Íslandsbanki

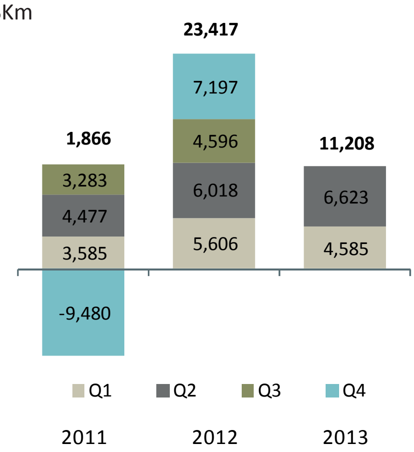
Íslandsbanki

CONSOLIDATED INTERIM FINANCIAL STATEMENTS 2Q2013

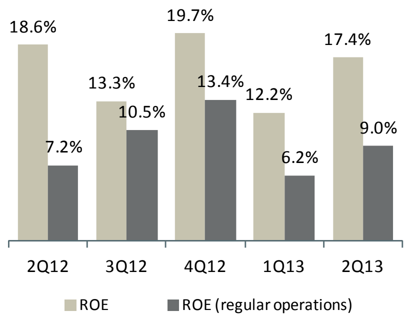
HIGHLIGHTS

- Profit after tax was ISK 6.6bn in 2Q13 (2Q12: ISK 6.0bn), and ISK 11.2bn in 1H13 (1H12: ISK11.6bn)
- Return on equity was 17.4% in the quarter (2Q12: 18.6%), but was 14.8% in 1H13 (1H12: 17.9%). The YoY decrease in ROE is primarily driven by higher equity which has increased by 15% YoY, from ISK 135bn to ISK 156bn at end of June 2013.
- Total taxes and levies paid to government institutions amounted to ISK 3.0bn in 2Q13, compared to ISK 2.2bn in 2Q12.
- Around 35 thousand individuals and 4 thousand corporates have received write-offs, debt forgiveness or some form of debt correction since the Bank's establishment, totalling ISK 500bn to date.
- Total assets were ISK 823bn (Mar13: ISK 829bn), with loans to customers down 1% to ISK 539bn (Mar13: ISK 543bn).
- The net interest margin was 3.4% in 2Q13 (1Q13: 3.6%) and is decreasing in line with expectations as deep discount following the acquisition of Glitnir loan book is being amortized.
- Net fee and commission income increased to ISK 2.7bn in the quarter (2Q12: ISK 2.3bn) and to 5.2 over the 1st half of the year (1H12: ISK4.4bn). This is a YoY increase of 15% which can mainly be attributed to Markets, Retail, Wealth and fee generating subsidiaries.
- Net valuation changes on the loan portfolio resulted in a gain of ISK 4.7bn in the quarter (2Q12: ISK 3.6bn) and ISK 7.9bn in the first half of the year (1H12: ISK 2.1bn).
- Total deposits increased to ISK 506bn (Mar13: ISK 492bn), due to normal fluctuation in deposits from customers and credit institutions.
- Equity was ISK 155.5bn, up 2% from Mar13 and 15% YoY. Total capital ratio strengthened to 27.4% (Mar13: 26.2%), and Tier 1 ratio was 24.0% (Mar13: 22.9%).

NET PROFIT
ISKm



ROE
%



KEY FIGURES	30.06.13	31.03.13
Balance sheet	ISKbn	ISKbn
Total assets	**823**	829
Total loans	**588**	601
Total deposits	**506**	492
Equity	**156**	152
Deposit / Loan ratio	**86%**	82%
Tier 1 ratio	**24.0%**	22.9%
Total capital ratio	**27.4%**	26.2%

KEY FIGURES	2Q13	2Q12
Income statement	ISKbn	ISKbn
ROE	**17.4%**	18.6%
ROE regular operations	**9.0%**	7.2%
Profit after tax	**6.6**	6.0
Profit from regular operations	**3.4**	2.3
Cost / income ratio	**41.1%**	50.7%
Net Interest Margin	**3.4%**	3.6%

Birna Einarsdóttir, Chief Executive Officer of Íslandsbanki:

„Íslandsbanki´s 2Q13 results are in line with projections. The numbers clearly show that positive synergies from mergers are being realised on both sides of the P&L. A great deal has been accomplished in terms of cost efficiency and the cost/income ratio, for the second quarter of 2013 has fallen to 41.1% and reduction in operating costs are down 7.5% in real terms.

Euromoney magazine ranked Íslandsbanki as the best bank in Iceland and the British financial magazine, World Finance, also awarded VÍB, Íslandsbanki´s Wealth Management division, the Investment Management Award for 2013. These two awards amply demonstrate the level of ambition and achievement that characterise work at the bank.

Íslandsbanki has tapped two covered bond issues in the quarter and has now become a regular issuer of commercial paper. Arranged by Bank of America Merrill Lynch, the Bank has recently signed a USD 250m GMTN programme allowing it to issue bonds in a broad range of currencies should opportunities arise in international markets.

Recalculation of foreign currency loans is on track and we estimate that 90% of transactions will have finished by end of August. The aim is that all remaining transactions, which amount to 15,000 contracts in total, will be recalculated by the end of the year.“

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INCOME STATEMENT

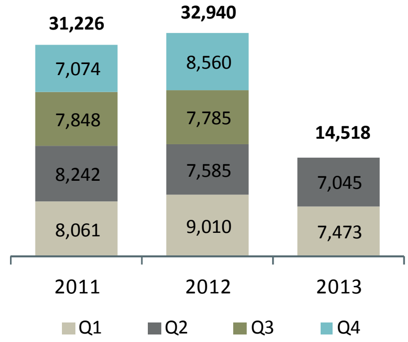
ISK m	**2Q13**	2Q12	**1H13**	1H12	FY12
Net interest income	**7,045**	7,585	**14,518**	16,595	32,940
Net valuation changes on loans and receivables	**4,751**	3,612	**7,868**	2,068	6,485
Provision for latent impairment	**106**	(149)	**(18)**	(270)	(776)
Net interest income after net valuation changes	**11,902**	11,048	**22,368**	18,393	38,649
Net fee and commission income	**2,670**	2,324	**5,122**	4,426	9,459
Net foreign exchange (loss)gain	**(152)**	(452)	**(1,715)**	739	2,737
Net financial income	**669**	191	**1,550**	1,105	1,517
Other net operating income	**716**	294	**1,128**	589	996
Total operating income	**15,805**	13,407	**28,453**	25,251	53,359
Salaries and related expenses	**(3,552)**	(3,336)	**(7,020)**	(6,621)	(13,080)
Other operating expenses	**(2,693)**	(3,260)	**(5,528)**	(6,404)	(12,366)
Insurance fund	**(256)**	(201)	**(502)**	(526)	(1,055)
Administrative expenses	**(6,501)**	(6,797)	**(13,050)**	(13,551)	(26,502)
Impairment of goodwill	**0**	0	**0**	0	(425)
Share profit of associates	**0**	0	**3**	0	0
Profit before tax	**9,304**	6,610	**15,4063**	11,701	26,432
Income tax	**(2,347)**	(1,546)	**(3,795)**	(2,998)	(6,253)
Profit (loss)from discontinued ops. net of tax	**(334)**	(954)	**(403)**	2,919	3,239
Profit after tax	**6,623**	6,018	**11,208**	11,624	23,418
Earnings from regular operations*	**3,441**	2,390	**5,787**	7,173	15,694

* Earnings from regular operations is defined as earnings excluding one-off items e.g. net valuation changes from the loan portfolio, fair value gain deriving from changes in accounting treatment, costs associated with the Byr merger and the impairment of goodwill and net earnings from discontinued operations.

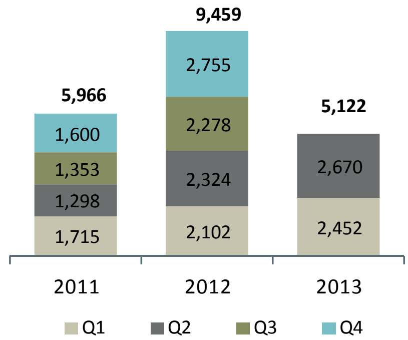
INCOME

- Total operating income increased to ISK 15.8bn in 2Q13, or up 18% YoY.
- Over 61% of the Bank's net operating income in 2Q13 derived from net interest income and net fee and commission income. This is in line with the Bank's focus on core earnings and its objective to generate stable cash flows over the long term.
- *Net interest income* amounted to ISK 7.0bn (2Q12: ISK 7.6bn) and is decreasing in line with expectations as deep discount following the acquisition of Glitnir loan book is being amortized.
- *Net interest margin,* calculated as the ratio of net interest income to the average carrying amount of total assets, was 3.4% (2Q12: 3.8%) which is in line with expectations as financial restructuring comes to a close.
- CPI imbalance amounted to ISK 2.6bn at end of June. The imbalance is managed via CPI-linked swaps, issuance of CPI-linked covered bonds and long term CPI-linked deposit programmes.
- *Net fee and commission income* increased to ISK 2.7bn (2Q12: ISK 2.3bn), a YoY increase of 15% which can mainly be attributed to Markets, Retail, Wealth and fee generating subsidiaries.
- *Foreign exchange loss* amounted to ISK 152m, compared to a ISK 452m loss in 2Q12. The net FX imbalance, amounting to ISK 19bn at the end of the period (Mar13: 19bn), is strictly monitored and is around 11% of equity and thus within the regulatory limit of 15%.
- *Net financial income,* which is mainly due to fair value gains on the Icelandair Group hf. equity stake, amounted to ISK 669m, compared to a gain of ISK 191m in 2Q12.
- Other net operating income, mainly sale of real estate, rental income and fees from service agreements and foreclosed assets, amounted to ISK 716m. The increase is due to increase of foreclosed assets in the Bank's books.

NET INTEREST INCOME
ISKm



NET FEE AND COMMISSION INCOME
ISKm



INCOME STATEMENT – cont.

EXPENSES

- Cost to income ratio decreased to 41.1% (2Q12: 50.6%).
- *Total administrative expenses decreased* to ISK 6.5bn (2Q12: ISK 6.8bn) which translates to 4.4% or 7.5% when adjusted for inflation. This is in line with the Bank's focus on cost control and its key projects aimed at improving operational efficiency and business process management.
- *Salaries and related expenses* amounted to ISK 3.5bn, up 6.5% YoY. Part of the increase is due to the addition of the Financial activities tax (FAT) to this line item, now 6.75% of salaries up from 5.45% in 2012, and changes in social security charges. The combined effect of these two factors is 1.2%. Salaries increased from ISK 2.6bn in 2Q12 to ISK 2.7bn in 2Q13, or by 5.2%. In comparison, the general Icelandic Wage Index rose 5.7% over the same period.
- The average number of full time employees for the parent was 1,085 at the end of the quarter, a 6% reduction from June 2012.
- *Other operating expenses* decreased 17.4% YoY, or to ISK 2.7bn in 2Q13 from ISK 3.3bn in 2Q12, and 20.1% in real terms when adjusting for inflation. Costs are on a downward trend with several cost programmes in place and costs associated with the acquisitions in 2012 drawing to a close.
- *Contributions to the Depositors' and Investors' Guarantee Fund* was ISK 256m. The contribution fluctuates with total deposits and lower risk weighing as a result of the Bank's higher equity and a considerably lower LPA ratio.

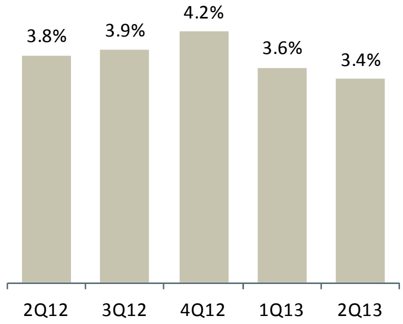
TAXES AND LEVIES PAID TO GOVERNMENT INSTITUTIONS

- Income tax was ISK 2.3bn during the quarter, which is an increase of 52% YoY. Taxation has increased considerably in recent years including a special financial activities tax of 6% on taxable profits above ISK 1bn for financial services providers.
- *Bank tax*, introduced in 2010, amounts to ISK 65m (2Q12: 200m), which includes taxation of 0.041% of the previous year's total liabilities and a temporary two year 0.0875% special tax on liabilities which ended 31.12.12. Note that Bank tax is now added to administrative expenses and comparative figures have been adjusted accordingly.
- Financial activities tax on salaries, now 6.75% up from 5.45% in 2012, calculated on salaries, amounted to ISK 214m, compared to ISK 147m in 2Q12.
- Expenses due to FME and the Debtors' Ombudsman were ISK 127m compared to ISK 128bn in 2Q12.
- Total taxes and levies paid to government institutions amounted to ISK 3.0bn in 2Q13, compared to ISK 2.2bn in 2Q12.

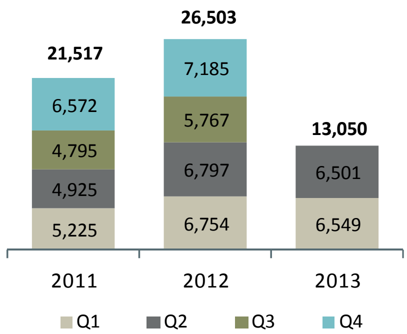
PROFIT/LOSS FROM DISCONTINUED OPERATIONS

- *Profit/Loss from discontinued operations* net of tax was a loss of ISK 334m, compared to a profit of ISK 954m in 2Q12. The profit in 2Q12 was due to the sale of equity stakes owned by Miðengi (Íslandsbanki subsidiary) as well as rental income and income from foreclosed assets.

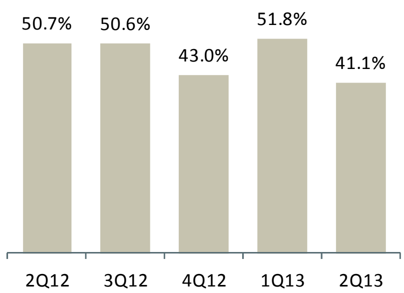
NET INTEREST MARGIN
%



ADMINISTRATIVE EXPENSES
ISKm (exl. goodwill write-off)



COST INCOME RATIO
% (exl. goodwill write-off)



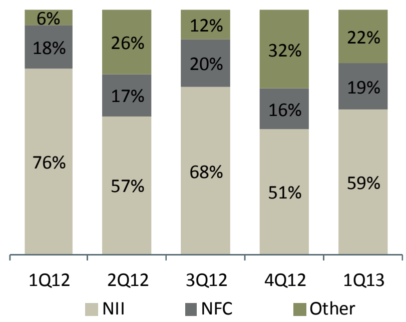
TAX & LEVIES	2Q13	2Q12
	ISKm	ISKm
Income tax	**2,347**	1,546
Bank tax	**65**	200
Financial activities tax	**214**	147
FME and the Debtors' Ombudsman	**127**	128
Contribution to The Depositors' and Investors' Guarantee Fund (TIF)	**256**	202
Total	**3,009**	2,223

INCOME STATEMENT – cont.

PROFIT

- *Profit after tax* in the quarter was ISK 6.6bn, compared to ISK 6.0bn in 2Q12 and ISK 11.2bn in the first half of 2013 (1H12: 11.6bn).
- Return on equity was 17.4% in 2Q13 and 14.8% in 1H13 compared to 18.6% and 17.9% in the same periods of 2012. The YoY decrease in ROE is primarily driven by higher equity which has increased by 15% YoY, from ISK 135bn a end June 2012 to ISK 156bn at end June 2013.
- Earnings from regular operations resulted in a profit of ISK 3.4bn in the quarter (2Q12: ISK 2.4bn) and ISK 5.8bn in 1H13 (1H12: ISK7.2bn). Return on equity from regular operations was 9.0% in 2Q13 and 14.8% in 1H13.

OPERATING INCOME SPLIT
%



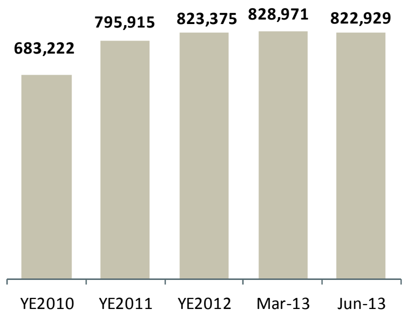
BALANCE SHEET

ASSETS	30.06.13	31.03.13	31.12.12
ISK m			
Cash and balances with CB	**98,042**	65,822	85,500
Derivatives	**229**	119	127
Bonds and debt instruments	**64,281**	71,796	64,035
Shares and equity instruments	**10,400**	9,730	10,445
Loans to credit institutions	**48,975**	57,633	54,043
Loans to customers	**538,565**	543,269	557,857
Investment in associates	**1,490**	505	503
Property and equipment	**9,153**	9,740	5,579
Intangible assets	**272**	277	261
Deferred tax assets	**1,139**	1,100	864
Non-current assets held for sale	**44,885**	46,929	39,046
Other assets	**5,497**	22,051	5,115
Total assets	**822,929**	828,971	823,375

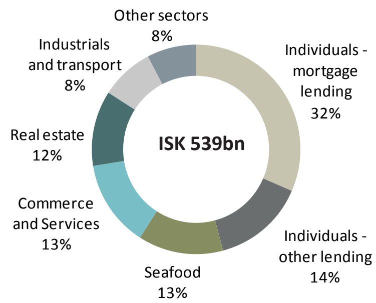
ASSETS

- *Bonds and debt instruments* amounted to ISK 64bn. The portfolio consists mainly of G5 government bonds in the Bank's liquidity portfolio.
- *Shares and equity instruments* amounted to ISK 10.4bn, up from ISK 9.7bn at 1Q13. The change is mainly attributable to fair value gains on Icelandair equity share holding. The Bank has actively sold if its equity stakes, with the Icelandair holding at 3.2%, down from 19.9% at end of March 2012.
- *Loans to customers* amounted to ISK 538.6 (1Q13: ISK 543.3bn), which is a 1% decrease QoQ. Repayments continue to exceed new lending as customers use any capacity they have to reduce their debt. Restructuring projects which have resulted in the acquisition of companies has also lowered the loan portfolio, as loans to companies owned by the Bank are not shown in the Consolidated statements.
- Restructuring of the largest corporate clients loan portfolio is expected to be largely completed by YE2013. Restructuring of the remainder of the loan portfolio will be completed by YE2014.
- Asset quality continued to improve with LPA ratio almost halved to 11.1% down from 19.6% in one year.
- Loans more than 90 days past due are unchanged from last quarter at 6%.
- *Non-current assets held for sale* decreased to ISK 44.9bn (1Q13: 46.9bn), down 14.4%.
- *Total assets* amounted to ISK 823bn, compared to ISK 829bn at 1Q13.

ASSETS
ISKm



LOAN PORTFOLTIO BY SECTOR
%, at 30.06.2013



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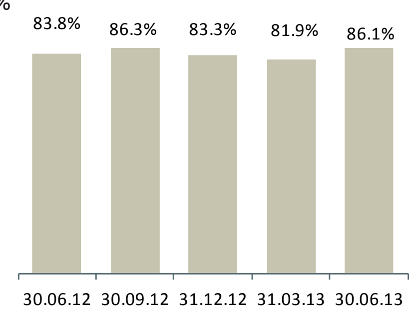
BALANCE SHEET - cont.

LIABILITIES	30.06.13	31.03.13	31.12.12
ISKm			
Derivatives and short positions	**11,082**	12,154	18,435
Deposits from CB and credit inst.	**29,405**	26,300	38,272
Deposits from customers	**476,212**	465,735	471,156
Debt issued and other borrowings	**74,764**	68,227	66,571
Subordinated loans	**22,249**	22,014	23,450
Current tax liabilities	**5,269**	3,396	2,052
Deferred tax liabilities	**30**	29	20
Non-current liabilities held for sale	**8,913**	10,522	6,805
Other liabilities	**39,468**	68,493	48,954
Total liabilities	**667,392**	676,870	675,715
Total equity	**155,537**	152,101	147,660
Total liabilities and equity	**822,929**	828,971	823,375

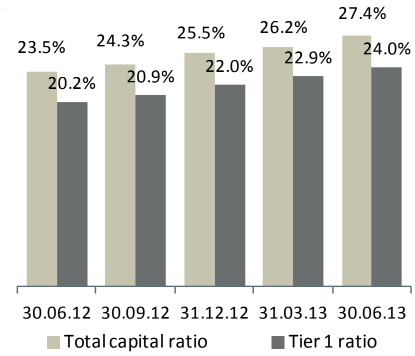
LIABILITIES AND EQUITY

- *Deposits from customers* have remained stable and amounted to ISK 476.2bn, compared to ISK 465.7bn at the end of March. Deposit to loan ratio was 86.1% (Mar13: 81.9%) and the customer deposit to loan ratio strengthened to 88.4% (Mar13: 85.7%).
- *Deposits from CB and credit institutions* increased to ISK 29.4bn from ISK 26.3bn. These less sticky deposits tend to fluctuate somewhat.
- *Subordinated loans* amounted to ISK 22.2bn, on par with end of Mar 2013. This represents a Tier 2 Government bond of EUR 138m that was issued following an agreement between Íslandsbanki, Glitnir and the Icelandic Government in September 2009.
- *Total liabilities* amounted to ISK 667.4bn (Mar 2013: ISK 676.9bn).
- *Total equity* was ISK 156bn, up 2.3% from Mar 2013 and 15% YoY.
- Total capital ratio strengthened to 27.4% (Mar 2013: 26.3%), notwithstanding a dividend payout in the quarter. The Tier 1 ratio was 24.0% up from 22.9% at end of March.

DEPOSIT RATIO



CAPITAL RATIOS



FUNDING AND LIQUIDITY POSITION

- The Bank's liquidity position is sound and all liquidity ratios well above regulatory requirements. The ratio of liquid assets against all deposits was 35%, well above the FME requirement of 20%. Cash equivalents over demand deposits was 17%, which was well above the 5% requirement set by the FME.
- The Bank's most recent step towards further funding diversification was signing a USD 250m Global Medium Term Note (GMTN) programme. The Bank is exploring its options in international markets and will take advantage of opportunities to access foreign currency funding as they arise.
- Íslandsbanki was the first bank to list commercial paper on the NASDAQ OMX Iceland in February 2013 and will issue regularly throughout the year. This was an important step towards further diversification of funding.
- Íslandsbanki has established itself as the largest issuer of covered bonds, with a total of ISK 17.6bn issued since its inaugural transaction in December 2011 when Íslandsbanki was the first bank to list securities since the autumn of 2008. Under the ISK 100bn covered bond programme that is in place, Íslandsbanki plans to issue around ISK 10bn of covered bonds annually.

FINANCIAL CALENDAR

Íslandsbanki plans to publish its interim and annual financial statements according to the financial calendar below:

- Silent period 17 – 26 November 2013
- 3Q13 – 27 November 2013
- Silent period 10 – 19 February 2014
- 4Q13 – 20 February 2014

Please note that the dates may change so please refer to the Bank's website for correct dates.