Arion Bank – Q2 2024 results

Financial highlights for the second quarter 2024

- Arion Bank reports net earnings of ISK 5.5bn in Q2 2024, compared with ISK 7.1bn in Q2 2023
- Return on equity was 11.5%, compared with 15.5% in Q2 2023
- Earnings per share in ISK of 3.86 in Q2, compared with 4.84 in Q2 2023
- Net interest margin of 3.2%, the same as in Q2 2023
- Strong quarter for net commission income of ISK 4.0bn, compared with ISK 4.2bn in Q2 2023
- Core operating income, defined as net interest income, net commission income and insurance service results (excluding opex of the insurance operation), increased by 1%, compared with Q2 2023
- Operating expenses increased by 19.1%, compared with Q2 2023, largely due to a settlement fine with the FSA
- Effective tax rate was high, 32.6%, due to unfavorable combination of income and expenses
- Cost-to-core income ratio was 46.2%, compared with 39.4% in Q2 2023
- The balance sheet increased by 1.6% during the quarter
- Loans to customers increased by 2.0% during the quarter. The increase was 1.4% in corporate lending and 2.6% in loans to individuals, mainly mortgages
- Deposits from customers increased by 5.6% during the quarter
- Share buybacks of ISK 4.5bn in Q2 2024 and further buybacks of ISK 2.5bn initiated 26 July
- The Bank's capital ratio was 22.8% and the CET1 ratio was 18.5% at the end of June. The ratios take into account the deduction of 50% of net earnings as foreseeable dividend in line with the Bank's dividend policy and ISK 3.0bn buyback of own shares approved by the Board and FSA. These ratios comfortably exceed the requirements made by the FSA and Icelandic law

Financial highlights for the first 6 months 2024

- Arion Bank reports net earnings of ISK 9.9bn for 6M 2024, compared with ISK 13.4bn in 6M 2023
- Return on equity was 10.2%, compared with 14.5% in 6M 2023
- Earnings per share in ISK of 6.92, compared with 9.17 in 6M 2023
- Net interest margin of 3.1%, the same as in 6M 2023
- Net commission income of ISK 7.3bn for the first half of the year, a decrease from the previous year. Fees were strong in Q2 following an unusually subdued Q1
- Core operating income, defined as net interest income, net commission income and insurance service results (excluding opex of the insurance operation), decreased by 1% compared with 6M 2023
- Operating expenses increased by 9.8%, compared with H1 2023, partly due to a settlement fine with the regulator
- Effective tax rate was high, 35.1%, due to unfavorable combination of income and expenses
- Cost-to-core income ratio was 47.2%, compared with 43.0% in 6M 2023
- The balance sheet increased by 2.8% from year-end 2023
- Dividend payment of ISK 9.0 per share or a total of ISK 13.1bn in Q1 2024

Benedikt Gíslason, CEO of Arion Bank

“There is plenty to be positive about in the Bank’s financial results for the second quarter of 2024, even though we did not reach our 13% ROE target. Deposits are growing strongly, and interest income and fee income both increased year-over-year on the back of solid momentum in most areas of the business, particularly asset management, card services and loans. Assets under management grew 10% in the first six months of the year, breaking the ISK 1,500 billion barrier for the first time, and are now approaching the Group’s balance sheet in size. The insurance business also performed well, with income growing by 13% compared with the second quarter of 2023. Vörður posted positive financial results despite the fact that the largest single claim in the company’s history was made during the period, with the participation of reinsurers dampening the impact of the claim. The Bank remains strongly capitalized and Tier 1 capital is 18.5%, or 3.3 percentage points above the statutory minimum. Liquidity continues to be excellent, and the funding profile is well balanced.

One of the factors affecting return on equity in the period was a settlement which the Bank reached with the Financial Supervisory Authority of the Central Bank of Iceland towards the end of the quarter. Under this settlement, the Bank agreed to pay of fine of ISK 585 million. If it had not been for this settlement, the Bank’s ROE would have been 12.7% in the second quarter. The settlement with the FSA was made following an inspection by the FSA in the summer of 2022 of the Bank’s AML measures. The FSA’s inspection revealed shortcomings in the Bank’s practices. The Bank took these findings with the utmost seriousness and we undertook a comprehensive review of our practices. We have now significantly reinforced our money laundering defences by enhancing our systems and expanding our AML team which performs this vital role.

In recent years, Arion Bank has been a leader on the domestic corporate advisory market, and during the second quarter the Bank advised on the sole stock market listing of the year so far when Kaldvík was listed on First North. Arion Bank is also advising JBT on its takeover offer for Marel. If JBT’s plans come to fruition, it will be one of the largest deals completed in Iceland in recent decades.

Our focus on running a reliable business and providing outstanding financial services, with convenient digital services at the forefront, has resulted in Arion Bank having been named the bank of the year in Iceland for the last three years by The Banker magazine, a leading global finance news publication published by the Financial Times. In addition, Euromoney recently named Arion as bank of the year in Iceland for 2024 and as Iceland’s number one digital bank. These accolades mirror the results of a survey conducted by Maskína in June, which revealed that bank customers in Iceland rated the Arion app as the best banking app in Iceland for the eighth year in a row. We are grateful for this positive response to our efforts and it inspires us to do even better in the future. We aspire to be a digital leader, as clearly reflected by the diverse array of services available to customers in the Arion app. The app offers customers a simple overview of their finances, including credit card bills, savings, insurance, pensions, and securities holdings. The latest features include Arion Family, where parents can automatically view their children’s accounts and share viewing access to their own finances with their spouse, and Arion Refund which gives people who are customers of both Arion and Vörður the option of a 5% refund on their insurance premiums if they have a claims free year.

Arion Bank is continuing to work on the development of two key residential and commercial building sites in the Reykjavík area. The sites are being transformed into diverse residential communities with related services. Arion Bank owns 51% of the Arnarland site, where 500 residential units and 30,000 m2 of commercial and retail property are being constructed. The Blikastaðaland site is wholly owned by the Bank and covers 100 hectares. The first phase of the project provides for the construction of 1,200 residential units and infrastructure, such as schools and play schools, on 30-35 hectares. Both these projects are being carried out in close cooperation with the local authorities and will significantly boost the supply of residential property in the next few years.”

Income Statement

In ISK millions	Q2 2024	Q2 2023	Δ	Δ %	H1 2024	H1 2023	Δ	Δ %
Net interest income	11,948	11,426	522	5%	23,193	22,419	774	3%
Net commission income	3,979	4,187	(208)	(5%)	7,344	8,631	(1,287)	(15%)
Insurance service results	523	762	(239)	(31%)	307	26	281	-
Net financial income	99	(617)	716	-	128	177	(49)	(28%)
Other operating income	38	1,586	(1,548)	-	87	1,600	(1,513)	-
Operating income	**16,587**	**17,344**	**(757)**	**(4%)**	**31,059**	**32,853**	**(1,794)**	**(5%)**
Operating expenses	(7,154)	(6,009)	(1,145)	19%	(13,706)	(12,449)	(1,257)	10%
Bank levy	(476)	(457)	(19)	4%	(936)	(906)	(30)	3%
Net impairment	(775)	(568)	(207)	36%	(1,090)	(620)	(470)	76%
Net earnings before income tax	**8,182**	**10,310**	**(2,128)**	**(21%)**	**15,327**	**18,878**	**(3,551)**	**(19%)**
Income tax expense	(2,671)	(3,226)	555	(17%)	(5,375)	(5,513)	138	(3%)
Net earnings from cont. operations	**5,511**	**7,084**	**(1,573)**	**(22%)**	**9,952**	**13,365**	**(3,413)**	**(26%)**
Discontinued operations, net of tax	(11)	7	(18)	-	(20)	17	(37)	-
Net earnings	**5,500**	**7,091**	**(1,591)**	**(22%)**	**9,932**	**13,382**	**(3,450)**	**(26%)**
KFI's								
Return on equity (ROE)	11.5%	15.5%			10.2%	14.5%		
Return on total assets (ROA)	1.4%	1.9%			1.3%	1.8%		
Earnings per share (in ISK)	6.92	4.84			6.92	9.17		
Cost to core income ratio	46.2%	39.4%			47.2%	43.0%		
Net interest margin (NIM)	3.2%	3.2%			3.1%	3.1%		
Core income / REA	7.3%	7.5%			7.0%	7.2%		

Net interest income in the second quarter of 2024 increased by 5%, compared with the second quarter of 2023. The net interest margin (NIM) as a percentage of average interest-bearing assets was 3.2% for the quarter, the same as for the second quarter of 2023. Despite lower inflation in Q2 2024 compared with Q2 2023 the effect of inflation on net interest income is positive by ISK 1,791m due to the increased net CPI balance, which increased by ISK 110bn between years. The Central Bank base rate was 9.25% at the end of June 2024, compared with 8.75% at the end of June 2023. Average interest-bearing assets increased by 3.1%, compared with the second quarter of 2023, mainly loans to customers, the same increase as interest-bearing liabilities, mainly deposits.

Net commission income was ISK 4.0bn in the second quarter, compared with ISK 4.2bn in the previous year. The quarter was strong and impacted by an increase in lending fees, mostly relating to corporates, as well as increased income from cards and payments. Asset management was robust with AuM increasing by more than 10% during the quarter or by ISK 75bn, largely due to a new Stefnir fund, SRE III slhf. The comparison between years is impacted by the closure of the Keflavík airport branch and the reclassification of card insurance fees to insurance service results, a total of ISK 220m in the second quarter 2024.

Insurance service results of the insurance company Vördur were ISK 523m during the quarter, after the elimination of intercompany transactions. There has been strong growth of 13% in insurance revenues, compared with the second quarter of 2023, while claims are affected by a major claim in June where several stores in the shopping mall Kringlan were affected by a fire in the building. The current estimate of net claim is ISK 270m. The combined ratio for the second quarter of 2024 was 89.4%, compared with 79.3% for the same period in 2023.

Net financial income was ISK 99m for the quarter in a market environment which continues to be challenging.

Operating expenses increased by 19.1% in the second quarter, compared with the same period in 2023. When operating expenses of the insurance operation are included (post IFRS 17 cost related to the insurance business is accounted for through insurance service results) the increase was 18.2%. The main driver for this increase is a settlement fine with the regulator of ISK 585m. There is an ongoing focus on operating expenses and efficiency within the Group. Cost-to-core income ratio was 46.2%, compared with 39.4% in the second quarter 2023, when including the operating expenses of the insurance operation. Salary expenses increased by 11% compared with the second quarter of 2023, partly due to a one-off payment related to new collective wage agreements and an increase in the number of FTEs. At the end of June, the number of full-time equivalent positions (FTEs) was 817, an increase of 4.6% from the same period in 2023.

Net impairment was ISK 775m in the second quarter of 2024. Impairments are calculated at 28 bps on an annual basis.

Income tax, as reported in the financial statements, comprises 21% income tax on earnings and a special 6% financial tax on the earnings of financial undertakings of more than ISK 1bn. The effective income tax rate was high in the second quarter 2024 or 32.6%. In general, the combination of income is the main driver behind the fluctuation in the effective tax rate. The effective tax rate was impacted by a combination of expenses and equity forward transactions in the second quarter of 2024. Profit and loss of equity forward contracts is offset in the income statement. However, loss from subsequent equity holdings is not deductible for tax purposes, while profit from underlying contracts is taxable income.

Balance sheet

The balance sheet increased by 2.8% from year-end 2023 and the liquidity position remains strong.

Assets

In ISK millions	**30.06.2024**	**31.12.2023**	**Δ**	**Δ %**	**30.06.2023**	**Δ**	**Δ %**
Cash & balances with CB	135,522	102,095	33,427	33%	76,499	59,023	77%
Loans to credit institutions	32,728	28,835	3,893	14%	43,428	(10,700)	(25%)
Loans to customers	1,202,616	1,152,789	49,827	4%	1,134,621	67,995	6%
Financial instruments	165,630	205,706	(40,076)	(19%)	225,828	(60,198)	(27%)
Investment property	9,633	9,493	140	1%	9,444	189	2%
Intangible assets	7,864	8,051	(187)	(2%)	8,486	(622)	(7%)
Other assets	14,796	18,703	(3,907)	(21%)	19,920	(5,124)	(26%)
Total assets	**1,568,789**	**1,525,672**	**43,117**	**3%**	**1,518,226**	**50,563**	**3%**
KFI's							
REA / Total assets	60.7%	59.7%			60.1%		
Share of stage 3 loans, gross	2.1%	1.7%			1.5%		

Loans to customers increased by 4.3% or ISK 50bn from the end of 2023, with loans to corporates increasing by 4.7%, and loans to individuals growing by 4.0%. Part of this growth, or ISK 16bn, is due to inflation and changes in exchange rates. The growth rate has decreased in recent quarters, especially in corporates, with the economy slowing down following the changes in the interest rate environment. The diversification of the corporate loan book continues to be good and in line with the Bank's credit strategy.

The Bank's liquidity position is strong with the total LCR ratio at 154% and the ISK LCR ratio at 134%. This is reflected in the strong position in *Cash and balances with Central Bank*, *Loans to credit institutions* and *Financial assets*, including bonds and debt instruments. The average duration of liquidity in the bond portfolio is less than one year and there is no HTM accounting.

Liabilities and equity

In ISK millions	**30.06.2024**	**31.12.2023**	**Δ**	**Δ %**	**30.06.2023**	**Δ**	**Δ %**
Due to credit institutions & CB	5,067	2,771	2,296	83%	21,702	(16,635)	(77%)
Deposits from customers	846,686	792,710	53,976	7%	781,202	65,484	8%
Other liabilities	67,378	69,152	(1,774)	(3%)	76,956	(9,578)	(12%)
Borrowings	415,116	420,460	(5,344)	(1%)	405,572	9,544	2%
Subordinated liabilities	42,091	41,278	813	2%	46,478	(4,387)	(9%)
Total liabilities	**1,376,338**	**1,326,371**	**49,967**	**3.8%**	**1,331,910**	**44,428**	**3%**
Shareholders equity	191,966	198,798	(6,832)	(3%)	185,651	6,315	3%
Non-controlling interest	485	503	(18)	(4%)	665	(180)	(27%)
Total equity	**192,451**	**199,301**	**(6,850)**	**(3%)**	**186,316**	**6,135**	**3%**
Total liabilities and equity	**1,568,789**	**1,525,672**	**43,117**	**3%**	**1,518,226**	**50,563**	**3%**
KFI's							
Loans to Deposits ratio	142.0%	145.4%			145.2%		
CET 1 ratio	18.5%	19.7%			18.9%		
Capital adequacy ratio	22.8%	24.1%			23.9%		

Deposits from customers remain the most important source of funding for Arion Bank, with 59% of total liabilities in deposits. The increase from year-end 2023 is mainly from individuals and pension funds.

The maturity profile of *Borrowings* is balanced, and the Bank has broad funding options. In May the Bank issued EUR 300 million senior preferred notes. The notes have a maturity of 4.5 years and pay a coupon of 4.625% which corresponds to a spread of 175bp over mid-swaps. The deal was more than 8.5 times oversubscribed with orders received from more than 190 investors spanning over 25 countries across EMEA and APAC. The EUR 300m Senior Preferred Green notes due in December 2024 were fully prepaid in the quarter. The Bank has no significant covered bonds maturities until Q2 2025 and FX maturities in Q3 2025. The Bank will continue to regularly issue in the domestic market and access the international markets periodically.

Shareholders' equity decreased due to ISK 13.1bn dividend payment which was offset by the net earnings of ISK 9.9bn in the first six months of 2024. The leverage ratio was 11.9% at the end of June, compared with 12.4% at the end of 2023, which is high by international standards. CET1 capital is ISK 8.0-17.5bn in excess of target capital structure. However, since the Bank does not currently fully utilize AT1 capital item, CET1 capital of ISK 3.7bn is used to make up that shortfall.

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

Medium-term financial targets of Arion Bank

	Actuals Q2 2024	Actuals 6M 2024	Arion Bank's medium-term financial targets
Return on equity	11.5%	10.2%	Exceed 13%
Core operating income / REA	7.3%	7.0%	Exceed 7.2%
Insurance revenue growth (YoY)	12.8%	13.9%	In excess of market growth (10.6% in Q1 2024)
Combined ratio	89.4%	96.5%	Below 95%
Cost-to-core income ratio	46.2%	47.2%	Below 45%
CET1 ratio above regulatory capital requirements	330 bps	330 bps	150-250 bps management buffer (assumes fully utilized AT1) (~16.7 - 17.7% based on management target buffer and optimal AT1 and T2 positions)
Dividend pay-out ratio	50%	50%	Pay-out ratio of approximately 50% of net earnings attributable to shareholders through either dividends or buyback of the Bank's shares or a combination of both

Investor meeting / webcast in English on 26 July at 10:30 CEST (8:30 GMT)

Arion Bank will be hosting a meeting at the Bank's headquarters in Borgartún 19, Reykjavík, on Friday 26 July at 10:30 CEST (8:30 GMT) where CEO Benedikt Gíslason and CFO Ólafur Hrafn Höskuldsson will present the results and give an update on the economic environment. The meeting will take place in English and will also be streamed live. The webcast will be accessible live on Lumiconnect and a link is also available on the Bank's website under Investor Relations.

Participants attending virtually will be able to ask questions during the meeting through a message board on the same site. Answers will be provided by presenters at the end of the webcast.

Financial calendar

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

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