

## ARION BANK'S H1 2017 FINANCIAL RESULTS

First six months of 2017 compared with the same period in 2016:

- Operating income ISK 27.3 billion (ISK 27.2 billion)
- Net earnings ISK 10.5 billion (ISK 9.8 billion)
- Earnings per share ISK 5.23 (ISK 4.62)
- Net interest margin (NIM) 3.0% (3.1%)
- Return on equity 9.7% (9.5%)
- Cost-to-income ratio 50.6% (55.8%)
- Tier 1 ratio 27.8% (26.8%)

### Höskuldur H. Ólafsson, CEO :

"Arion Bank's financial results for the first six months of 2017 are good and exceed our expectations. The Bank is performing well in its core operations and one-off items have had a positive impact on the results. The Bank is robust financially, as underlined by the Bank's capital ratio of 28.4%. The Bank is well positioned to provide strong support to its customers and the Icelandic business sector."

Arion Bank reported net earnings of ISK 10.5 billion for the first six months of 2017, compared with ISK 9.8 billion for the same period of 2016. Return on equity was 9.7%, compared with 9.5% for the first six months of 2016.

The Bank reported net earnings of ISK 7.1 billion during the second quarter of 2017, compared with ISK 6.9 billion for the same period of 2016. Return on equity during the quarter was 13.0%, compared with 13.3% in 2016.

Total assets amounted to ISK 1,126.4 billion at the end of June, compared with ISK 1,036.0 billion at the end of 2016. Shareholders' equity totalled ISK 221.6 billion at the end of June 2017, compared with ISK 211.2 billion at the end of 2016. The Bank enjoys a strong financial position and the focus has been on maintaining good liquidity as the capital controls are lifted, a process which is now largely at an end.

The Bank's capital ratio at the end of June was 28.4%, compared with 27.1% at the end of 2016. Tier 1 Capital increased during the period to 27.8%, compared with 26.5% at the end of 2016.

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

### Income Statement

<i>In ISK million</i>	<b>H1 2017</b>	<b>H1 2016</b>	<b>Diff</b>	<b>Q2 2017</b>	<b>Q2 2016</b>	<b>Diff</b>
Net interest income	15,320	14,626	5%	8,160	7,353	11%
Net commission income	6,838	6,747	1%	3,508	3,528	(1%)
Other income	5,174	5,810	(11%)	3,151	4,343	(27%)
<b>Operating income</b>	<b>27,332</b>	<b>27,183</b>	<b>1%</b>	<b>14,819</b>	<b>15,224</b>	<b>(3%)</b>
Operating expenses	(13,840)	(15,156)	(9%)	(5,784)	(7,958)	(27%)
Bank levy	(1,574)	(1,485)	6%	(777)	(743)	5%
Net impairment	1,289	945	36%	409	1,448	(72%)
<b>Net earnings before taxes</b>	<b>13,207</b>	<b>11,487</b>	<b>15%</b>	<b>8,667</b>	<b>7,971</b>	<b>9%</b>
Income tax	(3,161)	(2,091)	51%	(1,827)	(1,354)	35%
Net gain from assets held for sale	420	363	16%	273	259	5%
<b>Net earnings</b>	<b>10,466</b>	<b>9,759</b>	<b>7%</b>	<b>7,113</b>	<b>6,876</b>	<b>3%</b>

### KPI's:

Return on equity (ROE)	9.7%	9.5%	13.0%	13.3%
Earnings per share (ISK)	5.23	4.62	3.56	3.38
Net interest margin (int. b. assets)	3.0%	3.1%	3.1%	3.1%
Cost-to-income ratio	50.6%	55.8%	39.0%	52.3%
Tier 1 ratio	27.8%	26.8%	27.8%	26.8%



Highlights of the balance sheet and key performance indicators:

<i>In ISK million</i>	<b>30.06.2017</b>	<b>31.12.2016</b>	<b>Diff</b>	<b>Diff%</b>
Loans to customers	733,649	712,422	21,226	3%
Other assets	392,762	323,602	69,160	21%
Liabilities	904,644	824,640	80,004	10%
Equity	221,767	211,384	10,383	5%
Loans to Deposits ratio	167.7%	172.9%		
RWA / Total assets	67.0%	72.7%		
Tier 1 ratio	27.8%	26.5%		

For detailed information on the accounts please refer to Arion Bank's Consolidated Interim Financial Statements for the period 1 January – 30 June 2017 on the Bank's website, [www.arionbanki.is](http://www.arionbanki.is).

## **HÖSKULDUR H. ÓLAFSSON, CEO OF ARION BANK:**

“Arion Bank's financial results for the first six months of 2017 are good and exceed our expectations. The Bank is performing well in its core operations and one-off items have had a positive impact on the results. The Bank is robust financially, as underlined by the Bank's capital ratio of 28.4%. The Bank is well positioned to provide strong support to its customers and the Icelandic business sector.

We are determined to be the leading bank in Iceland as a provider of digital solutions. The goal is to make banking easy for our customers. We want our customers to be able to take care of their finances easily and conveniently, whether they are transferring money, getting an overdraft, spreading out credit card payments, attending to their savings or applying for a credit appraisal and a mortgage. Our focus on developing digital solutions in this area and the advent of electronic ID mean that our customers can now do all this and more through the Arion app and our online bank, whenever and wherever it suits them. We have also made it easy for people and companies to become customers of Arion Bank through a straightforward process on our website. We have a clear vision and we will continue in this direction and release even more digital products over the next few months.

In 2014 Arion Bank decided to participate in the funding process of United Silicon in relation to a project which had been in preparation for several years. The Bank lent a considerable amount of money to the project, as specified in the Bank's interim financial statement. The decision to participate in this project was made on the basis of several factors: all permits were in place, demand for the product was high and the market price was good, the technology had been thoroughly tested, the government and local authorities were supportive of the project, and Icelandic and international experts and investors were also on board. Furthermore, the experience of silicon plants had generally been positive and it was a project that would create much needed jobs and foreign currency revenue in an economy subject to capital controls. United Silicon commenced operations in November 2016, but unfortunately it has suffered repeated setbacks. The company has applied for a moratorium and is now seeking composition with creditors. Arion Bank is closely monitoring developments and, as its largest creditor, is assisting the company in the moratorium. The priority now is to complete the necessary improvements at the plant so that production is in order and environmental concerns are addressed and to ensure that the plant operates in harmony with the local community.

During the first half of the year the Bank has issued a total of €500 million in two international bond issues. An increasing number of investors are now looking at Arion Bank as an investment option as the Bank's bond issues perform well on the secondary markets. The Bank also has good access to funding on the Icelandic market. During the period the Bank fully repaid the Kaupthing bond issued in connection with composition agreements with Kaupthing, and Arion Bank is now fully market funded.

In March, the future ownership of the Bank began to take shape when international investors acquired a 29% share in the Bank. Preparations for the sale of Kaupthing's stake are ongoing and one of the options being examined is an IPO on the Icelandic and international markets, but no decision has been taken on this yet.”



## INCOME STATEMENT

<i>In ISK million</i>	<b>H1 2017</b>	<b>H1 2016</b>	<b>Diff</b>	<b>Diff%</b>
Net interest income	15,320	14,626	694	5%
Net commission income	6,838	6,745	93	1%
Net financial income	3,205	3,496	(291)	(8%)
Net insurance income	1,053	391	662	169%
Share of profit of associates and impairment	(934)	695	(1,629)	(234%)
Other operating income	1,850	1,231	619	50%
<b>Operating income</b>	<b>27,332</b>	<b>27,184</b>	<b>148</b>	<b>1%</b>
Salaries and related expense	(8,783)	(8,426)	(357)	4%
Other operating expenses	(5,057)	(6,729)	1,672	(25%)
Bank Levy	(1,574)	(1,485)	(89)	6%
Net change in valuation	1,289	945	344	-
<b>Net earnings before taxes</b>	<b>13,207</b>	<b>11,489</b>	<b>1,718</b>	<b>15%</b>
Income tax	(3,161)	(2,091)	(1,070)	51%
<b>Net earnings from continuing operation</b>	<b>10,046</b>	<b>9,398</b>	<b>648</b>	<b>7%</b>
Net gain from assets held for sale, net of tax	420	363	57	16%
<b>Net earnings</b>	<b>10,466</b>	<b>9,761</b>	<b>705</b>	<b>7%</b>

**Operating income** amounted to ISK 27.3 billion for the first six months of 2017, compared with ISK 27.2 billion for the same period in 2016. The main changes between years are related to the negative share in the profit of associates and impairment due to changes in the value of associates in the first six months of 2017 compared with a positive amount for the same period of 2016. There were improvements in net insurance income due to the acquisition of the subsidiary Vördur in late 2016. There was a positive change in other income, mainly related to fair value changes in the first six months of 2017.

*Net interest income* increased by 5% from the previous year. The net interest margin as a percentage of average interest-bearing assets was 3.0% during the first six months of 2017, compared with 3.1% for the same period in 2016. The growth in net interest income is mainly due to increased interest-bearing assets compared with last year.

*Net commission income* increased by 1% between years, primarily due to increased activity in Retail Banking, especially from the new branch at Keflavik International Airport, which was opened in 2016, while commissions from other segments are similar or have decreased from last year.

*Net financial income* amounted to ISK 3,205 million, compared with ISK 3,495 million for the first six months of 2016. The positive performance of listed shares and bonds is the main reason for the positive contribution from net financial income during the period, while the profit from the sale of the equity share in Visa Europe was the main reason behind last year's positive figures. Mark to market changes on hedging derivatives related to funding were unfavorable during the period.

*Net insurance income* amounted to ISK 1,053 million, compared with ISK 391 million for the first six months of 2016. The increase is primarily due to the acquisition of the insurance company Vördur at the end of September 2016.

*Share in the profit of associates and impairment* was negative by ISK 934 million during the first six months of 2017, compared with positive ISK 695 million for the same period in 2016. This change is mainly due to the approximately ISK 1,000 million impairment of the associated company Sameinað Sílikon hf. (United Silicon) in the first six months of 2017, compared with a profit from the sale of equity holdings in Bakkavor Group Ltd. during the same period in 2016.

*Other operating income* increased by ISK 620 million from the previous year and amounted to ISK 1,850 million during the first six months of 2017. A large part of the additional income in 2017 was due to fair value changes on investment property during the period.



**Operating expenses** amounted to ISK 13,840 million during the first six months of 2017, compared with ISK 15,156 million for the same period of 2016. The Bank's cost-to-income ratio was 50.6%, compared with 55.8% for the first six months of 2016. The reason for the lower ratio is mainly due to the reversal of a liability the Bank had recognized against the Depositors' and Investors' Guarantee Fund in the amount of ISK 2,669 million. The Bank received confirmation from the Fund stating that the claim will not be collected. The reversal is partly offset by higher operating expenses, compared with the previous year, relating to the subsidiary Vördur, which became part of the Group in late 2016, and higher expenses due to the growth of international operations at the subsidiary Valitor. The Cost-to-Total Assets ratio was 2.5% for the first six months of 2017, compared with 3.0% for the same period 2016.

**Salaries and related expenses** amounted to ISK 8,783 million during the period, an increase of 4% from the previous year. The increase is mainly due to the acquisition of Vördur and the increased number of employees at the subsidiary Valitor. The average salary per employee increased by less than 1% from the same period in 2016, but at the same time the salary index in Iceland rose by approximately 6.0%. Full-time equivalent positions at the end of June totalled 1,223 at the Group, 24 more than at the end of June 2016. The increase is largely a result of investments in new business opportunities in Iceland and abroad. Most significant in this respect are the acquisition of the insurance company Vördur, the growth of Valitor internationally and the opening of a new branch at Keflavik International Airport.

**Other operating expenses** amounted to ISK 5,057 million during the first six months, or a 25% decrease from the same period last year. As stated above, this decrease is mainly due to the reversal of a liability to the Depositors' and Investors' Guarantee Fund of ISK 2,669 million, but some of the increase is related to the new subsidiary Vördur, the growth of the international operations of Valitor and higher IT expenses due to the outsourcing of segments of the Bank's IT operation.

**Net valuation change** was positive by ISK 1,289 million during the first six months of 2017, compared with ISK 945 million in the same period last year. The positive net impairment is mainly due to composition payments from corporate customers, final loan payments from bankrupt entities, which had previously been impaired, and prepayments of mortgage loans to individuals during the period.

**Income tax** amounted to ISK 3,161 million, compared with ISK 2,091 million for the first six months 2016. Income tax, as reported in the annual financial statements, comprises 20% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings in excess of ISK 1 billion. The effective income tax rate was 23.9%, compared with 18.2% for the same period last year. The unusually high tax rate during the first six months is due to the high proportion of income from the parent company, which calculates an additional 6% tax on income above ISK 1 billion and thus the effective income tax rate is higher.



## Second quarter of 2017

The financial results for the second quarter of 2017 were good, as in the same period in 2016. One-off items had a significant effect on both periods. Return on equity was 13.0%, compared with 13.3% for the same period last year.

<i>In ISK million</i>	<b>Q2 2017</b>	<b>Q2 2016</b>	<b>Diff</b>	<b>Diff%</b>
Net interest income	8,160	7,353	807	11%
Net commission income	3,508	3,526	(18)	(1%)
Net financial income	1,975	3,797	(1,822)	(48%)
Net insurance income	606	247	359	145%
Share of profit of associates and impairment	(900)	18	(918)	-
Other operating income	1,470	283	1,187	419%
<b>Operating income</b>	<b>14,819</b>	<b>15,224</b>	<b>(405)</b>	<b>(3%)</b>
Salaries and related expense	(4,561)	(4,318)	(243)	6%
Other operating expenses	(1,223)	(3,641)	2,418	(66%)
Bank Levy	(777)	(743)	(34)	5%
Net change in valuation	409	1,448	(1,039)	(72%)
<b>Net earnings before taxes</b>	<b>8,667</b>	<b>7,970</b>	<b>697</b>	<b>9%</b>
Income tax	(1,827)	(1,354)	(473)	35%
<b>Net earnings from continuing operation</b>	<b>6,840</b>	<b>6,616</b>	<b>224</b>	<b>3%</b>
Net gain from assets held for sale, net of tax	273	259	14	5%
<b>Net earnings</b>	<b>7,113</b>	<b>6,875</b>	<b>238</b>	<b>3%</b>

*Operating income* in the second quarter was ISK 14,819 million, which is 3% lower than in 2016, mainly due to the profit from the sale of the equity share in Visa Europe during the second quarter of 2016 and the impairment of equity holdings in the associated company United Silicon during the second quarter of 2017. Net interest income increased by 11% between years, while net commission income was the same. Net financial income was ISK 1,975 million as a result of solid returns on securities in general. Income from insurance operations increased considerably due to the subsidiary Vördur, which was acquired in late 2016, and other operating income increased due to fair value changes in investment properties.

Total *Operating expenses* decreased significantly between quarters due to the revised liability to the Depositors' and Investors' Guarantee Fund, but in other respects operating expenses remain stable or are increasing as a result of a growth in activities, especially at subsidiaries.

*Net change in valuation* was positive in the second quarter and amounted to ISK 409 million, which is significantly lower than last year when high payments from bankrupt entities were made which were not factored into the valuation of the loans.



## 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 during the first six months of 2017.

<i>1.1.-30.6.2017</i>	Asset	Corporate	Investment	Retail	Treasury	Other div., headq. and subsidiaries	Total
<i>In ISK million</i>	Management	Banking	Banking	Banking			
Net interest income	275	3,195	132	7,899	3,326	493	15,320
Net commission income	1,776	457	637	2,148	(157)	1,977	6,838
Other income	68	1,256	(38)	26	(317)	4,179	5,174
<b>Operating income</b>	<b>2,119</b>	<b>4,908</b>	<b>731</b>	<b>10,073</b>	<b>2,852</b>	<b>6,649</b>	<b>27,332</b>
Operating expenses	(434)	(156)	(402)	(1,637)	280	(11,491)	(13,840)
Bank levy	0	0	0	0	0	(1,574)	(1,574)
Net impairment	0	832	21	402	55	(21)	1,289
<b>Net earnings before taxes</b>	<b>1,685</b>	<b>5,584</b>	<b>350</b>	<b>8,838</b>	<b>3,187</b>	<b>(6,437)</b>	<b>13,207</b>

<i>1.1.-30.6.2016</i>	Asset	Corporate	Investment	Retail	Treasury	Other div., headq. and subsidiaries	Total
<i>In ISK million</i>	Management	Banking	Banking	Banking			
Net interest income	300	3,151	940	7,731	2,301	203	14,626
Net commission income	1,865	497	771	1,562	(190)	2,242	6,747
Other income	2	(44)	704	79	(396)	5,465	5,810
<b>Operating income</b>	<b>2,167</b>	<b>3,604</b>	<b>2,415</b>	<b>9,372</b>	<b>1,715</b>	<b>7,910</b>	<b>27,183</b>
Operating expenses	(752)	(330)	(583)	(3,043)	(113)	(10,335)	(15,156)
Bank levy	0	0	0	0	0	(1,485)	(1,485)
Net impairment	0	1,405	1,446	(1,858)	3	(51)	945
<b>Net earnings before taxes</b>	<b>1,415</b>	<b>4,679</b>	<b>3,278</b>	<b>4,471</b>	<b>1,605</b>	<b>(3,961)</b>	<b>11,487</b>



**Asset Management** comprises Institutional Asset Management, Private Banking, Investment Services and Pension Fund Administration. Asset Management manages financial assets on behalf of its customers according to a pre-determined investment strategy. In addition, the division is the main distributor of funds managed by Stefnir hf. to individuals, companies and institutional investors as well as distributing funds managed by international fund management companies. Asset Management also administers pension funds. Stefnir hf. is an independently operating financial company owned by Arion Bank. Stefnir manages a broad range of mutual funds, investment funds and institutional investor funds.

<i>In ISK million</i>	H1 2017	H1 2016	Difference
Net interest income	275	300	(8.3%)
Net commission income	1,776	1,865	(4.8%)
Other income	68	2	-
<b>Operating income</b>	<b>2,119</b>	<b>2,167</b>	<b>(2.2%)</b>
Operating expenses	(434)	(752)	(42.3%)
<b>Net earnings before taxes</b>	<b>1,685</b>	<b>1,415</b>	<b>19.1%</b>

The decrease in operating income from the first half of 2016 is mainly related to changes in the market environment. However, operations are stable and assets under management have been developing positively during the last few years.

**Corporate Banking** provides comprehensive financial services and integrated solutions across the Bank's divisions to larger corporate clients in Iceland. Corporate Banking provides a full range of lending products, deposit accounts, payment solutions as well as value-added digital corporate solutions to meet the needs of each customer.

<i>In ISK million</i>	H1 2017	H1 2016	Difference
Net interest income	3,195	3,151	1.4%
Net commission income	457	497	(8.0%)
Other income	1,256	(44)	-
<b>Operating income</b>	<b>4,908</b>	<b>3,604</b>	<b>36.2%</b>
Operating expenses	(156)	(330)	(52.7%)
Net impairment	832	1,405	(40.8%)
<b>Net earnings before taxes</b>	<b>5,584</b>	<b>4,679</b>	<b>19.3%</b>

The net interest margin at Corporate Banking is similar to the same period in 2016 but the decrease in net fee and commission income is mainly related to less activity in new lending during the first six months of 2017 compared with the same period last year.

**Investment Banking** is divided into Corporate Finance, Capital Markets and Research. Corporate Finance arranges the buying and selling of companies and advises on other major financial decisions undertaken by companies and investors such as financial restructuring, IPOs and stock market listings. Capital Markets buys and sells securities and FX on behalf of Arion Bank's clients. Capital Markets manages securities issuance for clients and advises on hedges used in business operations, often in co-operation with Corporate Finance. Research is an independent research team covering the Icelandic economy and financial markets.

<i>In ISK million</i>	H1 2017	H1 2016	Difference
Net interest income	132	940	(86.0%)
Net commission income	637	771	(17.4%)
Other income	(38)	704	(105.4%)
<b>Operating income</b>	<b>731</b>	<b>2,415</b>	<b>(69.7%)</b>
Operating expenses	(402)	(583)	(31.0%)
Net impairment	21	1,446	(98.5%)
<b>Net earnings before taxes</b>	<b>350</b>	<b>3,278</b>	<b>(89.3%)</b>



Changes were made in Investment Banking in 2016 when a large part of the division's assets were transferred to other divisions, mainly to the CEO's Office, which is a part of the headquarters in the segment reporting. Therefore changes in Net interest income and Other income are quite significant between years. Net fee and commission income, which is the main source of income for the segment, were lower, mainly due to a reduction in activity in Corporate Finance compared with last year.

**Retail Banking** provides a comprehensive range of services, including deposits and loans, savings, payment cards, pension savings, insurance, securities and funds. To maximize operational efficiency the branch network is divided into five clusters, with the smaller branches capitalizing on the strength of larger units within each cluster. Retail Banking's 24 branches all around Iceland have a total of more than 100,000 customers. Arion Bank Mortgages Institutional Investor Fund is a part of Arion Bank's retail operations.

<i>In ISK million</i>	H1 2017	H1 2016	Difference
Net interest income	7,899	7,731	2.2%
Net commission income	2,148	1,562	37.5%
Other income	26	79	(67.1%)
<b>Operating income</b>	<b>10,073</b>	<b>9,372</b>	<b>7.5%</b>
Operating expenses	(1,637)	(3,043)	(46.2%)
Net impairment	402	(1,858)	(121.6%)
<b>Net earnings before taxes</b>	<b>8,838</b>	<b>4,471</b>	<b>97.7%</b>

Operating income from the period increased by 7.5% between years and the strong focus over the last few years on fee generating operations is resulting in higher income. The positive change in Net impairment is due to the one-off negative effect of the government payment on mortgages, which was finalized in early 2016, and prepayments on mortgage loans to individuals have been significant during the first half of 2017 and have a positive impact.

**Treasury** is responsible for the Bank's liquidity, currency and interest rate management. Other functions of Treasury are funds' transfer pricing and hedging and pricing of financial products.

<i>In ISK million</i>	H1 2017	H1 2016	Difference
Net interest income	3,326	2,301	44.5%
Net commission income	(157)	(190)	(17.4%)
Other income	(317)	(396)	-
<b>Operating income</b>	<b>2,852</b>	<b>1,715</b>	<b>66.3%</b>
Operating expenses	280	(113)	(347.8%)
Net impairment	55	3	-
<b>Net earnings before taxes</b>	<b>3,187</b>	<b>1,605</b>	<b>98.6%</b>

Operating income from Treasury increased between years, mainly due to higher interest income from cash balances at Central Bank and other liquidity but there is a loss from Other income, mainly due to mark to market changes on derivatives which are used for hedging but are not in hedge accounting.





## BALANCE SHEET

Arion Bank's **total assets** increased by 9% from year-end 2016. The main reason for the increase is the growth in balances with the Central Bank and loans to customers but loans to credit institutions and financial assets decreased.

<i>In ISK million</i>	<b>30.06.2017</b>	<b>31.12.2016</b>	<b>Diff</b>	<b>Diff%</b>
Cash & balances with CB	151,354	87,634	63,721	73%
Loans to credit institutions	78,250	80,116	(1,866)	(2%)
Loans to customers	733,649	712,422	21,226	3%
Financial assets	109,353	117,456	(8,103)	(7%)
Investment property	7,166	5,358	1,809	34%
Investments in associates	825	839	(13)	(2%)
Intangible assets	11,639	11,057	582	5%
Other assets	34,174	21,142	13,032	62%
<b>Total assets</b>	<b>1,126,411</b>	<b>1,036,024</b>	<b>90,387</b>	<b>9%</b>

*Cash and cash balances with Central Bank* amounted to ISK 151,354 million at the end of June, compared with ISK 87,634 million at the end of 2016. The increase is mainly due to increased deposits, primarily in Retail Banking but new borrowings during the first six months also increased liquidity.

*Loans to customers* totalled ISK 733,649 million at the end of June 2017, representing a 3% increase from year-end 2016. Loans to corporates increased by 4.0%, mainly in the real estate sector and fishing industry. Loans to individuals increased by 2% during the first six months 2017. The quality of loans to customers continues to improve. The ratio of problem loans decreased from 1.6% to 1.3% during the period. The Bank defines problem loans as the ratio of the book value of loans 90 days or more in default and loans for which special impairment is required to the Bank's total loans to customers. The proportion of impaired loans decreased from 3.2% at the end of 2016 to 2.1% at the end of June 2017.

*Financial assets* amounted to ISK 109,353 million at the end of June, compared with ISK 117,456 million at the end of 2016. Financial assets decreased due to the sale of assets, including the sale of all of the Bank's listed equities in Fasteignafélagið Reitir hf. and Síminn hf. Changes in financial assets are also partly related to liquidity management.

**Liabilities** increased from year-end, which is primarily a result of short-term deposits and new borrowings. **Equity** increased as a result of the positive financial results in the first half of 2017.

<i>In ISK million</i>	<b>30.06.2017</b>	<b>31.12.2016</b>	<b>Diff</b>	<b>Diff%</b>
Due to credit institutions & CB	7,644	7,987	(343)	(4%)
Deposits from customers	437,494	412,064	25,430	6%
Financial liabilities at fair value	5,029	3,726	1,303	35%
Other liabilities	74,416	61,387	13,029	21%
Borrowings	380,061	339,476	40,585	12%
Shareholders equity	221,593	211,212	10,381	5%
Non-controlling interest	174	172	2	1%
<b>Total liabilities and equity</b>	<b>1,126,411</b>	<b>1,036,024</b>	<b>90,386</b>	<b>9%</b>

*Deposits from customers* amounted to ISK 437,494 million at the end of June 2017, compared with ISK 412,064 million at the end of 2016. The increase is mainly due to new deposits from retail customers.

*Borrowings* amounted to ISK 380,061 million at the end of the period. In January the Bank added to a 5-year €200 million bond issue from November, and the total issue now is €500 million. This issue was partially used in prepayment of a USD bond held by Kaupthing, which was fully settled during the period. In June Arion Bank issued a 3-year €200 million bond, partly to finance the repayment of an issue with a due date in early 2018. The Bank took part in three international private placement issues, amounting to ISK 5.1 billion in NOK and SEK, during the first six months 2017. The Bank has also continued to issue covered bonds in the Icelandic market, a total of ISK 11.6 billion during the first half of 2017.



*Shareholders' equity* amounted to ISK 221,593 million at the end of June 2017, compared with ISK 211,212 million at the end of 2016. The increase is explained by the financial results for the period, but no dividend payment has been decided. The Tier 1 ratio was 27.8% at the end of June, compared with 26.5% at the end of 2016. The capital ratio according to the FME's rules was 27.7% at the end of June, compared with 26.5% at the end of 2016.

## EVENTS AFTER 30 JUNE 2017

On 14 August 2017 Sameinað Sílikon hf. ("**United Silicon**"), a client and associate of the Bank, was granted a moratorium, the aim of which is to allow the company to reach agreements with creditors on outstanding debts. The request was made after the company's silicon factory in Iceland had experienced operational difficulties owing to recurrent equipment failure since the operation started in November 2016. A recent ruling by an arbitral tribunal on United Silicon's dispute with the construction company ÍAV hf. has increased its level of indebtedness.

United Silicon intends to use the moratorium period in order to reach agreements with its creditors and other stakeholders on financial restructuring. Furthermore, it is likely that new capital will be required in order to make the necessary improvements to the equipment and facilities to enable the factory to produce both the quantity and the quality of products as originally intended.

The Bank is the largest creditor of United Silicon, with a total credit exposure of ISK 8.0 billion (including loan commitments and guarantees). Furthermore, the Bank holds 16.3% of the share capital, with voting rights of 23.9%, which has been fully impaired. Any further impairment requirements relating to the Bank's exposure remain highly uncertain and will depend on any financial restructuring agreement reached between United Silicon, the Bank and other stakeholders. The Bank is in discussions with United Silicon to minimize any potential further losses.



## KEY PERFORMANCE INDICATORS

	H1 2017	2016	H1 2016
Return on equity (ROE)	9.7%	10.5%	9.5%
Return on total assets (ROA)	1.9%	2.1%	1.9%
Net interest margin (int. bearing assets)	3.0%	3.1%	3.1%
Net interest margin (total assets)	2.8%	2.9%	2.9%
Cost-to-income ratio	50.6%	57.2%	55.8%
Cost-to-Total assets ratio	2.5%	3.0%	3.0%
Effective tax rate	23.9%	23.5%	18.2%
CAD ratio	28.4%	27.1%	27.8%
Tier 1 ratio	27.8%	26.5%	26.8%
Problem loans	1.3%	1.6%	1.9%
Gross impaired loans/Gross loans	2.1%	3.2%	3.8%
RWA/Total assets	67.0%	72.7%	71.8%
Loans to deposit ratio	167.7%	172.9%	168.6%
The Group's average number of employees	1,214	1,201	1,171
The Group's employees at the end of the period	1,223	1,239	1,216
The Parent's average number of employees	826	889	885
The Parent's employees at the end of the period	817	869	896

## FINANCIAL TARGETS

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

- *CET 1 Ratio* Reduce to approximately 17%
- *Loan Growth* Prudent lending to outpace economic growth in the next few years
- *RoE* Reach double digit returns
- *Dividend Policy* Payout ratio of circa 50% of net earnings attributable to shareholders
- *Cost to Income Ratio* Reduce to approximately 50%

## CONFERENCE CALL IN ENGLISH

Arion Bank will be hosting a conference call in English on Thursday 24 August at 1:00 pm GMT (3:00 pm CEST), where Stefán Pétursson, Chief Financial Officer, will discuss the highlights of the Bank's financial results. People interested in participating can contact [ir@arionbanki.is](mailto:ir@arionbanki.is) to obtain dial-in information.

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## FINANCIAL CALENDAR FOR 2017-18

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

Third quarter 2017	15 November 2017
Financial Statements for 2017	14 February 2018
Annual Report for 2017	1 March 2018
Annual General Meeting	15 March 2018
First quarter 2018	2 May 2018
Second quarter 2018	1 August 2018
Third quarter 2018	31 October 2018

This calendar may be subject to change.