Valitor, which was reclassified as a disposal group held for sale at year end 2018 and consequently the income statement for 2017 was restated as announced in press release from 21 January 2019.

Full year 2018

In ISK millions	**2018**	**2017**	**% diff.**
Net interest income	29,319	28,920	1%
Net commission income	10,350	10,211	1%
Net financial income	2,302	4,045	(43%)
Net insurance income	2,589	2,093	24%
Share of profit of associates and impairm.	27	(927)	-
Other operating income	1,584	2,521	(37%)
Operating income	**46,171**	**46,863**	**(1%)**
Salaries and related expenses	(14,278)	(13,602)	5%
Other operating expenses	(12,000)	(9,291)	29%
Operating expenses	**(26,278)**	**(22,893)**	**15%**
Bank levy	(3,386)	(3,172)	7%
Net impairment	(3,525)	312	(1,230%)
Net earnings before taxes	**12,982**	**21,110**	**(39%)**
Income tax expense	(4,046)	(5,966)	(32%)
Discontinued operations, net of tax	(1,159)	(725)	-
Net earnings	**7,777**	**14,419**	**(46%)**
KPI's			
Return on equity	3.7%	6.6%	
Earnings per share (in ISK)	3.86	7.20	
Cost to income ratio	56.9%	48.9%	

Net earnings in 2018 were significantly lower than in 2017, which can be explained by numerous one-offs during both years.

Net interest margin for the year 2018 was 2.8% compared with 2.9% in 2017, which can mainly be explained by high liquidity in ISK in 2017, which was largely used to pay out dividends and to buy treasury stock in 2018.

Loss from associates was relatively high in 2017, mainly due to the operational difficulties at United Silicon.

Positive fair value changes in investment properties were extraordinary in 2017, which explains the significant deviations in *other operating income*.

Operating expenses increased largely due to the reversal of a liability to the Depositors' and Investors' Guarantee Fund, amounting to ISK 2,669 million, which had a significant effect on other operating expenses during 2017.

Net impairment was significant for both years, due to Primera in 2018 and United Silicon in 2017. In 2017 there were significantly more positive changes in the loan book, partly due to prepayments of mortgages with the release of discounts and payments from composition and bankrupt estates. The bankruptcy of Primera Air greatly affected the impairment in 2018.

The cost-to-income ratio increased, mainly due to the reversal of a liability to the Depositors' and Investor's Guarantee Fund in 2017.

Earnings of operating segments

Arion Bank divides its operations into five profit centers plus subsidiaries and support units. The Bank's profit centers are Asset Management, Corporate Banking, Investment Banking, Retail Banking and Treasury.

All of the Bank's profit centers made a profit before income tax in the fourth quarter of 2018.

4th Quarter 2018 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	196	1,717	93	4,636	1,258	69	7,969
Net commission income	825	366	535	1,323	(92)	(211)	2,746
Other income	(16)	(672)	9	178	(262)	998	235
Operating income	**1,005**	**1,411**	**637**	**6,137**	**904**	**856**	**10,950**
Operating expenses	(611)	(912)	(415)	(3,402)	(334)	(925)	(6,599)
Bank levy	(36)	(155)	(10)	(273)	(291)	0	(765)
Net impairment	0	(292)	0	(274)	(22)	15	(573)
Earnings before income tax	**358**	**52**	**212**	**2,188**	**257**	**(54)**	**3,013**

3rd Quarter 2018 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	183	1,437	72	4,386	1,127	4	7,209
Net commission income	837	284	441	1,326	(68)	(133)	2,687
Other income	24	(2)	(5)	367	331	1,295	2,010
Operating income	**1,044**	**1,719**	**508**	**6,079**	**1,390**	**1,166**	**11,906**
Operating expenses	(515)	(747)	(343)	(2,961)	(272)	(1,155)	(5,993)
Bank levy	(42)	(188)	(12)	(329)	(366)	(1)	(938)
Net impairment	0	(2,672)	16	(12)	19	(2)	(2,651)
Earnings before income tax	**487**	**(1,888)**	**169**	**2,777**	**771**	**8**	**2,324**

4th Quarter 2017 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	103	1,225	58	3,684	1,910	84	7,064
Net commission income	1,368	400	370	1,297	(64)	(247)	3,124
Other income	26	50	(12)	127	327	1,441	1,959
Operating income	**1,497**	**1,675**	**416**	**5,108**	**2,173**	**1,278**	**12,147**
Operating expenses	(664)	(802)	(404)	(3,432)	(309)	(832)	(6,443)
Bank levy	33	(196)	(11)	(180)	(430)	0	(784)
Net impairment	0	642	(35)	1,283	15	(401)	1,504
Earnings before income tax	**866**	**1,319**	**(34)**	**2,779**	**1,449**	**45**	**6,424**

Asset Management

In ISK millions	Q4 2018	Q3 2018	% diff	Q4 2017	% diff
Net interest income	196	183	7.1%	103	90.3%
Net commission income	825	837	(1.4%)	1,368	(39.7%)
Other income	(16)	24	-	26	-
Operating income	**1,005**	**1,044**	**(3.7%)**	**1,497**	**(32.9%)**
Operating expenses	(611)	(515)	18.6%	(664)	(8.0%)
Bank levy	(36)	(42)	(14.3%)	33	-
Earnings before income tax	**358**	**487**	**(26.5%)**	**866**	**(58.7%)**

The operations of Asset Management have been rather stable and net earnings are good. Lower income compared to same period last year is mainly due to lower performance fees as few large projects were closed at year-end 2017. Operating expenses decreased compared with the fourth quarter of 2018, with increased focus on cost, but increase from third quarter is mainly due to seasonal fluctuations. Assets under management at the end of 2018 amounted to ISK 971 billion and decreased by 1.4% from year-end 2017, mainly due to few institutional investors in-sourcing their asset management function.

Corporate Banking

In ISK millions	Q4 2018	Q3 2018	% diff	Q4 2017	% diff
Net interest income	1,717	1,437	19.5%	1,225	40.2%
Net commission income	366	284	28.9%	400	(8.5%)
Other income	(672)	(2)	-	50	-
Operating income	**1,411**	**1,719**	**(17.9%)**	**1,675**	**(15.8%)**
Operating expenses	(912)	(747)	22.1%	(802)	13.7%
Bank levy	(155)	(188)	(17.6%)	(196)	(20.9%)
Net impairment	(292)	(2,672)	(89.1%)	642	-
Earnings before income tax	**52**	**(1,888)**	**-**	**1,319**	**(96.1%)**

Net interest income at Corporate Banking increased significantly between years and from third quarter, partly due to increased focus on return rather that growth in the corporate lending book. Operating expenses has increased from fourth quarter in 2017 due to focus on lending processes but increase from third quarter is mainly due to seasonality. The negative net valuation changes in the loan portfolio during the fourth quarter can be primarily attributed to loans and guarantees in the airline industry and in the third quarter provision and write-offs against Primera was the main driver for negative outcome. Valuation changes during the fourth quarter of 2017 were rather favorable, mainly due to economic conditions.

Investment Banking

In ISK millions	Q4 2018	Q3 2018	% diff	Q4 2017	% diff
Net interest income	93	72	29.2%	58	60.3%
Net commission income	535	441	21.3%	370	44.6%
Other income	9	(5)	-	(12)	-
Operating income	**637**	**508**	**25.4%**	**416**	**53.1%**
Operating expenses	(415)	(343)	21.0%	(404)	2.7%
Bank levy	(10)	(12)	(16.7%)	(11)	(9.1%)
Net impairment	0	16	-	(35)	-
Earnings before income tax	**212**	**169**	**25.4%**	**(34)**	**-**

Activities at Investment Banking have increased considerably during 2018, compared with the same period last year. Corporate Finance has continued to be actively engaged in internal projects at the Bank, such as resolving complex recovery cases, but has also increased the number of market transactions in which it is involved. Revenues from equities and fixed income brokerage at Capital Markets have been strong and the Bank has been a leader in terms of turnover on Nasdaq Iceland in recent years.

Retail Banking

In ISK millions	Q4 2018	Q3 2018	% diff	Q4 2017	% diff
Net interest income	4,636	4,386	5.7%	3,684	25.8%
Net commission income	1,323	1,326	(0.2%)	1,297	2.0%
Other income	178	367	(51.5%)	127	40.2%
Operating income	**6,137**	**6,079**	**1.0%**	**5,108**	**20.1%**
Operating expenses	(3,402)	(2,961)	14.9%	(3,432)	(0.9%)
Bank levy	(273)	(329)	(17.0%)	(180)	51.7%
Net impairment	(274)	(12)	2,183.3%	1,283	(121.4%)
Earnings before income tax	**2,188**	**2,777**	**(21.2%)**	**2,779**	**(21.3%)**

Operating income increased by 1% between the fourth quarter of 2018 and the third quarter of 2018 and by 20% compared with the fourth quarter of 2017. The increase can be attributed to growth in the loan book, both loans to individuals and SMEs, as well as to the strong focus over the last few years on fee generating operations.

Operating expenses are in line with the previous year, and reflect the strategic development of the branch network to align to changing customer behavior and the Bank's digital solutions.

Net impairment was slightly below expectations during the period but prepayments of mortgages, as a result of the favorable interest environment, continue and have a positive effect.

Treasury

In ISK millions	Q4 2018	Q3 2018	% diff	Q4 2017	% diff
Net interest income	1,258	1,127	11.6%	1,910	(34.1%)
Net commission income	(92)	(68)	35.3%	(64)	43.8%
Other income	(262)	331	-	327	-
Operating income	**904**	**1,390**	**(35.0%)**	**2,173**	**(58.4%)**
Operating expenses	(334)	(272)	22.8%	(309)	8.1%
Bank levy	(291)	(366)	(20.5%)	(430)	(32.3%)
Net impairment	(22)	19	(215.8%)	15	-
Earnings before income tax	**257**	**771**	**(66.7%)**	**1,449**	**(82.3%)**

Operating income from Treasury decreased during the fourth quarter of 2018 compared with the same period of 2017 and the third quarter of 2018. The decrease is mainly due to net financial income from derivatives and FX. Net interest income has decreased, mainly due to less liquid assets in ISK and more in foreign currencies, which bear lower interest.

BALANCE SHEET

Arion Bank's ***total assets*** increased by 1% from year-end 2018 but decreased by 4% during the last quarter.

In ISK millions	31.12.2018	31.12.2017	Diff.	% diff.	30.09.2018	% diff.
Cash & balances with CB	83,139	139,819	(56,680)	(41%)	99,525	(16%)
Loans to credit institutions	56,322	86,609	(30,286)	(35%)	123,446	(54%)
Loans to customers	833,826	765,101	68,725	9%	819,965	2%
Financial assets	114,557	109,450	5,107	5%	109,374	5%
Investment property	7,092	6,613	479	7%	7,044	1%
Investments in associates	818	760	57	8%	862	(5%)
Intangible assets	6,397	13,848	(7,451)	(54%)	14,039	(54%)
Assets and disposal groups held for sale	48,584	8,138	40,446	497%	8,351	482%
Other assets	13,592	17,416	(3,824)	(22%)	36,923	(63%)
Total assets	**1,164,327**	**1,147,754**	**16,573**	**1%**	**1,219,530**	**(5%)**

Cash and balances with the Central Bank amounted to ISK 83,139 million at the end of the year, compared with ISK 139,819 million at the end of 2017. The decrease is partly due to the buyback of own shares and dividend payments totalling ISK 33.3 billion in 2018.

Loans to customers totalled ISK 833,826 million at the end of the year, representing a 9% increase from year-end 2017 and 2% increase in the last three months. Loans to corporates increased by 8.3% between years, mainly loans to wholesale and retail on the one hand and real estate and construction on the other. Loans to individuals increased by 9.6%, primarily mortgage loans, as the Bank's market share remained stable during the year, although fourth quarter was lower compared to prior periods. In 2018 the Bank had to make impairments in relation to the bankruptcy of Primera Air by total of ISK 2.8 billion, which affected the loan growth slightly.

Financial assets amounted to ISK 114,557 million at the end of the year, compared with ISK 109,450 million at the end of 2017. The combination of securities held by the Bank is heavily related to the liquidity position at any given time. Transfers from international debt funds to highly rated foreign currency bonds during the year of 2018 represent part of the Bank's liquidity management but the Bank has also sold a significant part of its listed and unlisted equity holdings during 2018.

In ISK millions	31.12.2018	31.12.2017	Diff.	% diff.	30.09.2018	% diff.
Bonds	71,451	51,755	19,696	38%	64,256	11%
Shares and instruments w. variable income	20,265	36,190	(15,925)	(44%)	21,348	(5%)
Derivatives	6,241	7,624	(1,383)	(18%)	6,353	(2%)
Securities used for hedging	16,600	13,881	2,719	20%	17,417	(5%)
Securities total	**114,557**	**109,450**	**5,107**	**5%**	**109,374**	**5%**

Assets and disposal groups held for sale amounted to ISK 48,584 million at the end of 2018 compared with ISK 8,138 million at year-end 2017. The main changes are due to reclassification of the subsidiary Valitor, which is now classified as disposal group held for sale. The total assets of Valitor at year-end were ISK 40,003 million, with majority cash and bank accounts.

Liabilities increased by 4% from year-end 2017 but reduced by 5% during the last quarter. ***Equity*** decreased due to the purchase of treasury stock and dividend payments in 2018, totalling ISK 33.3 billion. Net earnings for the year and the effects of the adoption of IFRS 9 partly offset the decrease.

In ISK millions	31.12.2018	31.12.2017	Diff.	% diff.	30.09.2018	% diff.
Due to credit institutions & CB	9,204	7,370	1,834	25%	15,370	(40%)
Deposits from customers	466,067	462,161	3,906	1%	484,569	(4%)
Financial liabilities at fair value	2,320	3,601	(1,281)	(36%)	3,381	(31%)
Other liabilities	35,226	63,891	(28,665)	(45%)	90,553	(61%)
Borrowings	417,782	384,998	32,784	9%	425,601	(2%)
Subordinated loans	6,532	0	6,532	-	0	-
Liabilities associated w. disposal groups HFS	26,337	0	26,337	-	0	-
Shareholders equity	200,729	225,606	(24,877)	(11%)	199,315	1%
Non-controlling interest	130	128	2	2%	741	(82%)
Total liabilities and equity	**1,164,327**	**1,147,754**	**16,572**	**1%**	**1,219,530**	**(5%)**

Deposits from customers amounted to ISK 466,067 million at the end of 2018 and had increased by 1% from year-end 2017. However the combination of deposits have developed favorable as higher share of deposits are now from individuals and SME's through Retail Banking but share of deposits from institutional investors have decreased accordingly. Deposits remain the most important source of funding for Arion Bank and the Bank will aim to maintain as strong a position as possible on the deposits market.

Borrowings amounted to ISK 417,782 million at the end of 2018. In March Arion Bank issued a new 5-year EUR 300 million bond on the international markets (ISK 37 billion). The Bank has also continued to issue covered bonds on the Icelandic market, a total of approximately ISK 32 billion in 2018, as well as commercial papers for a total of ISK 31 billion.

Subordinated liabilities amounted to ISK 6,532 million at the end of 2018, following a Tier 2 issuance of SEK 500 million bond in November. The bonds were priced at a spread of STIBOR 310 and have ten year maturity with option to pay in 2023.

Shareholders' equity amounted to ISK 200,729 million at the end of 2018, compared with ISK 225,606 million at the end of 2017. The decrease is explained by a buyback of shares during the first quarter of 2018 and dividend payments during the first and the third quarters of 2018, a total of ISK 33.3 million, which is partly offset by an increase in equity due to the adoption of IFRS 9 and the financial results for the year. The CET 1 ratio was 21.2% at year-end 2018, compared with 23.6% at year-end 2017.

KEY PERFORMANCE INDICATORS

	Q4 2018	**Q4 2017**	**2018**	**2017**
Return on equity (ROE)	3.2%	7.3%	3.7%	6.6%
Return on total assets (ROA)	0.5%	1.4%	0.7%	1.3%
Net interest margin (int. bearing assets)	2.9%	2.7%	2.8%	2.9%
Net interest margin (total assets)	2.7%	2.5%	2.5%	2.6%
Cost-to-income ratio	60.3%	53.0%	56.9%	48.9%
Cost-to-Total assets ratio	2.2%	2.2%	2.3%	2.1%
Effective tax rate	29.2%	28.9%	31.2%	28.4%
CAD ratio	22.0%	24.0%	22.0%	24.0%
CET 1 ratio	21.2%	23.6%	13.8%	23.6%
Share of stage 3 loans, gross*	2.9%	-	2.3%	-
RWA/Total assets	68.4%	66.8%	68.4%	66.8%
Loans to deposit ratio	178.9%	165.5%	178.9%	165.5%
The Group's average number of employees	918	951	928	939
The Group's employees at the end of the period	904	949	904	949
The Parent's average number of employees	808	844	820	830
The Parent's employees at the end of the period	794	844	794	844

* Following the implementation of IFRS 9 on 1 January 2018 a new measurement is used:
(Gross loans in stage 3 + POCI loans in RISK class 5) / Gross carrying amount of loans to customers

FINANCIAL TARGETS

Arion Bank's medium-term targets are as follows:

RoE	Exceed 10%
CET 1	Reduce to circa 17%
Loan growth	Prudent lending in line with economic growth
Cost to Income ratio	Reduce to circa 50%
Dividend policy	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buy-back of the Bank's shares or a combination of both. Additional distributions will be considered when Arion Bank's capital levels are above limitations set by regulators in addition to the Bank's Management Buffer.

CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a meeting / webcast on Thursday 14 February at 8:30 GMT / 9:30 CET where CEO Höskuldur H. Ólafsson and CFO Stefán Pétursson will present the results and answer questions from participants. The meeting will take place in English at the Bank's headquarters, Borgartún 19, and will be streamed live.

Those attending the meeting in Borgartún 19 need to register here. To participate in the webcast via telephone and to submit questions please call in using the relevant number before the start of the webcast:

IS: +354 800 7417 (pin: 90959272#)
SE: +46 850 558 354
UK: +44 333 300 9260
US: +1 646 722 4902

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.

For further information please contact Sture Stölen, head of Arion Bank's Investor Relations at ir@arionbanki.is or Theódór Fridbertsson at Investor Relations at theodor.fridbertsson@arionbanki.is, tel. +354 444 6760.

FINANCIAL CALENDAR 2019

The Bank's Financial Statements are scheduled for publication as stated below.

AGM 2019	20 March 2019
First quarter 2019	8 May 2019
Second quarter 2019	8 August 2019
Third quarter 2019	30 October 2019

This calendar may be subject to change.

ANNUAL REPORT AND PILLAR 3 RISK DISCLOSURES

Arion Bank will publish its Annual Report 2018 and Pillar 3 disclosures on 20 February 2019 on the Bank's website, www.arionbanki.is.

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.