# Íslandsbanki

## CONSOLIDATED INTERIM FINANCIAL STATEMENTS **9M2016**

**9M16 HIGHLIGHTS**

- Profit after tax was ISK 15.6bn in 9M16, compared to ISK 16.7bn in 9M15. The profit in 9M16 was driven by strong core income and the completion of the sale of Borgun's shares in Visa Europe, compared to a high net loan impairment gain in 9M2015.
- Return on equity was 10.3% in 9M16, compared to 11.9% in 9M15.
- Earnings from regular operations was ISK 11.2bn, compared to ISK 11.8bn in 9M15. Return on equity from regular operations on 15% CET1 was 10.4% in 9M16 compared to 12.3% in 9M15.
- Net interest income amounted to ISK 23.7bn in 9M16 (9M15 ISK 21.0bn) up 13%. The net interest margin rose to 3.0% in 9M16 (9M15: 2.9%), in part due to high interest rate environment and rising equity levels.
- Net fee and commission income was ISK 9.9bn in 9M16 at comparable levels to previous year (9M15: 9.9bn).
- A loss of ISK 1.2bn was recognised due to building damages in current headquarters at Kirkjusandur.
- Cost to income ratio was 56.0% in 9M16 (9M15: 55.6%), the cost to income ratio excludes the Bank tax and one-off cost items.
- Total assets amounted to ISK 1,068bn (Jun16: ISK 1,030bn), whereby loans to customers and liquidity portfolio account for 95% of balance sheet.
- Loans to customers grew by 2.8% in 9M16 to ISK 684.2bn. Total new lending was ISK 124bn across various lending divisions, but strengthening of the ISK had some dampening effect on the growth of the portfolio.
- Ratio of loans more than 90 days past due and impaired was 2.3% (Jun16: 2.5%).
- Deposits from customers decreased by 6.8% in 9M16 to ISK 553bn in line with expectations following composition agreements and the CBI's FX auctions.
- The Bank issued a benchmark EUR 500m note maturing in 2020, making us fully market funded.
- Total capital ratio and CET1 ratio both at 27.8%, as the only subordinated loan of EUR 138m was prepaid in September.
- The liquidity position is strong and exceeds internal and external requirements. At June 2016, the Bank's liquidity coverage ratio (LCR) was 195% (Jun16: 173%) and the total net stable funding ratio (NSFR) was 126% (June16: 117%)
- Leverage ratio was at 17.7% at the end of September compared to 18.3% at Jun16, indicating a moderate leverage
- The Bank has issued three notes in FX over the period. Making the Bank fully market funded, Íslandsbanki issued a 4-year EUR 500m (ISK 65bn) 1.75% Fixed Rate Note, corresponding to a spread of 200 basis points over mid-swaps in August. This followed a USD 35m private placement in January and EUR 75m tap issue in May.
- S&P upgraded Íslandsbanki to BBB/A-2 with a positive outlook in October 2016, and Fitch affirmed its BBB-/F3 rating with a stable outlook in April. Íslandsbanki is the only Icelandic bank to have investment grade ratings from both S&P and Fitch

**3Q16 HIGHLIGHTS**

- Profit after tax was ISK 2.5bn in 3Q16 (3Q15: ISK 5.9bn).
- Return on regular operations on 15% CET1 was 8.7% in the quarter (3Q15: 11.1%).
- Net interest income amounted to ISK 7.8bn in 3Q16 (3Q15: ISK 7.5bn).
- Net fee and commission income was ISK 3.2bn in 3Q16 (3Q15: ISK 3.5bn).

**Birna Einarsdóttir, Chief Executive Officer at Íslandsbanki:**

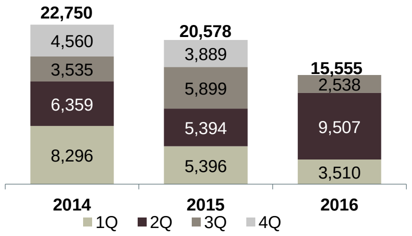
*"It has been a very eventful quarter for Íslandsbanki, in particular with regard to the Bank´s funding and operating environment.*

*The debt levels of the Icelandic sovereign, as well as for individuals and corporates in Iceland, have been greatly reduced and the long awaited steps towards the lifting of capital controls were finally passed into law. Íslandsbanki recently issued a benchmark EUR 500m note making us fully market funded. The Bond was more than twice oversubscribed and has performed very well in the secondary market. S&P Global Ratings (S&PGR) recent upgrade of Íslandsbanki to BBB/A-2 with positive outlook in October was well aligned with these positive trends in the Icelandic economy and the banking sector.*

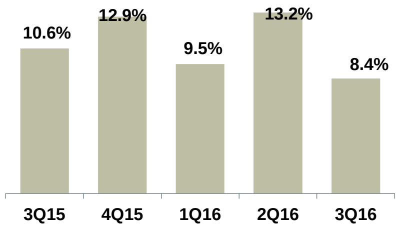
*Our sound business position continues to render strong recurring revenues and a resilient ROE. The profit for the first 9 months was ISK 15.6bn, rendering a ROE 10.3%. As previously reported, one-off items had a considerable impact over the period. When adjusted for, earnings from regular operations was 11.2bn rendering ROE of 10.4%. Net interest income rose 13% from year-end 2015, mainly due to a higher interest rate environment and equity levels. The loan portfolio grew 3% on the back of ISK 124bn in new lending. However, we note that competition for lending is stiffening, which coupled with increased taxation on the banking sector is likely to impact future profitability.*

*Leverage continues to be low at 17.7%. Our solid total capital ratio of 27.8% and sound liquidity position make us well prepared for any adverse effects that might stem from full capital account liberalisation.*

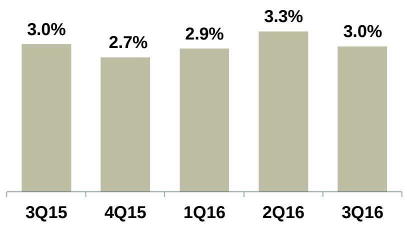
**NET PROFIT**
ISKm




**ROE** **(Regular operations CET1 15%)**
%




**NET INTEREST MARGIN**
%



| Income Statement (ISKm) | 9M16 | 9M15 | Δ | 3Q16 | 3Q15 | Δ |
|---|---|---|---|---|---|---|
| Net interest income | **23,653** | 21,007 | 2,646 | **7,758** | 7,457 | 301 |
| Net fee and commission income | **9,892** | 9,935 | (43) | **3,233** | 3,512 | (279) |
| Net financial income | **6,059** | 2,426 | 3,633 | **(607)** | 387 | (994) |
| Net foreign exchange gain (loss) | **366** | (1,353) | 1,719 | **49** | (1,072) | 1,121 |
| Other operating income | **669** | 699 | (30) | **45** | 158 | (112) |
| **Total operating income** | **40,639** | 32,714 | 7,925 | **10,478** | 10,442 | 36 |
| Administrative expenses | **(19,729)** | (17,241) | (2,488) | **(5,613)** | (5,310) | (303) |
| Depositors´and Investors Guarantee Fund | **(811)** | (797) | (14) | **(283)** | (263) | (19) |
| Bank Tax | **(2,152)** | (2,060) | (92) | **(745)** | (732) | (13) |
| **Total operating expenses** | **(22,692)** | (20,099) | (2,593) | **(6,641)** | (6,305) | (337) |
| **Profit before net loan impairment** | **17,947** | 12,615 | 5,332 | **3,837** | 4,137 | (300) |
| Net loan impairment | **251** | 7,726 | (7,475) | **(118)** | 3,418 | (3,536) |
| **Profit before tax** | **18,198** | 20,341 | (2,143) | **3,719** | 7,555 | (3,836) |
| Income tax expense | **(3,852)** | (4,704) | 852 | **(1,266)** | (1,784) | 518 |
| **Profit for the period from continuing operations** | **14,346** | 15,637 | (1,291) | **2,452** | 5,771 | (3,318) |
| Profit from discontinued ops. net of income tax | **1,209** | 1,052 | 157 | **85** | 128 | (43) |
| **Profit for the period** | **15,555** | 16,689 | (1,134) | **2,538** | 5,899 | (3,361) |

## INCOME STATEMENT

### Stable recurring revenues

- Total operating income amounted to ISK 40.6bn in 9M16 (3Q16: ISK 10.5bn), an increase of 24% from 9M15.

- Net interest income totalled ISK 23.7bn (3Q16: ISK 7.8bn), an increase of 13% from the same period last year mainly due to a higher interest rate environment and higher equity level. The net interest margin was 3.0% (3Q16: 3.0%), compared to 2.9% in 9M15 (3Q15: 3.0%), and is expected to remain around 3.0% in the near to medium term.

- Net fee and commission income finishes the period at ISK 9.9bn which is comparable to 9M15 (3Q16: ISK 3.2bn). This item is driven by Retail Banking and fee generating subsidiary Borgun (64% equity stake).

- Core income (net interest income and net fee and commission income) accounts for only 83% (9M16) of total operating income as a result of one off items. Usually, core income is over 90% of the banks earnings and in line with the Bank's focus on core earnings and objective to generate stable revenues over the long term.

- Net financial income amounted to ISK 6.1bn in 9M16 (3Q16: -0.6bn), as opposed to ISK 2.4bn in 1H15 (3Q15: 0.4bn). The income is derived from gains in equity holdings and trading of bonds and shares. The increase in net financial income is due to the sale of shares in Visa Europe which resulted in a ISK 6.2bn revenue to the income statement. The agreement was finalised in 2Q16.

- Other operating income, consisting of real estate sales, rental income, service level agreement fees, and a share in the profit or loss of associates, totalled ISK 669m in 9M16 (3Q16: ISK 45m), as opposed to ISK 699m in 9M15 (3Q15: ISK 158m).

### Cost awareness

- Administrative expenses (excluding one-off extraordinary expenses) rose by ISK 1.5bn year-on-year. Total salaries and related expenses grew to ISK 10.7bn (3Q16: ISK 3.1bn), a 5.0% increase from 9M15. The increase is primarily down to pay rises negotiated in collective wage agreements which came into fruition in 4Q15 and 1Q16. According to Statistics Iceland, the wage index has risen by 10.5% over the same period.

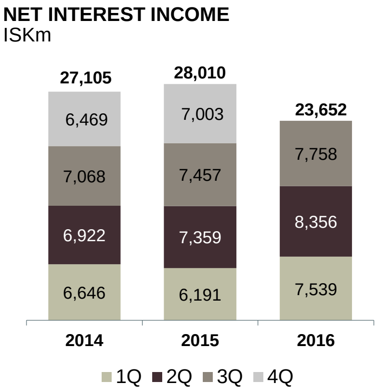
- The average number of full time equivalent (FTEs) employees in the parent company was 968, and 1,131 FTEs on a consolidated basis excluding held for sale entities.

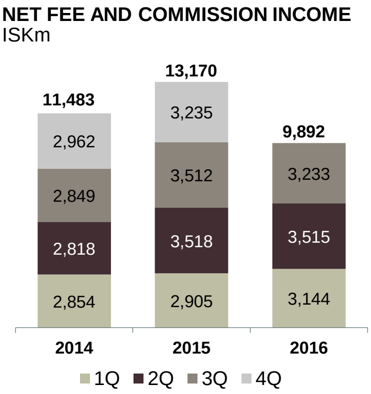
- The cost-to-income ratio for the period was 56.0% compared to 56.3% in 9M15.The cost income ratio excludes the Bank tax, which is considered temporary, and other one off cost items.

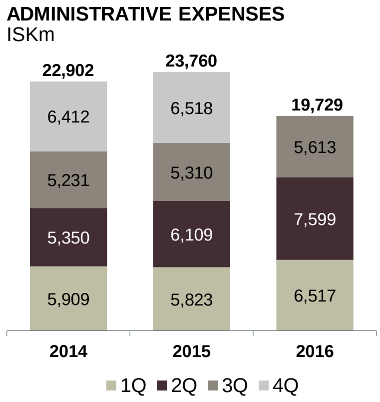
- A one off loss of ISK 1.2bn in 9M16 due to building damages in current headquarters at Kirkjusandur.

- This autumn, the Bank's operations will be consolidated in new headquarters at the North Tower in Kópavogur. In addition, three branches will be merged into one, strategically located at the ground floor of the North Tower. Furthermore, the branches in Kirkjusandur and Suðurlandsbraut will merge to a new branch in Laugardalur bringing the total number of branches down from 17 to 14 in early 2017. These changes will add front end costs in 2016, but these are expected to be off-set by future cost savings.

- Investments into digital solutions such as KASS, mortgage calculators, electronic signatures, and the Sopra payment system increase the operating expenses short term, but are expected to be off-set by future revenues.




### Net loan impairment

- Net loan impairment totalled ISK 0.3bn in 9M16 compared to ISK 7.7bn gain in 9M15.
- Net loan impairments have since 2008 been substantially impacted by an increase in value of loans bought at deep discount. As restructuring of the loan book has now been concluded there should be a less positive impact from net loan impairment going forward.

### Taxes and levies rise

- Tax on the profit for the period amounted to ISK 3.9bn, as compared with ISK 4.7bn in 9M15. The effective tax rate was 21.2%, as opposed to 23.1% in 9M15.
- Bank tax accounted for ISK 2.2bn in 9M16, an increase of 4% from 9M15 in line with growth in total liabilities. The Bank tax was originally introduced as a temporary tax and uncertainty on its future arrangement.
- Íslandsbanki is subject to the special financial tax of 6% on taxable profits in excess of ISK 1bn, as well as contributions to the Depositors' and Investors' Guarantee Fund, the Financial Supervisory Authority, and the Debtors' Ombudsman. Total taxes and levies amounted to ISK 7.6bn in 9M16, as opposed to ISK 8.3bn in 9M15.
- The contribution to the Depositors' and Investors' Guarantee Fund in the amount of ISK 811m in 9M16 was comparable to that in the previous year.

### Profit for the period

- The profit from discontinued operations, net of tax, was ISK 1.2bn in 9M16 (3Q16: ISK 0.1bn), compared to ISK 1.1bn in 9M15 (3Q15: ISK 0.1bn). The profit derives from the sale of foreclosed and held for sale assets.
- Profit after tax was ISK 15.6bn in 9M16 (3Q16: ISK 2.5bn) compared to ISK 16.7bn in 9M15 (3Q15: ISK 5.9bn), rendering a ROE of 10.8%. Profit is at comparable levels due to the Visa Europe payment in 2016 and the high net loan impairment gain in 2015.
- Earnings from regular operations was ISK 11.2bn (3Q16: ISK 4.0bn), compared to ISK 11.8bn in 9M15 (3Q15: ISK 3.6bn). Return on equity from regular operations on 15% CET1 was 10.4% in 9M16 compared to 12.3% in 9M15. The decrease is a result of fair value losses in the market. and front loaded collective salary increases.

## BALANCE SHEET

### Assets - healthy growth anchored in a balanced economy

- The balance sheet grew 3.8% in the last quarter, to ISK 1,068bn at September 2016. This is mainly due to an increase in cash levels, bonds and debt instruments and unsettled transactions. Loans to customers and liquidity portfolio account for 95% of balance sheet.

| Asset (ISK m) | 30.09.2015 | 30.06.2016 | 31.03.2016 |
|---|---|---|---|
| Cash and balances with CB | **205,148** | 182,177 | 182,453 |
| Bonds and debt instruments | **89,026** | 71,756 | 79,873 |
| Shares and equity instruments | **12,007** | 12,692 | 18,664 |
| Derivatives | **1,690** | 2,036 | 2,759 |
| Loans to credit institutions | **38,189** | 33,088 | 27,811 |
| Loans to customers | **684,170** | 698,669 | 677,079 |
| Investment in associates | **764** | 764 | 1,009 |
| Property and equipment | **5,924** | 5,884 | 7,289 |
| Intangible assets | **2,039** | 1,700 | 1,471 |
| Other assets | **20,691** | 11,268 | 11,177 |
| Non-current assets held for sale | **8,615** | 9,583 | 11,190 |
| **Total assets** | **1,068,263** | 1,029,617 | 1,020,775 |

- Loans to customers increased 2.8%, or ISK 18.5bn, in 9M16 (3Q16: -2,1% or ISK -14.5bn), whereas the contraction in 3Q16 is mainly due to strengthening of the ISK. Demand for new credit was well spread across lending divisions. New lending amounted to ISK 124bn (3Q16: ISK 33.2bn), as opposed to ISK 109bn (3Q15: ISK 40.3bn) over the same period in the prior year.
- The share of loans that are either 90 days in arrears or impaired was 2.3% at September 2016, compared to 2.2% at year-end 2015. This places Íslandsbanki's credit quality securely in the top interquartile range of European banks in terms of the European Systemic Risk Board solvency indicator. A more detailed discussion of the loan portfolio and credit risks can be found in the Bank's 2015 Pillar 3 Report.
- Real estate remains Íslandsbanki´s most important type of collateral. The weighted average loan-to-value (LTV) ratio for the residential mortgage portfolio was 65.8% at September 2016, compared to 65.0% at June 2016.
- Investment banking activities respresent only a fraction of the Bank's activities. Of the total risk weighted assets, only 6% was atttributable to investment banking activities and only 3% of credit risk at the end of September 2016.

| Liabilities and Equity (ISK m) | 30.09.2016 | 30.06.2016 | 31.03.2016 |
|---|---|---|---|
| Deposits from CB and credit inst. | **13,362** | 14,633 | 28,338 |
| Deposits from customers | **553,107** | 566,220 | 544,430 |
| Derivatives and short positions | **5,334** | 6,079 | 4,902 |
| Debt issued and other borrowings | **222,598** | 163,469 | 161,802 |
| Subordinated loans | **0** | 18,886 | 19,415 |
| Tax liabilities | **10,454** | 9,894 | 8,963 |
| Other liabilities | **59,856** | 49,252 | 44,170 |
| Non-current liabilities held for sale | **2,161** | 2,347 | 3,128 |
| Total liabilities | **866,872** | 830,780 | 815,148 |
| Total equity | **201,391** | 198,837 | 205,627 |
| **Total liabilities and equity** | **1,068,263** | 1,029,617 | 1,020,775 |

**Liabilities – solid liquidity position and well prepared for lifting of capital controls**

- Total liabilities amounted to ISK 866.9bn at September 2016, an increase of 4.3% from June 2016.
- Deposits from customers decreased by 2.3% from June 2016, to ISK 553.1bn. As a result, the ratio of customer deposits to customer loans decreased slightly to 78.4% at September 2016, compared to 79.4% at June 2016.
- Customer deposits are still Íslandsbanki's main source of funding, and concentration levels are monitored closely. At the end of September 2016, 19% of the Banks deposits belonged to the 10 largest depositors, down from 25% at year-end 2015. The drop is largely attributable to the reduction in deposits from old Glitnir following their composition agreement.
- Íslandsbanki maintained a strong liquidity position into 2016, and all regulatory and internal metrics were well above the set limits. At June 2016 its liquidity coverage ratio (LCR) was 195% (Jun16: 173%) at the group level, and the FX net stable funding ratio (NSFR) and total NSFR were 145% (Jun16: 154%) and 126% (Jun16: 117%) respectively at group level.
- Íslandsbanki´s debt issuance has continued into 2016, primarily reflecting issuance under its Global Medium Term Note Programme (GMTN) and covered bond programme, aimed at mitigating risk through diversification of funding.
- In August, Íslandsbanki has issued a benchmark 4-year EUR 500m (ISK 65bn) 1.75% Fixed Rate Note, corresponding to a spread of 200 basis points over mid-swaps. The transaction was more than twice oversubscribed and placed with investors in EU and Nordics. Part of the proceeds was used to prepay a EUR 138m subordinated loan due 2019.
- Other FX issuance includes a USD 35m one-year floating-rate note paying 3 month USD LIBOR +170 bp in January, and a EUR 75 million euros note maturing in 2018 with price equivalent to 247 bps over 3 month Euribor in May.
- The Bank is the largest Icelandic bank issuer of covered bonds issuing ISK 12.2bn in in the first nine months (9M15: ISK 12.8 bn), bringing the total outstanding balance to ISK 63.5bn. The Bank also issues commercial paper, with an outstanding balance of just over ISK 6.4bn at September 2016.

**Equity**

- Total equity amounted to ISK 201.4bn at the end of September 2016, compared with ISK 198.8bn at June 2016. Of that total, ISK 3.9bn is attributable to minority interests. The nominal value of Íslandsbanki´s authorised share capital was ISK 10bn at June 2016, and paid-up share capital amounted to ISK 65bn.
- The Tier 2 subordinated loan was repaid during the quarter lowering the total capital base to the same level as the Tier 1 capital at 27.8%.
- Risk weighted assets (RWA) decreased between quarters mainly due to an decrease in the loan portfolio, wheras RWA are approximately 67% of total assets closing the period at ISK 714bn marginally down from ISK 725bn in Jun16.

**Equity (cont.)**

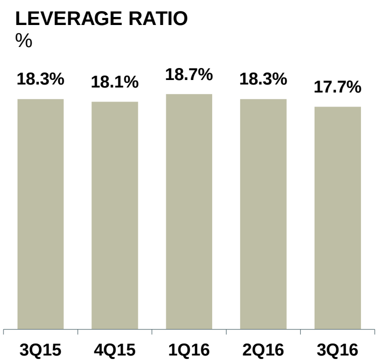
- The short term capital target is expected to remain at >23% and the CET1 target is expected to rise. Long term capital targets may be revised in the next 3-6 months, as further clarity is expected in the Bank's operating environment as easing of capital controls continues. However, it is clear that the new CET1 target will be at a minimum of 15%, thus the Bank's adjustments to calculating ROE on regular operations have been changed accordingly.
- The total regulatory capital requirement is 19.1%.
- At the 19 April AGM, it was decided that ISK 10bn (just under 50% of net profit in 2015) would be paid in dividends to shareholders, but otherwise the profit would be added to the Bank's equity (the dividend pay-out date was 27th April 2016). In addition it was agreed that the Board may convene a special shareholder meeting later in the year where a proposal regarding payment of dividends of profit for the previous fiscal years could be discussed.

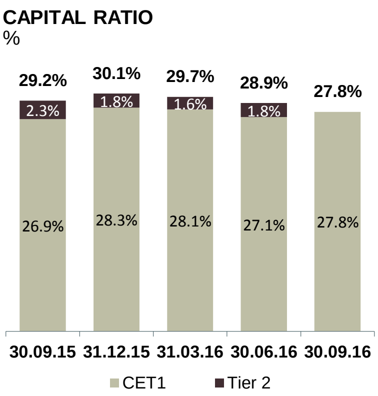
**Imbalances**

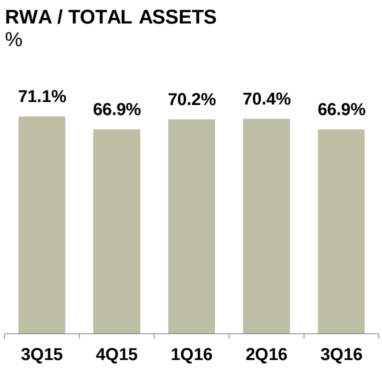
- Íslandsbanki is exposed to inflation risk as CPI-linked assets exceed CPI-linked liabilities. At September 2016, the net inflation (CPI) imbalance amounted to ISK 56.4bn (28.4% of the total capital base), compared to ISK 49.2bn at June 2016 (23.5% of the total capital base). The imbalance is managed via CPI-linked swaps, issuance of CPI-linked covered bonds, and long-term CPI-linked deposit programmes.
- The consolidated foreign exchange balance at the end of September 2016 was ISK 0.2bn (0.1% of the total capital base), compared to 0.5bn at June 2016 (0.2% of the total capital base). The Bank's imbalances are strictly monitored and are within the regulatory limits.

**Ratings**

- In october, S&P Global upgraded Íslandsbanki to BBB/A-2 with positive outlook.
- Íslandsbanki is the only bank in Iceland that is rated by two international rating agencies, Fitch and SP Global (S&P). In January 2016, S&P raised the sovereign rating to BBB+/A-2, citing further progress towards capital account liberalisation and declining debt levels. Shortly thereafter, Íslandsbanki's ratings were affirmed at BBB-/A-3 with a positive outlook. In April, Fitch Ratings affirmed the Bank's investment grade rating of BBB-/F3, with a stable outlook.




## INVESTOR RELATIONS

**Investor call in English**

On Wednesday 9 November 2016 at 1pm Icelandic time, the Bank will host an investor call in English to present the results. 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 two hours prior to the call.

All presentation material will subsequently be available and archived on [www.islandsbanki.is/ir.](www.islandsbanki.is/ir.)

**Financial Calendar**

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

- 3Q16 – 9 November 2016
- 4Q16 – 24 February 2017
- AGM - 23 March 2017
- 1Q17 - 11 May 2017
- 2Q17 - 17 August 2017
- 3Q17 - 9 November 2017

Please note that the dates are subject to change. For information on Íslandsbanki's financial calendar and silent periods see [http://www.islandsbanki.is/english/investor-relations/calendar/.](http://www.islandsbanki.is/english/investor-relations/calendar/.)