Arion Bank

Earnings Press Release, 2 August 2018

ARION BANK'S Q2 2018 FINANCIAL RESULTS

LISTING AND INITIAL PUBLIC OFFERING

Arion Bank was listed on Nasdaq Iceland and Nasdaq Stockholm on 15 June 2018 following an initial public offering of 28.7% of shares in the Bank. The offering was heavily oversubscribed and the shares were placed with investors in Iceland, Scandinavia, the UK, Continental Europe and the US. This was the first listing of an Icelandic bank on the main market in Iceland since 2008.

Arion Bank reported net earnings of ISK 3.1 billion for the second quarter of 2018, compared with ISK 7.1 billion for the same period of 2017. Return on equity was 5.9% for the second quarter of 2018, compared with 13.0% for the same period in 2017. During the first half of 2018 net earnings were ISK 5.0 billion and return on equity 4.7% compared with ISK 10.5 billion and 9.7% during the first half of 2017.

Total assets amounted to ISK 1,174.8 billion at the end of June 2018, compared with ISK 1,147.8 billion at the end of 2017. Shareholders' equity totalled ISK 206.9 billion, compared with ISK 225.6 billion at the end of 2017.

The Bank's capital ratio at the end of June was 21.9%, compared with 24.0% at the end of 2017. The CET1 ratio was 21.8% at the end of June, compared with 23.6% at the end of 2017.

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

In ISK millions	**Q2 2018**	**Q2 2017**	**% change**	**H1 2018**	**H1 2017**	**% change**
Net interest income	7,613	8,160	(7%)	14,521	15,320	(5%)
Net commission income	4,492	3,508	28%	8,034	6,838	17%
Net financial income	927	1,975	(53%)	2,267	3,205	(29%)
Net insurance income	758	606	25%	901	1,053	(14%)
Share of profit of associates and impairment	2	(900)	(100%)	(16)	(934)	(98%)
Other operating income	610	1,811	(66%)	879	2,375	(63%)
Operating income	**14,402**	**15,160**	**(5%)**	**26,586**	**27,857**	**(5%)**
Salaries and related expenses	(5,011)	(4,561)	10%	(9,647)	(8,783)	10%
Other operating expenses	(3,964)	(1,223)	224%	(7,960)	(5,057)	57%
Operating expenses	**(8,975)**	**(5,784)**	**55%**	**(17,607)**	**(13,840)**	**27%**
Bank levy	(880)	(777)	13%	(1,684)	(1,574)	7%
Net impairment	(192)	409	(147%)	(291)	1,289	(123%)
Net earnings before taxes	**4,355**	**9,008**	**(52%)**	**7,004**	**13,732**	**(49%)**
Income tax expense	(1,287)	(1,895)	(32%)	(2,105)	(3,266)	(36%)
Discontinued operations, net of tax	(6)	0	-	112	0	-
Net earnings	**3,062**	**7,113**	**(57%)**	**5,011**	**10,466**	**(52%)**
KPI's						
Return on equity	5.9%	13.0%		4.7%	9.7%	
Earnings per share (in ISK)	1.35	3.56		2.35	5.23	
Cost to income ratio	62.3%	38.2%		66.2%	49.7%	

Highlights of the balance sheet and key performance indicators:

In ISK millions	**30.06.2018**	**31.12.2017**	**Diff**	**Diff%**
Loans to customers	803,694	765,101	38,593	5%
Other assets	371,151	382,653	(11,503)	(3%)
Liabilities	967,213	922,020	45,193	5%
Equity	207,631	225,734	(18,103)	(8%)
Loans to Deposits ratio	168.8%	165.5%		
RWA / Total assets	67.8%	66.8%		
CET 1 ratio	21.8%	23.6%		

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

HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK

"The Bank's financial results for the second quarter of 2018 are in line with expectations following a somewhat challenging first three months. There was strong growth in the Bank's regular activities, and loans to customers were up 5% during the first six months. The net interest margin on interest-bearing assets increased to 2.8% in Q2 from 2.6% in Q1, and commission income grew by more than 25%. Income from insurance activities showed more than a fourfold increase compared with the first quarter. The Bank's balance sheet remains robust, which enables us to provide a full-range of services to our retail and corporate customers.

A major milestone was reached when the Bank was listed on the stock exchange in 15 June following a successful IPO, in which approximately 30% of the Bank was sold to investors. The IPO was heavily oversubscribed and international investors showed strong interest, with around 70% of investors in the IPO being from overseas. On 15 June Arion Bank was admitted to trading on Nasdaq Iceland and Nasdaq Stockholm simultaneously. The listing in Sweden was the second largest so far this year, while in Iceland it was the second largest listing ever.

Throughout the entire process we were delighted to see the strong level of interest from Icelandic and international investors in the Bank and our vision for the future, as well as their interest in the Icelandic economy in general. We hope that the firm backing shown by international investors will have a positive effect on the investment environment in Iceland in the long term.

One of the things which clearly attracted investors was the Bank's robust capital position and the potential for reducing it in stages over the next few years through dividends or share buybacks. The Board of Directors has now agreed to submit a proposal to a shareholders' meeting scheduled for September that a dividend of ISK 10 billion be paid to shareholders before the end of third quarter, which corresponds to ISK 5 a share. Investors also showed an interest in developments at the Bank's subsidiary Valitor, which operates in the field of payment services in Iceland, Scandinavia and the United Kingdom. The Bank has now appointed an international management consultancy to assist with a strategic review of the company.

Arion Bank completed four new digital projects in Q2. We believe that the future success in banking in general will to a large extend depend on the ability of banks to adopt digital solutions into their operations. We were therefore pleased to be recognised by the magazine Retail Banker International, which awarded the bank a prize for the most disruptive innovation for its digital mortgage process and credit assessment.

Preparations are being made to commence a sale process for Stakksberg, the holding company of the silicon plant at Helguvík, in the second half of the year. The Bank will also continue to seek ways to optimize its capital and look into the possibility of issuing subordinated loans in the second half of the year, if market conditions allow."

INCOME STATEMENT

In ISK millions	Q2 2018	Q2 2017	% change	Q1 2018	% change
Net interest income	7,613	8,160	(7%)	6,908	10%
Net commission income	4,492	3,508	28%	3,542	27%
Net financial income	927	1,975	(53%)	1,340	(31%)
Net insurance income	758	606	25%	143	430%
Share of profit of associates and impairment	2	(900)	(100%)	(18)	(111%)
Other operating income	610	1,811	(66%)	269	127%
Operating income	**14,402**	**15,160**	**(5%)**	**12,184**	**18%**
Salaries and related expenses	(5,011)	(4,561)	10%	(4,636)	8%
Other operating expenses	(3,964)	(1,223)	224%	(3,996)	(1%)
Operating expenses	**(8,975)**	**(5,784)**	**55%**	**(8,632)**	**4%**
Bank levy	(880)	(777)	13%	(804)	9%
Net impairment	(192)	409	(147%)	(99)	94%
Net earnings before taxes	**4,355**	**9,008**	**(52%)**	**2,649**	**64%**
Income tax expense	(1,287)	(1,895)	(32%)	(818)	57%
Discontinued operations, net of tax	(6)	0	-	118	(105%)
Net earnings	**3,062**	**7,113**	**(57%)**	**1,949**	**57%**

Operating income amounted to ISK 14.4 billion for the second quarter of 2018, compared with ISK 15.2 billion for the same period in 2017. Net commission income increased between years, whereas net interest income and net financial income decreased. Other operating income also decreased. Operating income increased significantly, primarily net interest income, net commission income and net insurance income.

Net interest income decreased by 7% between quarters. The net interest margin as a percentage of average interest-bearing assets was 2.8% during the second quarter of 2018, compared with 3.1% for the same period in 2017 and 2.6% during the first quarter of 2018. Interest-bearing assets increased by 2.3% from the second quarter of 2017 and by approximately 1.8% from the first quarter of 2018. The lower interest margin between years is partly due to the higher proportion of cash and cash equivalents in foreign currency, which bear low interest rates, and to pressure on the Bank's interest rates in a highly competitive environment with falling interest rates, both for corporates and retail customers. The increase in net interest margin from the first quarter is mainly due to the payment at the end of first quarter of legacy EUR funding from 2015, when the Bank issued its first long-term bond on the international market.

Net commission income increased by 28% during the second quarter of 2018 compared with the same period in 2017 and the first quarter of 2018. This is primarily due to growing activity in cards and payment solutions which increased by 62% from the same period in 2017, and a rise in commission income from Investment Banking due to increased business activity.

Net financial income amounted to ISK 927 million, compared with ISK 1,975 million for the second quarter of 2017 and ISK 1,340 million for the first quarter of 2018. Positive market changes in equity holdings are the main reason for the positive contribution from net financial income in all periods and are mainly from sale or changes in holdings of listed and unlisted equity holdings.

Net insurance income amounted to ISK 758 million, compared with ISK 606 million for the second quarter of 2017 and ISK 143 million during the first quarter of 2018. The increase from 2017 is primarily due to increasing premiums earned at the insurance company Vördur, while the increase from the first quarter of 2018 is mainly due to a lower claim rate, which was unusually high during that quarter.

Other operating income was ISK 610 million during the quarter, compared with ISK 1,811 million during the same period in 2017 and ISK 269 million during the first quarter of 2018. Higher fair value changes on investment property during the second quarter of 2017 are the main reason for the fluctuations between quarters in other operating income.

Operating expenses amounted to ISK 8,975 million during the second quarter, compared with ISK 5,784 million in the same period in 2017 and ISK 8,662 million during the first quarter of 2018. The Bank's cost-to-income ratio was 62.3% for the second quarter, compared with 38.2% for the same period in 2017 and 70.8% during the first quarter of 2018. The cost-to-total assets ratio was 3.1% for the second quarter but was 2.1% during the same period for 2017 and 3.0% during the first quarter of 2018.

Salaries and related expenses amounted to ISK 5,011 million for the second quarter of 2018, an increase of 10% from the same period in 2017 and by 8% from the first quarter of 2018. The increase is mainly due to a general rise in salaries under labor agreements which came into effect in May 2018 and an increase in the number of employees in the international operation at the subsidiary Valitor. The average salary per employee increased by 3.3% between years, but at the same time the salary index in Iceland rose by 6.5%. Full-time equivalent positions at the end of June totalled 1,309 at the Group, 86 more than at the end the second quarter of 2017 and 25 compared with year-end 2017. The increase is largely a result of Valitor's investments in the UK. The decrease in number of FTEs continues at the parent company, mainly due to the outsourcing of projects, e.g. the cash center, and the effect of the Bank's focus on increasing digitalization and automation.

Other operating expenses amounted to ISK 3,964 million during the second quarter of 2018, compared with ISK 1,223 million during the same period in 2017 and ISK 3,996 million during the first quarter of 2018. The increase from the second quarter of 2017 is mainly related to ISK 2,669 million reversal in 2017 of a liability the Bank had recognized against the Depositors' and Investors' Guarantee Fund but changes from the first quarter of 2018 are minimal.

Net impairment was ISK 192 million during the second quarter of 2018, compared with a positive net impairment of ISK 409 million in the same period in 2017 and net impairment ISK 99 million in the first quarter of 2018. Prepayments of mortgage loans and composition payments from corporate customers and final loan payments from bankrupt entities, which had previously been impaired, had a positive impact in 2017. The impairment of loans to customers is now levelling off, following the release of discounts in connection with restructuring of the loan book.

Income tax amounted to ISK 1,287 million during the second quarter of 2018, compared with ISK 1,895 million in the same period in 2017. 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 30.1% for the first six months of 2018, compared with 23.8% during the same period in 2017. The high tax rate is due to the high proportion of income from the parent company, which calculates an additional 6% tax on income above ISK 1 billion. Furthermore, the bank levy is not tax deductible and the effective income tax rate is therefore higher.

First half of 2018

In ISK millions	H1 2018	H1 2017	Change	% change
Net interest income	14,521	15,320	(799)	(5%)
Net commission income	8,034	6,838	1,196	17%
Net financial income	2,267	3,205	(938)	(29%)
Net insurance income	901	1,053	(152)	(14%)
Share of profit of associates and impairment	(16)	(934)	918	(98%)
Other operating income	879	2,375	(1,496)	(63%)
Operating income	**26,586**	**27,857**	**(1,271)**	**(5%)**
Salaries and related expenses	(9,647)	(8,783)	(864)	10%
Other operating expenses	(7,960)	(5,057)	(2,903)	57%
Operating expenses	**(17,607)**	**(13,840)**	**(3,767)**	**27%**
Bank levy	(1,684)	(1,574)	(110)	7%
Net impairment	(291)	1,289	(1,580)	(123%)
Net earnings before taxes	**7,004**	**13,732**	**(6,728)**	**(49%)**
Income tax expense	(2,105)	(3,266)	1,161	(36%)
Discontinued operations, net of tax	112	0	112	-
Net earnings	**5,011**	**10,466**	**(5,455)**	**(52%)**
KPI's				
Return on equity	4.7%	9.7%		
Earnings per share (in ISK)	2.35	5.23		
Cost to income ratio	66.2%	49.7%		

Net earnings during the first half of 2018 were significantly lower than in the same period in 2017, which can be explained by numerous positive one-offs during that period. Net interest income was 5% lower, mainly due to a high level of temporary ISK liquidity in early 2017. Valuation changes in investment properties were unusually high during the first half of 2017 and this is reflected in high other operating income. Net impairment on loans was also positive during the first half of 2017, which was mainly from payments from composition agreements and bankrupt entities. Finally, there was 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.

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 second quarter of 2018.

2nd Quarter 2018 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	175	1,464	94	4,310	1,189	381	7,613
Net commission income	865	305	425	1,235	(82)	1,744	4,492
Other income	43	18	(1)	74	143	2,020	2,297
Operating income	**1,083**	**1,787**	**518**	**5,619**	**1,250**	**4,145**	**14,402**
Operating expenses	(630)	(878)	(398)	(3,398)	(313)	(3,358)	(8,975)
Bank levy	(41)	(180)	(14)	(312)	(333)	0	(880)
Net impairment	0	(413)	0	238	10	(27)	(192)
Earnings before taxes	**412**	**316**	**106**	**2,147**	**614**	**760**	**4,355**

2nd Quarter 2017 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	129	1,539	63	3,925	2,230	274	8,160
Net commission income	938	281	304	1,152	(79)	912	3,508
Other income	20	1,004	(7)	388	(46)	2,133	3,492
Operating income	**1,087**	**2,824**	**360**	**5,465**	**2,105**	**3,319**	**15,160**
Operating expenses	(283)	(534)	(369)	(1,414)	114	(3,298)	(5,784)
Bank levy	(49)	(137)	(10)	(198)	(383)	0	(777)
Net impairment	0	13	7	382	0	7	409
Earnings before taxes	**755**	**2,166**	**(12)**	**4,235**	**1,836**	**28**	**9,008**

1st Quarter of 2018 *In ISK millions*	**Asset Manage-ment**	**Corporate Banking**	**Investment Banking**	**Retail Banking**	**Treasury**	**Other div., headq. and subsid.**	**Total**
Net interest income	148	1,314	38	4,333	979	96	6,908
Net commission income	866	236	465	1,092	(82)	965	3,542
Other income	18	(161)	2	81	268	1,526	1,734
Operating income	**1,032**	**1,389**	**505**	**5,506**	**1,165**	**2,587**	**12,184**
Operating expenses	(601)	(888)	(392)	(3,451)	(329)	(2,971)	(8,632)
Bank levy	(46)	(170)	(10)	(278)	(300)	0	(804)
Net impairment	0	(376)	0	268	(29)	38	(99)
Earnings before taxes	**385**	**(45)**	**103**	**2,045**	**507**	**(346)**	**2,649**

Asset Management

In ISK millions	Q2 2018	Q2 2017	% diff	Q1 2018	% diff
Net interest income	175	129	35.7%	148	18.2%
Net commission income	865	938	(7.8%)	866	(0.1%)
Other income	43	20	-	18	138.9%
Operating income	**1,083**	**1,087**	**(0.4%)**	**1,032**	**4.9%**
Operating expenses	(630)	(283)	122.6%	(601)	4.8%
Bank levy	(41)	(49)	(16.3%)	(46)	(10.9%)
Earnings before taxes	**412**	**755**	**(45.4%)**	**385**	**7.0%**

The operations of Asset Management are stable and net earnings are good. Fluctuations in operating income are usually due to changes in the securities market. Operating expenses increased significantly during the second quarter of 2018, compared with the same period in 2017. This was mainly due to a reversed liability to the Depositors' and Investors' Guarantee Fund of ISK 360 million during the second quarter of 2017, while operating expenses decreased slightly from the first quarter of this year. Assets under management at the end of June amounted to ISK 971 billion and decreased by 1.4% from year-end 2017.

Corporate Banking

In ISK millions	Q2 2018	Q2 2017	% diff	Q1 2018	% diff
Net interest income	1,464	1,539	(4.9%)	1,314	11.4%
Net commission income	305	281	8.5%	236	29.2%
Other income	18	1,004	(98.2%)	(161)	-
Operating income	**1,787**	**2,824**	**(36.7%)**	**1,389**	**28.7%**
Operating expenses	(878)	(534)	64.4%	(888)	(1.1%)
Bank levy	(180)	(137)	31.4%	(170)	5.9%
Net impairment	(413)	13	-	(376)	9.8%
Earnings before taxes	**316**	**2,166**	**(85.4%)**	**(45)**	**-**

Net interest income at Corporate Banking was slightly lower in the second quarter of 2018 than the same period in 2017 and the first quarter of 2018, as a result of increasing competition in the corporate market and falling interest rates. Net commission income increased in line with growing business activity in the market. Other income was mainly from valuation changes on foreclosed assets, as there were significant valuation changes on investment properties during the second quarter of 2017. These assets have now been transferred to other divisions. Operating expenses were significantly higher in the second quarter of 2018 compared with the same period in 2017, primarily as a result of a reversed liability to the Depositors' and Investors' Guarantee Fund of ISK 198 million during the second quarter of 2017. The negative net valuation changes in the loan portfolio can be primarily attributed to impairments on loans and claims against a number of corporates. During the same period in 2017 claims were recovered from bankrupt estates and composition agreements which yielded a net positive change.

Investment Banking

In ISK millions	Q2 2018	Q2 2017	% diff	Q1 2018	% diff
Net interest income	94	63	49.2%	38	147.4%
Net commission income	425	304	39.8%	465	(8.6%)
Other income	(1)	(7)	-	2	-
Operating income	**518**	**360**	**43.9%**	**505**	**2.6%**
Operating expenses	(398)	(369)	7.9%	(392)	1.5%
Bank levy	(14)	(10)	40.0%	(10)	40.0%
Net impairment	0	7	-	0	-
Earnings before taxes	**106**	**(12)**	**-**	**103**	**2.9%**

Activities at Investment Banking increased in the second quarter of 2018, compared with the same period last year. The division conducted extensive work in connection with the listing of Arion Bank in Iceland and Stockholm which was completed during the quarter. 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 transactions in which it is involved on the market. 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	Q2 2018	Q2 2017	% diff	Q1 2018	% diff
Net interest income	4,310	3,925	9.8%	4,333	(0.5%)
Net commission income	1,235	1,152	7.2%	1,092	13.1%
Other income	74	388	(80.9%)	81	(8.6%)
Operating income	**5,619**	**5,465**	**2.8%**	**5,506**	**2.1%**
Operating expenses	(3,398)	(1,414)	140.3%	(3,451)	(1.5%)
Bank levy	(312)	(198)	57.6%	(278)	12.2%
Net impairment	238	382	(37.7%)	268	(11.2%)
Earnings before taxes	**2,147**	**4,235**	**(49.3%)**	**2,045**	**5.0%**

Operating income increased by 2.8% between the second quarter of 2018 and the same period in 2017 and by 2.1% compared with the first quarter of 2018. The increase can be attributed to growth in the loan book, both to individual retail customers and SMEs, as well as the strong focus over the last few years on fee generating operations. Other income has decreased, mainly due to lower activity in the foreclosure and sale of assets, compared with previous periods, as the economic environment is favorable to customers. Operating expenses were significantly higher in the second quarter of 2018 compared with the same period in 2017 chiefly because of the reversed liability to the Depositors' and Investors' Guarantee Fund of ISK 1,733 million during the second quarter of 2017. Excluding this item, the growth in operating expenses was in line with increased business activity. The positive outcome in net impairment is mainly due to prepayments of mortgages as the interest rate environment is favorable for customers.

Treasury

In ISK millions	Q2 2018	Q2 2017	% diff	Q1 2018	% diff
Net interest income	1,189	2,230	(46.7%)	979	21.5%
Net commission income	(82)	(79)	3.8%	(82)	0.0%
Other income	143	(46)	-	268	-
Operating income	**1,250**	**2,105**	**(40.6%)**	**1,165**	**7.3%**
Operating expenses	(313)	114	-	(329)	(4.9%)
Bank levy	(333)	(383)	(13.1%)	(300)	11.0%
Net impairment	10	0	-	(29)	(134.5%)
Earnings before taxes	**614**	**1,836**	**(66.6%)**	**507**	**21.1%**

Operating income from Treasury decreased during the second quarter of 2018 compared with the same quarter of 2017, mainly due to decreased liquidity in the Icelandic króna and lower interest rates in general. Operating expenses increased, in particular due to professional services. Operating expenses in Treasury increased significantly, mainly due to the reversed liability to the Depositors' and Investors' Guarantee Fund of ISK 378 million during the second quarter of 2017 and additional professional services.

BALANCE SHEET

Arion Bank's ***total assets*** increased by 2% from year-end 2017.

In ISK millions	30.06.2018	31.12.2017	Diff.	% diff.
Cash & balances with CB	112,996	139,819	(26,823)	(19%)
Loans to credit institutions	113,546	86,609	26,938	31%
Loans to customers	803,694	765,101	38,593	5%
Financial assets	95,266	109,450	(14,184)	(13%)
Investment property	7,027	6,613	414	6%
Investments in associates	743	760	(17)	(2%)
Intangible assets	13,858	13,848	10	0%
Other assets	27,714	25,555	2,159	8%
Total assets	**1,174,844**	**1,147,754**	**27,090**	**2%**

Cash and balances with the Central Bank amounted to ISK 112,996 million at the end of the period, 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 24.3 billion during the period.

Loans to customers totalled ISK 803,694 million at the end of the period, representing a 5% increase from year-end 2017. Loans to corporates increased by 2.0% during the period, mainly in loans to wholesale and retail and real estate and construction. Loans to individuals increased by 2.5%, primarily mortgage loans despite strong competition from the pension funds in this market.

Financial assets amounted to ISK 95,266 million at the end of the period, compared with ISK 109,450 million at the end of 2017. Financial assets have decreased, primarily due to the sale of international debt funds related to liquidity management.

In ISK millions	30.06.2018	31.12.2017	Diff.	% diff.
Bonds	49,659	51,755	(2,096)	(4%)
Shares and instruments w. variable income	20,801	36,190	(15,389)	(43%)
Derivatives	5,130	7,624	(2,494)	(33%)
Securities used for hedging	19,675	13,881	5,794	42%
Securities total	**95,265**	**109,450**	**(14,185)**	**(13%)**

Liabilities increased by 5% from year-end 2017. ***Equity*** decreased due to the purchase of treasury stock and a dividend payment during the period, totalling ISK 24.3 billion. Net earnings for the period and the effects of the adoption of IFRS 9 partly offset the decrease.

In ISK millions	30.06.2018	31.12.2017	Diff.	% diff.
Due to credit institutions & CB	6,336	7,370	(1,034)	(14%)
Deposits from customers	476,182	462,161	14,021	3%
Financial liabilities at fair value	3,895	3,601	294	8%
Other liabilities	70,027	63,890	6,137	10%
Borrowings	410,773	384,998	25,775	7%
Shareholders equity	206,890	225,606	(18,716)	(8%)
Non-controlling interest	741	128	613	479%
Total liabilities and equity	**1,174,844**	**1,147,754**	**27,090**	**2%**

Deposits from customers amounted to ISK 476,182 million at the end of June 2018 and had increased by 3% from year-end 2017, primarily from individuals and SMEs. 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 410,773 million at the end of June 2018. In March, Arion Bank issued a new 5-year EUR 300 million bond on the international markets (ISK 37 billion). The bonds were sold at rates corresponding to a 0.65% margin over interbank rates. The bond issue was partly used to repay a 3-year bond in the amount of EUR 200 million. The Bank has also continued to issue covered bonds on the Icelandic market, a total of approximately ISK 16 billion and commercial paper for a total of ISK 16 billion in the first half of 2018.

Shareholders' equity amounted to ISK 206,890 million at the end of June 2018, compared with ISK 225,605 million at the end of 2017. The decrease is explained by a buyback of shares and a dividend payment during the first quarter of 2018, which is partly offset by an increase in equity due to the adoption of IFRS 9 and the financial results for the period. The CET 1 ratio was 21.8% at the end of June 2018, compared with 23.6% at year-end 2017, taken into account a ISK 10 billion dividend payment in third quarter of 2018.

KEY PERFORMANCE INDICATORS

	Q2 2018	Q2 2017	% change	H1 2018	H1 2017	% change
Return on equity (ROE)	5.9%	13.0%	(54%)	4.7%	9.7%	(51%)
Return on total assets (ROA)	1.1%	2.6%	(58%)	0.9%	1.9%	(55%)
Net interest margin (int. bearing assets)	2.8%	3.1%	(9%)	2.7%	3.0%	(9%)
Net interest margin (total assets)	2.6%	2.9%	(9%)	2.5%	2.8%	(10%)
Cost-to-income ratio	62.3%	38.2%	63%	66.2%	49.7%	33%
Cost-to-Total assets ratio	3.1%	2.1%	51%	3.1%	2.5%	21%
Effective tax rate	29.6%	21.0%	40%	30.1%	23.8%	26%
CAD ratio	21.9%	28.4%	(23%)	21.9%	28.4%	(23%)
CET 1 ratio	21.8%	27.8%	(22%)	21.8%	27.8%	(22%)
Share of stage 3 loans, gross	2.3%	-	-	2.3%	-	-
Gross impaired loans/Gross loans	-	2.1%	-	-	2.1%	-
RWA/Total assets	67.8%	67.0%	1%	67.8%	67.0%	1%
Loans to deposit ratio	168.8%	167.7%	1%	168.8%	167.7%	1%
The Group's average number of employees	1,313	1,214	8%	1,301	1,214	7%
The Group's employees at the end of the period	1,309	1,223	7%	1,309	1,223	7%
The Parent's average number of employees	829	820	1%	831	826	1%
The Parent's employees at the end of the period	823	817	1%	823	817	1%

FINANCIAL TARGETS

In late 2016 Arion Bank approved the following medium-term targets, for the next four to five years.

- ***CET 1*** Reduce to circa 17%
- ***Loan growth*** Prudent lending in line with economic growth
- ***RoE*** Exceed 10%
- ***Dividend policy*** Pay-out ratio of circa 50% on net earnings attributable to shareholders
- ***Cost to Income ratio*** Reduce to circa 50%

CONFERENCE CALL IN ENGLISH

Arion Bank is holding a presentation in English of its financial results for market participants at 1:00 p.m. on 3 August. The presentation will be streamed live in financialhearings.com and the livestream can also be viewed on the Bank's investor relations website. Höskuldur H. Ólafsson and Stefán Pétursson will present the results and then answer any questions. If you wish to participate and submit questions, please call the following number before the presentation begins:

Sweden: +46 856 642 662
UK: +44 20 3008 9808
Iceland: 800 7417

For further information please contact Sture Stolen, 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.

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, at 19:00 CEST and 17:00 Iceland time, on August 2 2018.

FINANCIAL CALENDAR FOR 2018

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

Third quarter 2018	31 October 2018
Fourth quarter 2018	13 February 2019
AGM 2019	13 March 2019

This calendar may be subject to change.

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.