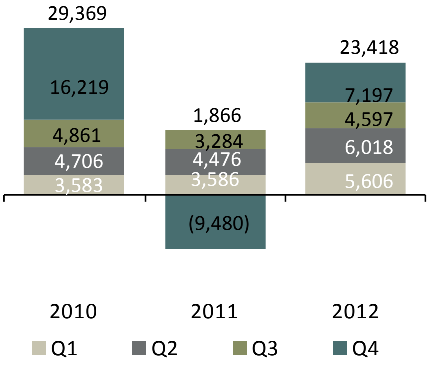
# Íslandsbanki

## CONSOLIDATED ANNUAL FINANCIAL STATEMENTS 2012

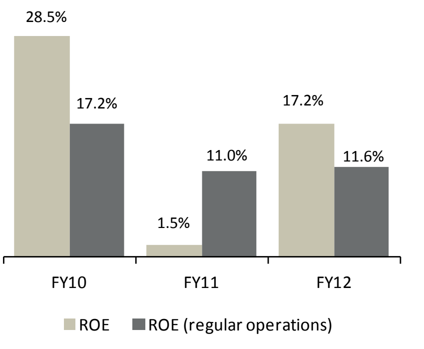
### HIGHLIGHTS

- Profit after tax was ISK 23.4bn in 2012 compared to ISK 1.9bn in 2011. The entire goodwill from the acquisition of Byr was impaired at year-end 2011 which resulted in a one-off charge of ISK 17.9bn.
- Profit after tax in 4Q12 was ISK 7.2bn, compared to a loss of ISK 9.5bn in 4Q11.
- Profit after tax from regular operations, defined as earnings excluding one-off items was ISK 15.7bn in 2012, compared to ISK 13.9bn in 2011.
- Return on equity was 17.2% compared to 1.5% in 2011. Return on equity from regular operations was 11.6% compared to 11.0% in 2011.
- Tax and levies paid to government institutions amounted to ISK 9.3bn in 2012 compared to ISK 2.0bn in 2011.
- Around 20,900 individuals and 3,660 corporates have received write-offs, debt forgiveness or some form of debt correction since the Bank's establishment, totalling ISK 463bn to date.
- Total assets were ISK 823bn at year-end 2012, compared to ISK 796bn in 2011.
- The net interest margin was 3.9% at year-end 2012, compared to 4.8% in 2011.
- Net valuation changes on the loan portfolio resulted in a gain of ISK 6.5bn in 2012, compared to a loss of ISK 1.3bn during the same period in 2011.
- Total deposits were ISK 509bn at year-end 2012, compared to ISK 526bn in 2011.
- Equity was ISK 148bn, up 19.4% from last year.
- At year-end, the total capital ratio was 25.5% compared to 22.6% at year end 2011.

**NET PROFIT**
ISKm




**ROE**
%




### Birna Einarsdóttir, Chief Executive Officer of Íslandsbanki:

*"The year 2012 will always be notable in the Bank's history marking the year when the merger of Íslandsbanki and Byr was completed. The merger increased the Bank's market share significantly and set the scene for future income generation and synergy effects. This is clearly illustrated in the 2012 financial results, where core earnings continue to strengthen and 75% of operating income was generated by net interest income and net fee and commission income.*

*Important milestones were reached in the reconstruction of the Icelandic financial market in 2012. Íslandsbanki's role was instrumental in that regard, e.g. by further issuance of the Bank's covered bonds and managing the IPO of Eimskip hf. and Fjarskipti hf. (Vodafone) on NASDAQ OMX Iceland. Furthermore, the Bank managed the bond offering of real-estate company Eik, which was the largest private sector bond offering since late 2008 and marked a breakthrough in market funding for corporates. More projects are in the pipeline which will continue to contribute to a more vibrant capital market in Iceland.*

*Remarkable progress was made in financial restructuring during the year with several large projects being completed. Recalculation of FX loans is also drawing to a close. In order to speed up the process, the Bank dropped three court cases, and will now recalculate the 15,000 remaining transactions. As a result, loan portfolio performance has improved significantly, whereby the proportion of loans in restructuring decreased from 22.6% to 13.7%. Furthermore, the three positive ESA conclusions on measures taken in 2008 marked important milestones in removing uncertainties in the Bank's operations. All of the above, along with more activity in financial markets, indicate a new turning point for Íslandsbanki and our operational environment."*

| Key figures | 31.12.12 | 31.12.11 |
|---|---|---|
| | ISKbn | ISKbn |
| Total assets | **823** | 796 |
| Total loans | **612** | 608 |
| Total deposits | **509** | 526 |
| Equity | **148** | 124 |
| Deposit / Loan | **83%** | 87% |
| Tier 1 | **22.0%** | 19.1% |
| Total capital | **25.5%** | 22.6% |

| Key figures | FY2012 | FY2011 |
|---|---|---|
| | ISKbn | ISKbn |
| ROE | **17.2%** | 1.5% |
| ROE regular operations | **11.6%** | 11.0% |
| Profit after tax | **23.4** | 1.9 |
| Profit from regular operations | **15.7** | 13.9 |
| Cost / income | **48.1%** | 51.5% |
| Net Interest Margin | **3.9%** | 4.5% |

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## INCOME STATEMENT

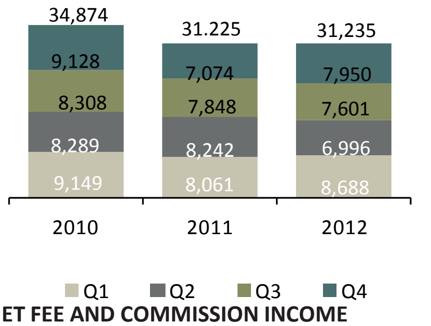
| ISK m | FY12 | FY11 | FY10 |
|---|---|---|---|
| Net interest income | **31,235** | 31,225 | 34,874 |
| Net valuation changes | **6,485** | (1,296) | 14,507 |
| Provision for latent impairment | **(776)** | 76 | (514) |
| Net interest income after valuation changes | **36,945** | 30,005 | 48,867 |
| Net fee and commission income | **9,459** | 5,966 | 7,380 |
| Net foreign exchange | **3,304** | 937 | (963) |
| Net financial income/loss | **2,655** | 2,649 | (910) |
| Other net operating income | **996** | 894 | 1,186 |
| Total operating income | **53,359** | 40,451 | 55,560 |
| Salaries and related expenses | **(13,080)** | (10,531) | (9,207) |
| Other operating expenses | **(11,508)** | (9,339) | (8,659) |
| Contribution to the Depositors' and Investors' Guarantee Fund | **(1,055)** | (965) | (607) |
| Administrative expenses | **(25,644)** | (20,835) | (18,473) |
| Impairment of goodwill | **(425)** | (17,873) | 0 |
| Share profit of associates | **0** | 39 | 0 |
| **Profit before tax** | **27,290** | 1,782 | 37,087 |
| Income tax | **(6,253)** | (75) | (7,214) |
| Bank tax | **(858)** | (682) | (221) |
| Profit from discontinued ops. net of tax | **3,239** | 841 | (283) |
| **Profit after tax** | **23,418** | 1,866 | 29,369 |
| **Earnings from regular operations** | **15,694** | 13,905 | 17,756 |

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.

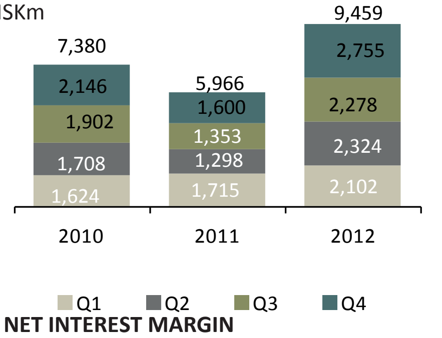
### INCOME

- Over 75% of the Bank's net operating income in 2012 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 31.2bn, compared to ISK 31.2bn in 2011. Calculated as the ratio of net interest income to the average carrying amount of total assets, the net interest margin was 3.9% at year-end, compared to 4.5% in 2011.
- CPI-linked imbalance amounted to ISK 1.3bn at year-end .The imbalance is managed via CPI-linked swaps and issuance of CPI-linked covered bonds. New product development, e.g. long term CPI-linked deposit programmes, has also contributed to reducing the imbalance.
- *Net fee and commission income* amounted to ISK 9.5bn in 2012, compared to ISK 6.0bn in 2011. This is a YoY increase of 58.5% which can be attributed to merger with Byr, new fee generating subsidiaries and increased capital markets activity.
- *Foreign exchange gain* in 2012 amounted to ISK 3.3bn, compared to an ISK 0.9bn gain in 2011. The increase is mostly due to weakening of the ISK. The gross foreign currency gap is gradually diminishing in line with restructuring of the loan portfolio. The net FX imbalance, amounting to ISK 28bn at year-end, is strictly monitored and is within the regulatory limit.
- *Net financial income*, which is mainly due to fair value gains on the Icelandair Group hf. equity stake, amounted to ISK 2.7bn in 2012, compared to a gain of ISK 2.6bn in 2011.

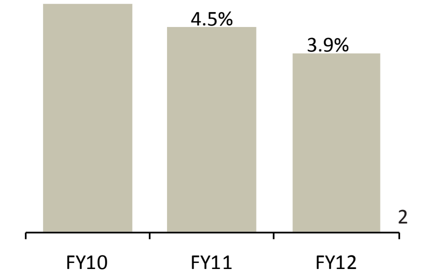
**NET INTEREST INCOME**
ISKm




**NET FEE AND COMMISSION INCOME**
ISKm




**NET INTEREST MARGIN**
%



## INCOME STATEMENT – cont.

- Other net operating income, mainly rental income and fees from service agreements and foreclosed assets, amounted to ISK 1.0bn in 2012, compared to ISK 0.9bn in 2011.
- Total operating income amounted to ISK 53.4bn, compared to ISK 40.5bn in 2011, which is an increase of 32%.

## EXPENSES

- Cost to income ratio was 48.1% in 2012, compared to 51.5% in 2011 (excluding goodwill write-off in 2H11).
- Core cost to income ratio, calculated as the ratio of total operating expenses over net interest income and net fee and commission income, was 63.0% in 2012, compared to 56.0% in 2011.
- *Salaries and related expenses* amounted to ISK 13.1bn in 2012, compared to ISK 10.5bn in 2011. The YoY increase is mainly attributed to the Byr merger and the new financial activities tax of 5.45% of total salaries as introduced in the beginning of 2012. Thereof, salaries increased from ISK 8.5bn to 10.1bn. This represents a 5.6% increase per FTE, which includes a contractual wage increase of 3.5% per FTE. In comparison, the general Icelandic Wage Index rose 7.8% over the same period.
- The average number of full time employees at the Bank was 1,119 at year-end, compared to 1,003 in 2011.
- *Other operating expenses* amounted to ISK 11.5bn in 2012, compared to ISK 9.4bn in 2011. The increase is partly attributable to the acquisition of Byr, in particular in relation to professional fees and IT services, new subsidiaries joining the Group as well as continued costs.
- *Contributions to the Depositors' and Investors' Guarantee Fund* increased by ISK 0.1bn YoY, from ISK 1.0bn in 2011 to ISK 1.1bn in 2012, mainly due to an increase in the deposit base following the Byr merger.
- *Total administrative expenses* amounted to ISK 25.7bn in 2012, compared to ISK 20.8bn in 2011, which is an increase of 25%.

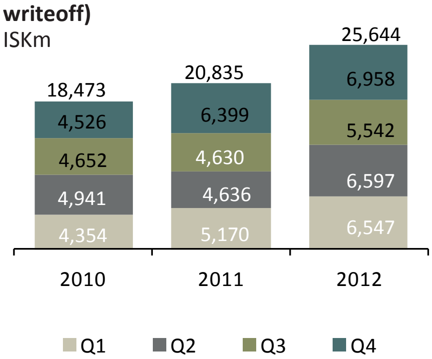
## TAXES AND LEVIES PAID TO GOVERNMENT INSTITUTIONS

- Income tax in 2012 was ISK 6.3bn compared to ISK 0.08bn in 2011 (profit before tax was ISK 27.3bn in 2012, compared to ISK 1.8bn in 2011). 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 0.9bn in 2012 compared to ISK 0.7bn in 2011. This includes taxation of 0.041% of the previous year's total liabilities and a temporary 0.0875% special tax on liabilities in 2012-13.
- Financial activities tax, a new tax of 5.45% calculated on salaries, amounted to ISK 0.6bn 2012.
- Expenses due to FME and the Debtors' Ombudsman amounted to ISK 0.5bn in 2012 compared to ISK 0.3bn in 2011.
- Total taxes and levies paid to government institutions amounted to ISK 9.3bn in 2012 compared to ISK 2.0bn in 2011.

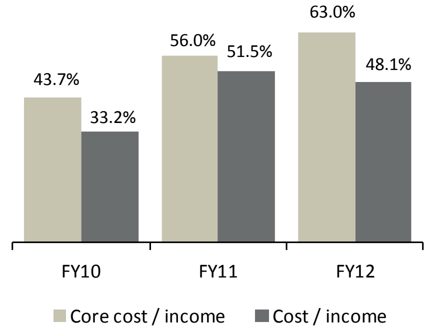
## PROFIT FROM DISCONTINUED OPERATIONS

- Profit from discontinued operations net of tax was ISK 3.2bn in 2012, compared to ISK 0.8bn in 2011. The increase can mainly be attributed to the sale of equity stakes owned by Miðengi (Íslandsbanki subsidiary) as well as rental income and income from foreclosed assets.

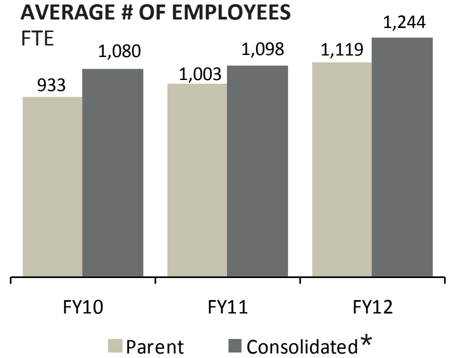
**ADMINISTRATIVE EXPENSES (exl. goodwill writeoff)**
ISKm




**COST / INCOME RATIOS (excl.goodwill writeoff)**
%




**AVERAGE # OF EMPLOYEES**
FTE




* Excluding FTEs of groups held for sale

**Tax and levies**
ISKm

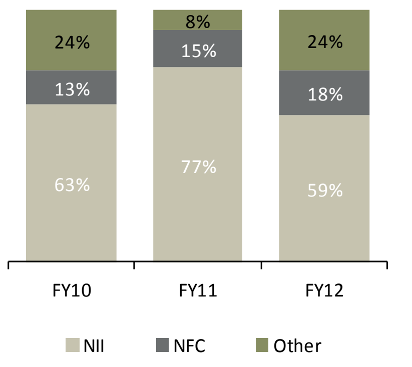
| | 2012 | 2011 |
|---|---|---|
| Income tax | **6,253** | 75 |
| Bank tax | **858** | 682 |
| Financial activities tax | **623** | 0 |
| FME and the Debtors' Ombudsman | **462** | 303 |
| Contribution to The Depositors' and Investors' Guarantee Fund (TIF) | **1,055** | 965 |
| **Total** | **9,251** | 2,025 |

## INCOME STATEMENT – cont.

### PROFIT

- *Profit after tax* was ISK 23.4bn in 2012, compared to ISK 1.9bn in 2011. This translates to a return on equity of 17.2%, compared to 1.5% in 2011. The YoY increase is due to the one-off impairment of goodwill of ISK 17.9bn in 2011 which negatively affected profitability and thereby ROE.
- Earnings from regular operations resulted in a profit of ISK 15.7bn and a return on equity of 11.6%. In comparison, earnings from regular operations was ISK 13.9bn in 2011, translating into a return on equity of 11.0%.
- Earnings from regular operations is defined as earnings excluding one-off items e.g. net valuation changes from the loan portfolio, fair value gains deriving from changes in accounting treatment, costs associated with the Byr merger and the impairment of goodwill, and net earnings from discontinued operations

**INCOME SPLIT**
%



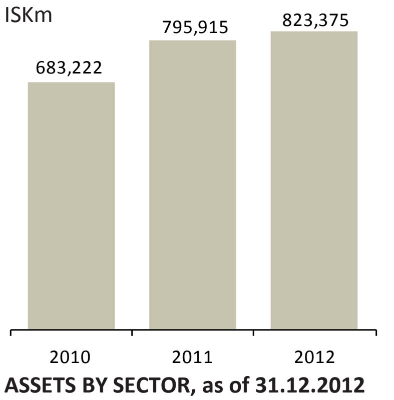

## BALANCE SHEET

| ASSETS | ISKm | 31.12.12 | 31.12.11 | 31.12.10 |
|---|---|---|---|---|
| Cash and balances with CB | | **85,500** | 57,992 | 30,799 |
| Derivatives | | **127** | 339 | 70 |
| Bonds and debt instruments | | **64,035** | 58,662 | 68,024 |
| Shares and equity instruments | | **10,445** | 11,107 | 3,022 |
| Loans to credit institutions | | **54,043** | 43,655 | 30,870 |
| Loans to customers | | **557,857** | 564,394 | 515,161 |
| Investment in associates | | **503** | 1,070 | 354 |
| Property and equipment | | **5,579** | 5,276 | 5,419 |
| Intangible assets | | **261** | 544 | 187 |
| Deferred tax assets | | **864** | 2,629 | 283 |
| Non-current assets held for sale | | **39,046** | 42,690 | 23,489 |
| Other assets | | **5,115** | 7,557 | 5,544 |
| **Total assets** | | **823,375** | 795,915 | 683,222 |

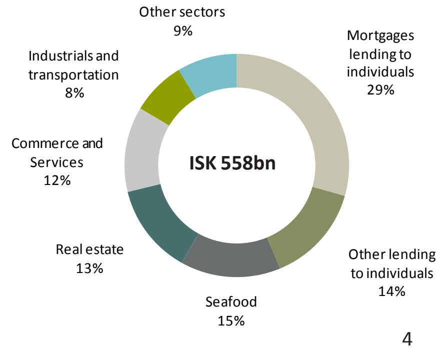
### ASSETS

- *Bonds and debt instruments* amounted to ISK 64.0bn at year-end 2012. The portfolio consists mainly of G5 government bonds in the bank's liquidity portfolio, with no exposure to GIPSIs.
- *Shares and equity instruments* amounted to ISK 10.4bn at year-end 2012, down from ISK 11.1bn at year-end 2011, mainly attributable to sale of equity stake in Icelandair.
- *Loans to customers* amounted to ISK 557.9bn at year-end 2012, compared to ISK 564.4bn at year-end 2011. The decrease is mainly attributable to a repayment of a large government secured customer loan. Excluding this repayment, loans to customers increased by 6.3% in 2012.
- Restructuring of the largest corporate clients loan portfolio is expected to be largely completed by the end of 2013. Restructuring of the remainder of the loan portfolio will be completed by the end of 2014.
- *Non-current assets held for sale* amounted to ISK 39bn at year-end, compared to ISK 42.7bn at year-end 2011. The decrease is partly due to a sale of equity stakes held by Íslandsbanki's subsidiary Miðengi.
- *Total assets* amounted to ISK 823.4bn at year-end 2012, compared to ISK 795.9bn at year-end 2011.

**TOTAL ASSETS**
ISKm




**ASSETS BY SECTOR, as of 31.12.2012**
%



## BALANCE SHEET

| LIABILITIES & EQUITY | ISKm | 31.12.12 | 31.12.11 | 31.12.10 |
|---|---|---|---|---|
| Derivative instruments and short positions | | **18,435** | 13,373 | 9,519 |
| Deposits from CB and credit inst. | | **38,272** | 62,845 | 96,238 |
| Deposits from customers | | **471,156** | 462,943 | 327,158 |
| Debt issued and other borrowings | | **66,571** | 63,221 | 55,425 |
| Subordinated loans | | **23,450** | 21,937 | 21,214 |
| Current tax liabilities | | **2,052** | 2,670 | 9,024 |
| Deferred tax liabilities | | **20** | 17 | 18 |
| Non-current liabilities held for sale | | **6,805** | 7,317 | 16,442 |
| Other liabilities | | **48,954** | 37,889 | 26,694 |
| Total liabilities | | **675,715** | 672,212 | 561,759 |
| Total equity | | **147,660** | 123,703 | 121,463 |
| **Total liabilities and equity** | | **823,375** | 795,915 | 683,222 |

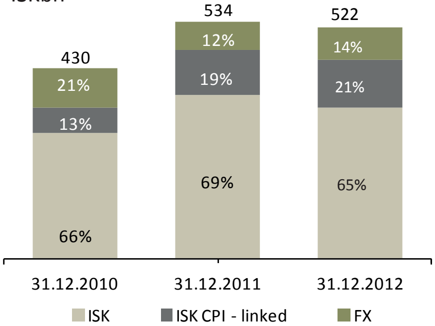
## LIABILITIES

- *Deposits from customers* have remained stable and amounted to ISK 471.2bn at year-end, compared to ISK 462.9bn at year-end 2011. Deposit to loan ratio was 83.3% and a customer deposit to loan ratio was 84.5% at year-end 2012.
- *Subordinated loans* amounted to ISK 23.5bn, which is a EUR 138m denominated Tier II Government bond that was issued following an agreement between Íslandsbanki, Glitnir and the Icelandic Government in September 2009.
- *Total liabilities* amounted to ISK 675.7bn at year-end, compared to ISK 672.2bn at year-end 2011.
- *Total equity* was ISK 147.7bn at year-end, compared to ISK 123.7bn at year-end 2011, which is an increase of 19.4% over the period.
- Total capital ratio was 25.5% and Tier 1 was 22.0%. Capital ratios have been increasing on the back of retained earnings.

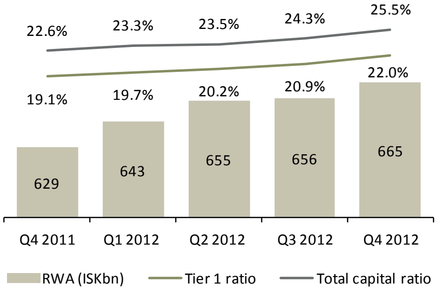
## FUNDING AND LIQUIDITY POSITION

- The Bank's liquidity position is sound and all liquidity ratios well above regulatory requirements. At year-end, the ratio of liquid assets against all deposits was 33%, well above the FME requirement of 20%.
- Cash equivalents over demand deposits was 18% at year-end, which was well above the 5% requirement set by the FME.
- The Bank has been largely funded with deposits since its incorporation in 2008.
- Íslandsbanki was the first bank to list securities on the NASDAQ OMX Iceland since the autumn of 2008, an important step towards diversification of funding for the Bank. Under the ISK 100bn covered bond programme that is in place, Íslandsbanki plans to issue around ISK 10bn of covered bonds annually. To date, the Bank has issued covered bonds amounting to ISK 13.4bn since its inaugural transaction in December 2011.
- The Bank is not reliant on foreign currency funding and does not have a need to raise such funds in the short to medium term. The Bank has, however, been exploring its options and will take advantage of opportunities to fund loan book growth in foreign currencies should they arise.

### DEPOSITS - PARENT
ISKbn




### CAPITAL RATIO
%




### FINANCIAL CALENDAR

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

- AGM - 18 April 2013
- Silent period 20 May – 29 May
- 1Q 2013 – 30 May 2013
- Silent period 20 August - 27 August
- 2Q 2013 – 28 August 2013
- Silent period 17 November – 26 November
- 3Q 2013 – 27 November 2013

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