Press Release

Consolidated Unaudited Interim Financial Statements 9M18

Íslandsbanki hf

8 November 2018

First 9 months 2018 (9M18) financial highlights

- Profit after tax was ISK 9.2bn (9M17: ISK 10.1bn) generating an 7.1% annualised return on equity (9M17: 7.7%).
- Earnings from regular operations were ISK 9.0bn (9M17: ISK 10.2bn) with 9.0% annualised return on equity from regular operations normalised for 16% CET1 (9M17: 9.7%).
- Net interest income was ISK 23.6bn (9M17: ISK 22.7bn), an increase of 4.3% between years and the net interest margin was 2.9% (9M17: 2.9%).
- Net fee and commission income was ISK 8.7bn (9M17: ISK 10.1bn), down by 13.5% from the same time last year mostly due to lower activity levels from two of the Bank's fee-generating subsidiaries.
- Net impairment on financial assets generated a gain of ISK 1.9bn in 9M18, compared to ISK 0.6bn gain in 9M17.
- Administrative costs grew by approximately 4.5% between years and totalled ISK 20.2bn (9M17: ISK 19.3bn), mainly due to increases in negotiated salary agreements and costs related to new core banking system.
- The cost to income ratio for the group by end September was 65.6% compared to 60.3% for same period in 2017, while the same ratio for parent company and Íslandssjóðir was 57.8% and slightly above the Bank‘s 55% long term target.
- Loans to customers grew by 10.6% (ISK 80.4bn) to a total of ISK 836bn at the end of September. Total new lending amounted to ISK 175.6bn, split across lending divisions.
- Deposits from customers grew by 7.3% (ISK 41.6bn) to ISK 609bn at the end of September.
- The Bank's liquidity position is strong in both Icelandic kroners and foreign currency. Capital ratios continue to be elevated and exceed all internal and external requirements.

Third quarter 2018 (3Q18) financial highlights

- Profit after tax was ISK 2.1bn, comparable to 3Q17, generating an 4.9% annualised return on equity (3Q17: 4.7%).
- Earnings from regular operations were ISK 2.9bn, (3Q17: ISK 2.8bn) and annualised return on equity for regular operations normalised for 16% CET1 was 8.1% (3Q17: 7.9%).
- Net interest income amounted to ISK 8.3bn (3Q17: ISK 7.5bn) with 3.0% net interest margin (2Q17: 2.8%).
- Net fee and commission income was ISK 2.9bn (3Q17: ISK 3.3bn).

Key figures and ratios

		9M18	9M17	3Q18	3Q17	2017
PROFITABILITY	ROE 16% CET1 (regular operations)[1]	**9.0%**	9.7%	**8.1%**	7.9%	10.3%
	ROE (after tax)	**7.1%**	7.7%	**4.9%**	4.7%	7.5%
	Net interest margin (of total assets)	**2.9%**	2.9%	**3.0%**	2.8%	2.9%
	Cost to income ratio[2]	**65.6%**	60.2%	**62.1%**	62.7%	62.5%
	After tax profit, ISK m	**9,241**	10,114	**2,111**	2,073	13,226
	Earnings from regular operations, ISK m[3]	**8,979**	10,178	**2,929**	2,812	13,848

		30.9.2018	30.6.2018	31.3.2018	31.12.2017
CAPITAL	Total equity, ISK m	**174,630**	172,182	166,337	181,045
	Tier 1 capital ratio	**19.9%**	20.5%	20.3%	22.6%
	Total capital ratio	**21.7%**	21.6%	21.4%	24.1%
	Leverage ratio	**14.0%**	14.5%	14.3%	16.2%
BALANCE SHEET	Total assets, ISK m	**1,162,639**	1,111,742	1,088,308	1,035,822
	Loans to customers, ISK m	**835,582**	799,938	776,149	755,175
	Deposits from Customers, ISK m	**608,646**	578,414	575,196	567,029
	Customer deposit / customer loan ratio	**72.8%**	72.3%	74.1%	75.1%

Birna Einarsdóttir, CEO of Íslandsbanki

Íslandsbanki made a net profit of ISK 9.2 billion in the first nine months of the year and an annualised ROE of 7.1% (9.0% for regular operations). Fees and commissions rose by 6.1% for the parent company and its core subsidiary Íslandssjóðir, while the combined cost-to-income ratio for the two was slightly above the Bank's long term target of 55%. Lower activity levels for the Bank's two other subsidiaries did however reduce overall fees and commissions for the Group by 13.5% as well as raising its cost-to-income ratio up to 65.6%.

Lending growth continued to be strong in the third quarter with a 10.6% increase (ISK 80bn) during the year's first nine months, with the Bank's loan portfolio comparing well with its international peers. The Bank's liquidity position is strong, both in the domestic ISK and foreign currencies and funding has been successful during the year with the Bank issuing its second subordinated bond at the end of summer. In addition, the Financial Supervisory Authority lowered the Íslandsbanki's capital requirement from 19.8% to 18.8% which reflects the Bank's lower risk profile.

The FX market in Iceland has been very active this autumn and the Bank's FX trading desk has posted back to back record months. Íslandssjóðir obtained its highest market share in the Icelandic investment fund market and the real estate company, FAST-1, managed by Íslands-sjóðir, was recently sold yielding a good investor return.

Íslandsbanki recently launched its new core system for payments and deposits and has been investing in new technologies which will prepare it for the new banking environment. The Bank has recently been introducing new digital solutions, including a safe online live chat service for its customers, the first of its kind in Iceland and which has proven to be successful in international markets. Next week, the Bank will start offering its customers the opportunity to use their mobile phones to pay for goods and services.

We are confident that the Bank's investments in technological and digital platforms along with its personal service, will contribute to sustaining the Bank's vision of be a leading financial service provider in Iceland.

1. Return from regular operations on normalised CET1 of 16%, adjusted for risk free interest on excess capital. From January 2018 the definition of regular operations has been revised to include profit from discontinued operations as the Bank has successfully divested most non-core business related assets.
2. The Bank has introduced a new long term minimum capital target of 16% (CET1 16%), resulting in adjustments to its ROE on regular operations from previous levels (CET1 15%).
3. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items).
4. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax and one-off costs and income.

First 9 months 2018 (9M18) operational highlights

- Íslandsbanki introduced a new core payments and deposit system in September which was one of the largest IT projects ever to be carried out in Iceland and which will prepare the Bank for a new banking environment.

- The Bank announced a new solution that will allow users to pay for goods and services at all point-of-sale terminals using their mobile phone which will be launched next week bringing a new level of convenience to the Bank‘s customers.

- A new online chat service has recently been activated on Íslandsbanki´s website, which is the first of its kind in Iceland. Such functionality has proven to be quite popular internationally.

- Customers can now change their account overdrafts through the Íslandsbanki app. This has been an instant success as more than half of overdraft applications are now received through the app and around 11,000 overdrafts have been automatically approved.

- Íslandssjóðir‘s covered bonds funds have reached a size of ISK 10 billion and they are by far the largest funds of their kind on the market.

- The FX market in Iceland has been very active this autumn and the Bank‘s FX trading desk has posted back to back record months.

- Several reports were issued by the Bank on topic such as SMEs, the Icelandic residential property market as well as a new economic forecast. The Bank also organised several meetings for its customers about topics such as finances at retirement, mortgage options for customers (index vs. non-index loans) etc.

- Over ISK 155 million was raised for charities in relation to the Íslandsbanki sponsored Reykjavik Marathon which took place on 18 August 2018. About 14,000 runners took part with a record number of runners being set for the 3k and 10k runs.

INCOME STATEMENT

ISK m	9M18	9M17	Δ	3Q18	3Q17	Δ
Net interest income	**23,643**	22,661	982	**8,301**	7,450	851
Net fee and commission income	**8,749**	10,118	(1,369)	**2,939**	3,305	(366)
Net financial income	**(325)**	(975)	650	**(420)**	(1,084)	664
Net foreign exchange gain	**(75)**	446	(521)	**(8)**	76	(84)
Other operating income	**1,664**	506	1,158	**64**	291	(227)
Total operating income	**33,656**	32,756	900	**10,876**	10,038	838
Salaries and related expenses	**(11,453)**	(10,936)	(517)	**(3,501)**	(3,168)	(333)
Other operating expenses	**(8,732)**	(8,377)	(355)	**(2,962)**	(2,879)	(83)
Administrative expenses	**(20,185)**	(19,313)	(872)	**(6,463)**	(6,047)	(416)
Depositors' and Investors' Guarantee Fund	**(874)**	(795)	(79)	**(295)**	(280)	(15)
Bank tax	**(2,541)**	(2,278)	(263)	**(944)**	(806)	(138)
Total operating expenses	**(23,600)**	(22,386)	(1,214)	**(7,702)**	(7,133)	(569)
Profit before net impairment on financial assets	**10,056**	10,370	(314)	**3,174**	2,905	269
Net impairment on financial assets	**1,881**	587	1,294	**(53)**	147	(200)
Profit before tax	**11,937**	10,957	980	**3,121**	3,052	69
Income tax expense	**(3,616)**	(3,335)	(281)	**(1,136)**	(1,072)	(64)
Profit for the period from continuing operations	**8,321**	7,622	699	**1,985**	1,980	5
Profit from discontinued operations net of income tax	**920**	2,492	(1,572)	**126**	93	33
Profit for the period	**9,241**	10,114	(873)	**2,111**	2,073	38

Income slightly up compared to same period last year

Total income amounted to ISK 33.7bn in 9M18, a 2.7% increase between years.
Net interest income totalled ISK 23.6bn, an increase of 4.3% from the previous year. The net interest margin was 2.9%, which is at comparable levels to 9M17. The net interest margin is expected to be slightly below 3.0% in the near to medium term.

Net fee and commission income amounted to ISK 8.7bn, compared to ISK 10.1bn in 9M17. Overall net fee income showed a 13,5% decline year on year, principally due to lower activity levels from two of the Bank's fee generating subsidiaries.

Core income (net interest income and net fee and commission income) contributed 96% to the Bank's total operating income during the first nine months of 2018. The Bank remains focused on strong core earnings and stable long-term income.

The Bank recorded a net financial loss of ISK 325m in 9M18, compared to a loss of ISK 975m in 9M17. The losses derive largely from fair value positions of financial assets. The Bank also realised a net foreign exchange loss of ISK 75m in 9M18, compared with profit of ISK 446m in 9M17.

Other operating income totalled ISK 1.7bn in 9M18, as opposed to ISK 506m in 9M17. The substantial gain in 2018 derives from the sale of a subsidiary, which owned land.

Administrative expenses above previous year due to collective wage agreements and new core banking system

Administrative expenses grew by ISK 0.9bn year-on-year or 4.5% but when adjusted for inflation, the increase is 1.8%. This can be explained by various factors, such as wage increases coming collective wage agreements and costs related to the implementation of a new core banking system.

The average number of full-time equivalent positions (FTE) in 9M18 was 885 for the parent company (930 in 9M17) and 1,076 (1,112 in 9M17) for the Group. The number of FTE's at the close of the period excluding seasonal employees was 835 (881 in 9M17) in the parent company and 1,075 (1,066 in 9M17) for the Group.

The cost-to-income (C/I) ratio at end September was 65.6%, compared with 60.3% in 9M17, which is above the Bank's long-term target of 55%. The C/I ratio excludes the bank tax and other one-off cost items. The C/I in the parent company was 57.4% in 9M18 and 57.8% for parent company and Íslandssjóðir for the same period.

The after-tax profit from discontinued operations was ISK 0.9bn in 9M18, compared with ISK 2.5bn in 9M17. The profit derives from the sale of the Bank's assets and income from foreclosed assets. The 2.4bn gain in 2017 stems mostly from gain realised from disposal of assets within subsidiaries in 2Q17.

Positive net impairment on financial assets

Net impairment on financial assets generated a gain of ISK 1.9bn in 9M18, compared to ISK 0.6bn gain in 9M17, mostly deriving from the lifting of the Bank's provisions in relation to foreign currency-based loans. Other changes in net impairment on financial assets are results of normal business operations, including net remeasurement of loss allowance.

Taxes and levies continue to affect profitability

The tax on the profit for the period amounted to ISK 3.6bn, compared to ISK 3.3bn in 9M17. The effective tax rate was 30.3%, compared to 30.4% in 9M17 when untaxed income was lower. The bank tax accounted for ISK 2.5bn in 9M18, compared with ISK 2.3bn in 9M17. The bank tax increased significantly in 2013 as a temporary measure, but according to the government's long-term plans, the tax is expected to gradually decrease from 0.376% to 0.145% during the 2018-23 period. In addition, the Bank is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn and makes contributions to the Debtors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Office of the Debtors' Ombudsman. The contribution to the Depositors' and Investors' Guarantee Fund, was at ISK 0.9bn, marginally higher than previous year. Total taxes and levies amounted to ISK 7.6bn in 9M18, compared to 7.0bn in 9M17.

Standard international NPL measurement not yet available since adoption of IFRS 9

Following the implementation of IFRS 9, a new standard measure for non-performing loans (NPL's) has not been fully established at the international level. It is therefore currently difficult to compare the quality of the Bank's loan book to other banks and to analyse historical development. However, the European Banking Authority (EBA) has published a measure of NPL's as the ratio of the gross carrying amount of loans and advances in Stage 3 as a proportion of the total gross carrying amount of loans and advances. At the end of the reporting period this ratio was 2.0% for the Group compared to a 3.6% weighted average for European banks at the end of June 2018. When only taking into account the quality of loans to customers, the NPL ratio was at 1.7% at the end of September (net carrying amount).

Profitability in line with the Bank's expectations

Profit after tax was ISK 9.2bn in 9M18 (9M17: ISK 10.1bn) and annualised return on equity (after tax) was 7.1% in 9M18 (9M17: 7.7%) is in-line with the Bank's expectations. Earnings from regular operations were ISK 9.0bn, (9M17: ISK 10.2bn) and annualised return on equity from regular operations normalised for 16% CET1 was 9.0% in 9M18, compared to 9.7% in 9M17. Regular earnings decreased by ISK 1.2bn between years, mainly due to underperformance from two of the Bank's fee generating subsidiaries.

BALANCE SHEET

Assets – growing balance sheet through continued strong loan growth

The balance sheet grew by 12,2% from year-end 2017, to ISK 1,163bn with loans to customers growing by 10.6%, or ISK 80.4bn. Demand for new credit came from all of the Bank's lending units but was concentrated mostly in Corporate & Investment Banking. Mortgage loans rose by ISK 17.3bn from year-end 2017. New lending amounted to ISK 175.6bn in 9M18, as opposed to ISK 152.0bn in the previous year, an increase of 15.5%. Outstanding loans to the tourism industry in Iceland are 13% of the loan portfolio which is well diversified, unchanged from year-end 2017.

Loans are generally well covered by stable collateral, majority in residential and commercial real estate while the second most important collateral type is fishing vessels. The weighted average loan-to-value (LTV) ratio for the residential mortgage portfolio was 61.4% at end June 2018 compared to 60.8% at end June 2018. The Bank's asset encumbrance ratio was 16.7% at September 2018 compared to 16.5% at June 2018.

Liquidity levels in both Icelandic kroners and foreign currencies remained very strong during the quarter, benefitting among others from reduced concentration in the deposit base. Three items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amount to about ISK 287bn, some ISK 254bn of which are liquid assets.

Assets, ISK m	**30.9.2018**	30.6.2018	31.3.2018
Cash and balances with CB	**156,251**	166,194	177,029
Bonds and debt instruments	**63,324**	48,603	49,140
Shares and equity instruments	**13,995**	13,581	10,208
Derivatives	**3,479**	3,209	4,673
Loans to credit institutions	**67,047**	59,858	47,220
Loans to customers	**835,582**	799,938	776,149
Investment in associates	**533**	614	672
Property and equipment	**5,079**	5,058	7,025
Intangible assets	**4,910**	4,774	4,412
Other assets	**11,205**	8,512	10,732
Non-current assets held for sale	**1,234**	1,401	1,048
Total assets	**1,162,639**	1,111,742	1,088,308

Liabilities – diversified funding strategy

Total liabilities amount to ISK 988bn, an increase of 15.6% from year-end 2017. The Bank maintained strong liquidity levels into 2018, and all regulatory and internal metrics were well above the set limits. At September 2018, the Bank's liquidity coverage ratio (LCR) was 164% for the Group. The net stable funding ratio (NSFR) in foreign currency was 159% and the total NSFR was 117% for the Group.

Total deposits increased by 7.3% from year-end 2017, to ISK 609bn. Deposits are still the Bank's main source of funding, and concentration levels are monitored closely. The increase was due mainly to a rise in pension fund positions and from SMEs and individuals. The ratio of customer deposits to customer loans increased to 72.8% at September 2018, compared to 72.3% at June 2018.

Liabilities & equity, ISK m	**30.9.2018**	30.6.2018	31.3.2018
Deposits from CB and credit inst.	**15,530**	15,391	13,563
Deposits from customers	**608,646**	578,414	575,196
Derivatives and short positions	**5,585**	7,075	8,104
Debt issued and other borrowed funds	**297,318**	288,360	269,255
Subordinated loans	**15,531**	8,872	8,838
Tax liabilities	**10,311**	8,925	7,908
Other liabilities	**35,014**	32,447	39,028
Non-current liabilities held for sale	**74**	76	79
Total liabilities	**988,009**	939,560	921,971
Total equity	**174,630**	172,182	166,337
Total liabilities and equity	**1,162,639**	1,111,742	1,088,308

The Bank's debt issuance continued to be successful in 2018, executed primarily through its Global Medium-Term Note (GMTN) and covered bond programmes, with an eye to mitigate risk through diversification of funding. Apart from deposits, the main domestic funding vehicles were covered bonds and short-term unsecured bonds. Market access for covered bonds remains solid, with issuance of ISK 21.1bn in the first nine months of 2018, reinforcing the Bank's position as Iceland's largest covered bond issuer.

In August 2018 the Bank issued a SEK 500 million 10NC5 Tier 2 at a spread of STIBOR +250. This is Íslandsbanki's second subordinated issue and it follows from a successful SEK 750 million Tier 2 debut issue in November 2017.

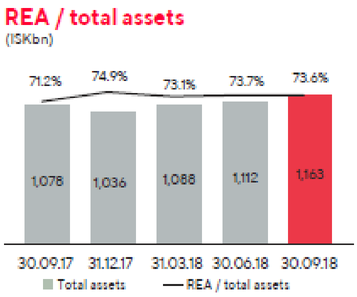
Equity

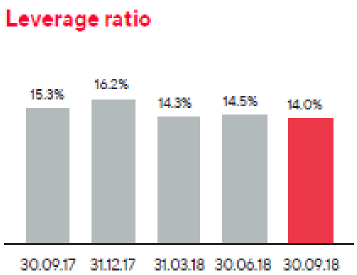
Total equity amounted to ISK 175bn at September 2018, compared to ISK 181bn at the end of 2017; it was agreed at the Bank's AGM in March to pay out a ISK 13bn dividend. Of that total, ISK 2.5bn is attributable to non-controlling interests. The nominal value of the Bank's authorised share capital was ISK 10bn at the end of the quarter, and total share capital amounted to ISK 65bn.

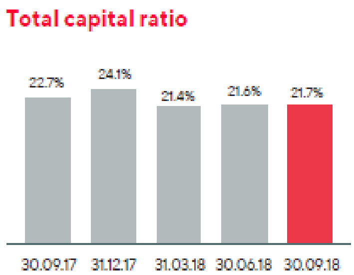
At the end of September, the Bank's total capital ratio was 21.7%, compared to 21.6% at June 2018, slightly above its target range of 19.3-20.8%. The Bank's Tier 1 ratio was 19.9% at

September 2018, compared to 20.5% at June 2018. In late September, the Icelandic Financial Supervisory Authority (FME) lowered the minimum requirement for total capital for Íslandsbanki from 19.8% to 18.8%. The decrease was credited to the Bank's lower risk profile.

The Bank has introduced a new long-term capital target, which is based on its internal capital adequacy assessment (ICAAP) and the supervisory review and evaluation process (SREP). The target assumes that the Bank will maintain a capital management buffer in excess of the SREP results to ensure that short-term fluctuations do not bring the ratio below the regulatory minimum. The capital target supports the Bank's business strategy and takes into account changes or uncertainties in the operating environment. It can change over time, reflecting changes in the Bank's risk profile, business strategy, and external environment. In light of recent changes to regulatory requirements and an updated assessment of the business environment, the Bank has decided to revise its management buffer from 0.5-1.5% to 0.5-2.0%. It is worth noting that the FME has instructed that the countercyclical capital buffer should be increased from 1.25% to 1.75%, effective in May 2019.







Íslandsbanki uses the standardised method to calculate its risk exposure amount (REA), which amounted to ISK 855.2bn at September 2018, or 73.6% of total assets, an increase of 4.4% from June 2018. The leverage ratio was 14.0% at end September compared to 14.5% at June 2018, indicating low leverage. The RAC ratio for the Bank was 19.4% at end June 2018 according to S&P Global Ratings.

Ratings

Íslandsbanki is the only bank in Iceland with credit ratings from two international rating agencies, Fitch Ratings and S&P Global Ratings (S&P).

Fitch Ratings upgraded the Bank to BBB/F3 in January 2017, with a stable outlook, and affirmed the ratings in December 2017.

In June 2018 S&P affirmed Iceland's A sovereign rating in recognition of its continued progress towards capital account liberalisation and its declining debt levels.

In October 2017, S&P upgraded Íslandsbanki's credit ratings to BBB+/A-2 with a stable outlook and affirmed the ratings in July 2018.

INVESTOR RELATIONS

Investor call in English at 9.30 am (GMT)

Today, 8 November, the Bank will host an investor call in English to present the financial results at 9.30 am (GMT). The call will start with a short macro update on the Icelandic economy, followed by a review of the financial results and Q&A.

Please register by replying to: ir@islandsbanki.is. Dial-in details and presentation will be sent out prior to the call.

Additional investor material

All presentation material will subsequently be available and archived on the Bank's investor relations website where other information on the Bank's financial calendar and silent periods is also available: https://www.islandsbanki.is/english/investor-relations/

Financial calendar

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

- Q4 2018 and year-end results
  14 February 2019

- Annual General Meeting
  21 March 2019

Please note that the dates are subject to change.