Press Release

First Quarter 2023 Results

Íslandsbanki hf.

4 May 2023

FINANCIAL AND OPERATIONAL HIGHLIGHTS

First quarter 2023 (1Q23) financial highlights – Solid financial results in challenging market conditions

- Íslandsbanki reported a profit of ISK 6.2bn in the first quarter (1Q22: ISK 5.2bn), generating an annualised return on equity (ROE) of 11.4% (1Q22: 10.2%), which is above the Bank's financial targets. The main driver for the good performance was strong income generation, offsetting an increase in costs.
- Net interest income (NII) grew by 34.9% YoY and totalled ISK 12.4bn in 1Q23, compared to ISK 9.2bn in 1Q22, owing mainly to the higher interest rate environment and growth in both loans and deposits from customers in recent quarters. The net interest margin was 3.2% in 1Q23, compared to 2.6% in 1Q22.
- Net fee and commission income (NFCI) grew 13.2% YoY and amounted to ISK 3.5bn in 1Q23, compared to ISK 3.1bn in 1Q22. Fees from cards and payment processing and fee income from Allianz Ísland hf. continue to be the primary drivers of the increase.
- Core banking operations remain the most important part of the Bank's revenues, with NII and NFCI accounting for 95% of total operating income in 1Q23 (97% in 1Q22). These two items combined grew by 29.5% from 1Q22 to 1Q23.
- Net financial income was ISK 538m in 1Q23, compared to net financial expense of ISK 95m in 1Q22, mainly owing to fluctuations in interest rates in both Icelandic krona and foreign currencies.
- Administrative expenses rose considerably and were ISK 7.0bn in 1Q23 compared to ISK 5.8bn in 1Q22, an increase of 20.7% YoY. The rise is mainly explained by contractual wage increases, strategic projects, increased activity in Allianz Ísland hf. and high inflation. Part of the cost increase in 1Q23 should even out through the year or is offset by higher revenues.
- The cost-to-income ratio was 42.1% in 1Q23, which is within the Bank's financial target of between 40-45%, and down from 47.6% in 1Q22. Increasing costs are partly offset by strong revenue generation.
- The net impairment of ISK 0.7bn in 1Q23 is mostly due to growth in the loan portfolio. This is compared to a positive impairment of ISK 0.5bn in 1Q22. The net impairment charge as a share of loans to customers, the annualised cost of risk, was +22bp in 1Q23, compared to -17bp in 1Q22.
- Loans to customers grew by ISK 32.4bn in the quarter, or by 2.7% to ISK 1,219bn.
- Deposits from customers grew by ISK 10.2bn, or 1.3%, during the quarter, up to ISK 800.1bn. The increase primarily came from Personal Banking.
- The capital and liquidity position of the Bank remains robust with all ratios well above both internal targets and regulatory requirements.
- Total equity at period-end amounted to ISK 210.4bn compared to ISK 218.9bn at year-end 2022. In 1Q23, Íslandsbanki paid approximately ISK 12.3bn in dividends to its shareholders. The Bank's total capital ratio was 23.2% at end of 1Q23, compared to 22.2% at year-end 2022. The corresponding CET1 ratio was 19.9%, compared to 18.8% at year-end 2022. The Bank's updated CET1 target is based on 100-300bp capital buffer on top of regulatory requirements.
- The Bank plans to continue its ISK 5bn share buyback plan over the coming few months and to optimize its capital structure before year-end 2024, both being subject to market conditions.

Key figures and ratios

		1Q23	4Q22	3Q22	2Q22	1Q22
PROFITABILITY	Profit for the period, ISKm	**6,211**	5,982	7,486	5,880	5,187
	Return on equity	**11.4%**	11.1%	14.4%	11.7%	10.2%
	Net interest margin (of total assets)	**3.2%**	3.1%	3.0%	2.9%	2.6%
	Cost-to-income ratio[1]	**42.1%**	42.5%	36.3%	42.7%	47.6%
	Cost of risk[2]	**0.22%**	0.22%	(0.40%)	(0.20%)	(0.17%)
		31.3.23	31.12.22	30.9.22	30.6.22	31.3.22
BALANCE SHEET	Loans to customers, ISKm	**1,218,999**	1,186,639	1,153,047	1,153,677	1,107,893
	Total assets, ISKm	**1,551,530**	1,566,235	1,548,672	1,437,253	1,446,355
	Risk exposure amount, ISKm	**1,004,978**	999,491	1,012,986	992,883	945,321
	Deposits from customers, ISKm	**800,071**	789,897	781,614	756,862	761,471
	Customer loans to customer deposits ratio	**152%**	150%	148%	152%	145%
	Non-performing loans (NPL) ratio[3]	**1.7%**	1.8%	1.7%	1.8%	1.8%
LIQUIDITY	Net stable funding ratio (NSFR), for all currencies	**115%**	118%	127%	118%	123%
	Liquidity coverage ratio (LCR), for all currencies	**171%**	205%	371%	147%	195%
CAPITAL	Total equity, ISKm	**210,385**	218,874	211,613	203,662	197,201
	CET 1 ratio[4]	**19.9%**	18.8%	18.2%	18.2%	18.8%
	Tier 1 ratio[4]	**20.8%**	19.8%	19.2%	19.2%	19.9%
	Total capital ratio[4]	**23.2%**	22.2%	21.4%	21.5%	22.5%
	Leverage ratio[4]	**12.9%**	12.1%	11.9%	12.5%	12.4%

1. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One-off items) / (Total operating income – One-off items).
2. Negative cost of risk means that there is a net release of impairments.
3. Stage 3, loans to customers, gross carrying amount.
4. Including quarter profit for 31.3.23, 30.9.22 and 31.3.22

Birna Einarsdóttir, CEO of Íslandsbanki

We are satisfied with Íslandsbanki's results in the first quarter of 2023. The tasks have been diverse and exciting during the first part of the year, with financial markets having been very challenging in recent months. The first quarter net profit amounted to ISK 6.2bn and return on equity was 11.4% which is above the Bank's financial targets. The Bank's operating income rose by 32.6% compared to 1Q22 and the growth in net interest income amounted to almost 35%, compared to 1Q22. Administrative expenses grew considerably during the quarter and increased by 20.7%, compared to 1Q22. The increase is mainly caused by contractual wage increases and contingent cost items. Strong revenue generation during the quarter resulted in the cost-to-income ratio being 42.1%, which is within the Bank's financial targets. Loans to customers grew by 2.7% during the quarter and increase in deposits to customers amounted to ISK 10bn.

During the quarter we initiated a share repurchase programme, based on the authorisation granted by the 2022 AGM to the Bank to purchase own shares. From February to 15 March the Bank purchased own shares for more than ISK 900 million. The purchase is part of the Bank's previous announcement on the intended buy back of own shares for up to ISK 5bn in the coming months, as part of the Bank's capital optimisation planned before year end 2024, subject to market conditions. The authorisation to purchase own shares was renewed during the Bank's AGM held in March, along with a decision to pay approximately ISK 12.3bn in dividends to shareholders.

The Bank's new strategy was approved by the Board of Directors in March. The strategy was formed in close co-operation with employees from across the Bank. According to the new strategy the Bank's purpose will continue to be a force for good, by creating value for the future with our customers. A successful implementation of the previous strategy resulted in strong internal growth and targeted steps were taken towards increasing the return on equity. The direction of the strategic priorities for the next two years is "Move forward and grow", implying both organic growth and opportunities outside the Bank.

The ongoing discussions with Kvika banki hf. are thus, in our opinion, a natural step on that journey. The project is large in scale, and the companies and advisors are currently assessing the synergies to be gained from the merger, as well as assessing the position of the merged company in the market. While a dedicated group of employees, along with our advisors, has been cast with the task of analysing this matter, we put great emphasis on continuing putting effort into all the exciting projects we get to be a part of with our customers.

First quarter 2023 (1Q23) operational highlights

- In February the Bank launched a share buyback programme, based on the authorisation of the Bank's 2022 Annual General Meeting (AGM) allowing the Board of Directors to acquire, on behalf of the Bank, up to 10% of issued share capital of the Bank. The share buyback programme concluded on 15 March 2023 and the Bank currently holds 7,480,831 own shares with the total purchase under the programme being ISK 933,081,185.
- Íslandsbanki's Annual General Meeting (AGM) was held on 16 March 2023. The AGM approved both the payment of a dividend of ISK 6.15 per share, amounting to approximately ISK 12.3bn, and renewal of the authorisation allowing Íslandsbanki to acquire up to 10% of the issued share capital in the Bank.
- Following the Central Bank hike of the policy rate in February and March, by 0.50% and 1.00% respectively, Íslandsbanki made rate changes in response, generally reflecting the rate hikes by increasing its rates by the same number of percentage points, both for loans and deposits. Floating rates on non-indexed mortgages, floating base rate for corporates, car loans and overdrafts rates as well as rates on non-indexed deposit accounts were thus raised by 1.5% and current account rates increased by 1.0%.
- Iceland Funds, a fund management company and a subsidiary of the Bank, established an ISK 10bn specialised fund, IS Haf fjárfestingar, which invests in sea-related activities on a broad basis. The fund is fully funded and has already started its operations. The largest investors are some of the Icelandic pensions funds. UR Seafood and Brim are the cornerstone investors in the fund.
- The third, and last, tranche of the reclassification of Iceland to the FTSE Russell's Secondary Emerging market status took place on 20 March. Vanguard remains on Íslandsbanki's top ten shareholder list.
- Following the request from the Board of Directors of Kvika banki hf. requesting the Bank's Board of Directors position on commencing merger discussions between the two companies, and the subsequent decision to commence preliminary discussions, both parties are carrying out their separate analysis along with their advisors.
- Reykjavik Economics, produced a report for Íslandsbanki, where the significance of small and medium companies for the Icelandic economy is highlighted.
- The Bank's website, www.islandsbanki.is, was elected the best website in the category for large companies by the Association of Web Industries (SVEF).

INCOME STATEMENT

Net profit increase driven by core income increase but administrative expenses are high

Income statement, ISKm	1Q23	1Q22	Δ%	4Q22	Δ%
Net interest income	**12,423**	9,209	35%	12,348	1%
Net fee and commission income	**3,469**	3,064	13%	4,038	(14%)
Net financial income (expense)	**538**	(95)	-	(899)	-
Net foreign exchange gain	**244**	166	47%	576	(58%)
Other operating income	**43**	265	(84%)	(2)	-
Total operating income	**16,717**	12,609	33%	16,061	4%
Salaries and related expenses	**(3,960)**	(3,422)	16%	(3,718)	7%
Other operating expenses	**(3,082)**	(2,412)	28%	(3,100)	(1%)
Administrative expenses	**(7,042)**	(5,834)	21%	(6,818)	3%
Contribution to the Depositor's and Investors' Guarantee Fund	**-**	(165)	-	-	-
Bank tax	**(462)**	(430)	7%	(481)	(4%)
Total operating expenses	**(7,504)**	(6,429)	17%	(7,299)	3%
Net impairment on financial assets	**(675)**	483	-	(647)	4%
Profit before tax	**8,538**	6,663	28%	8,115	5%
Income tax expense	**(2,335)**	(1,463)	60%	(2,166)	8%
Profit for the period from continuing operations	**6,203**	5,200	19%	5,949	4%
Discontinued operations held for sale, net of income tax	**8**	(13)	-	33	(76%)
Profit for the period	**6,211**	5,187	20%	5,982	4%
Key ratios					
Net Interest Margin (NIM)	**3.2%**	2.6%		3.1%	
Cost-to-income ratio (C/I)	**42.1%**	47.6%		42.5%	
Return on Equity (ROE)	**11.4%**	10.2%		11.1%	
Cost of risk (COR)	**0.22%**	(0.17%)		0.22%	

Growth in core income key driver in a strong result

- Net interest income (NII) rose mainly as a result of a larger balance sheet and higher interest rate environment. The average CB policy rate was 6.4% in 1Q23, as compared to 2.4% in 1Q22. Net interest margin (NIM) on total assets was 3.2% in 1Q23 (2.6% in 1Q22). Lending margin was 1.8% in 1Q23 (2.0% in 1Q22) while deposit margin was 2.2% in 1Q23 (1.6% in 1Q22).
- The rise in net fee and commission income (NFCI) by 13.2% YoY in 1Q23 stems from several sources. Fees from cards and payment processing is the largest single component of 1Q23 NFCI, with fee income from investment banking and brokerage following in terms of significance. Total core income (NII and NFCI) was up by 29.5% YoY in 1Q23.

Cost-to-income ratio within financial target range

- The cost-to-income ratio was 42.1% in 1Q23, compared to 47.6% in 1Q22.
- Salaries and related expenses increased by 15.7% in 1Q23 compared to 1Q22. The increase is largely explained by wage increases through general wage agreements in Iceland. The YoY increase in other operating expenses of 27.8% in 1Q23 derives from various sources but is mainly explained by costs associated with strategic projects, increased IT cost and high inflation. Part of the high 1Q23 costs should even out during the year or are offset by higher revenues.

Taxes and levies

- The effective tax rate was 27.3% in 1Q23, compared to 22.0% in 1Q22. The Bank is subject to the special financial tax of 6% on taxable profits over ISK 1bn, a financial activities tax and social security charges. It also makes contributions to the Central Bank of Iceland Financial Supervisory Authority and the Office of the Debtors' Ombudsman. In line with recent changes in legislation, the Bank does not pay premiums to the Icelandic Financial Institutions Guarantee Fund. This can however change in the future based on the status of the fund and the size of the deposit system. Total taxes and levies amounted to ISK 3.0bn for the period, compared to ISK 2.6bn for 1Q22.

Net impairment on financial assets in 1Q23

– The net impairment of ISK 0.7bn in 1Q23 (1Q22: positive net impairment of ISK 0.5bn) is due to growth in the loan portfolio. Current impairment outlook is relatively benign due to low unemployment and good economic growth outlook and increased rates have not impacted the NPL ratio. The annualised cost of risk, measured as net impairment charge as a share of loans to customers, was +22bp in 1Q23 (-17bp in 1Q22).

BALANCE SHEET

Loans to customers increase in all business segments

Assets, ISKm	31.3.23	31.12.22	Δ	Δ%
Cash and balances w ith Central Bank	**67,764**	94,424	(26,660)	(28%)
Loans to credit institutions	**81,331**	110,364	(29,033)	(26%)
Bonds and debt instruments	**127,254**	130,804	(3,550)	(3%)
Derivatives	**5,605**	7,461	(1,856)	(25%)
Loans to customers	**1,218,999**	1,186,639	32,360	3%
Shares and equity instruments	**13,839**	15,868	(2,029)	(13%)
Investment in associates	**3,853**	3,844	9	0%
Property and equipment	**6,734**	6,752	(18)	(0%)
Intangible assets	**3,252**	3,279	(27)	(1%)
Other assets	**22,191**	6,072	16,119	265%
Non-current assets and disposal groups held for sale	**708**	728	(20)	(3%)
Total Assets	**1,551,530**	**1,566,235**	**(14,705)**	**(1%)**
Key ratios				
Risk Exposure Amount (REA)	**1,004,978**	999,491	5,487	0.5%
Non-performing loans (NPL) ratio[1]	**1.7%**	1.8%		

1. Stage 3, loans to customers, gross carrying amount

Loan portfolio remains well diversified and highly collateralised

– Loans to customers grew by 2.7% in the quarter. Mortgages increased by ISK 9.7bn during the quarter and at the end of March accounted for 42% of loans to customers. Loans to corporates rose by ISK 23.7bn during the quarter. Personal Banking saw an increase of ISK 8.4bn, Business Banking growth of ISK 14.0bn, and Corporate & Investment Banking an increase of ISK 10.9bn.

– Loans to customers are generally well covered by stable collateral, the majority of which is in residential and commercial real estate, while the second most important collateral type is fishing vessels. Conservative lending policies result in healthy coverage ratios. The weighted average loan-to-value (LTV) ratio for the loan portfolio was 59% at the end of 1Q23 (58% at YE22) and the LTV for the residential mortgage portfolio was 61% at the end of 1Q23 (60% at YE22). The mortgage portfolio remains resilient to high interest rate environment and inflation due to conservative payment assessment at loan origination, resulting in stable levels of mortgages on stage 2 or NPLs.

- In 2024 and 2025 a substantial part of the non-index linked, fixed rate mortgages have an interest rate reset, with the first part of that reset, amounting to ISK 14bn, being set for this year. According to Íslandsbanki's Research, the policy rate is expected to peak in 2Q23, and perhaps start to fall again in 1Q24 with a gradual easing towards the equilibrium real rate, probably around 1-1.5%. The nominal policy rate could therefore be around 4.0% at the end of the forecast horizon in 2025, lower than the year-end 2022 6.0% policy rate.
- The Bank's asset encumbrance ratio was 25.1% at the end of 1Q23, compared with 26.5% at YE22.

Credit quality remains strong

- At the end of 1Q23, 3.3% of the gross performing loan book (not in Stage 3) was classified as forborne, down from 3.8% at the end of 4Q22. At the end of the 1Q23, the share of credit-impaired loans to customers, Stage 3, was 1.7% (gross), down from 1.8% at the end of 4Q22. For the mortgage portfolio, the share was 0.8% at end of 1Q23 (0.7% at end of 4Q22).
- Loans to customers in Stage 2 was 3.0% at 1Q23, up from 2.5% at the end of 4Q22 For the mortgage portfolio the share of loans in Stage 2 was 0.8% at the end of 1Q23, (0.7% at end of 4Q22).

Liabilities – strong capital and liquidity ratios combined with low leverage

Liabilities & Equity, ISKm	**31.3.23**	31.12.22	Δ	Δ%
Deposits from Central Bank and credit institutions	**13,694**	15,269	(1,575)	(10%)
Deposits from customers	**800,071**	789,897	10,174	1%
Derivative instruments and short positions	**12,745**	10,804	1,941	18%
Debt issued and other borrowed funds	**438,605**	468,270	(29,665)	(6%)
Subordinated loans	**33,839**	34,392	(553)	(2%)
Tax liabilities	**13,206**	12,128	1,078	9%
Other liabilities	**28,985**	16,601	12,384	75%
Total Liabilities	**1,341,145**	1,347,361	(6,216)	(0%)
Total Equity	**210,385**	218,874	(8,489)	(4%)
Total Liabilities and Equity	**1,551,530**	1,566,235	(14,705)	(1%)
Key ratios				
Customer loans to customer deposits ratio	**152%**	150%		
REA/total assets	**64.8%**	63.8%		
Net stable funding ratio (NSFR)	**115%**	118%		
Liquidity coverage ratio (LCR)	**171%**	205%		
Total capital ratio	**23.2%**	22.2%		
Tier 1 capital ratio	**20.8%**	19.8%		
Leverage ratio	**12.9%**	12.1%		

Deposits continue to be the largest source of funding

- Funding is raised to match the Bank's lending programmes using three main funding sources: stable deposits, covered bonds and senior preferred bonds. Deposits from customers grew by 1.3% during the quarter. Personal Banking had an increase of ISK 15.7bn, Corporate & Investment Banking an increase of ISK 5.2bn and Business Banking a decrease of ISK 12.1bn. All deposit concentration levels are monitored closely, with concentration remaining stable in 1Q23. The ratio of customer loans to customer deposits was 152% at the end of 1Q23, from the previous 150% at YE22.

- The Bank continued issuing ISK-denominated covered bonds to fund the increase in mortgage lending. Domestically, the Bank sold ISK 8.5bn in covered bonds in ISK during the quarter. In February the Bank tapped ISB GB 27 1122, a green senior preferred bond, for ISK 1.7bn.
- The liquidity position remains strong, with all ratios well above regulatory requirements and internal thresholds. The Bank's total liquidity coverage ratio (LCR) was 171% at end of 1Q23, down from 205% at YE22. The LCR in foreign currencies was 289% at end of 1Q23, down from 492% at YE22 and the LCR in ISK increased from 109% at YE22 to 121% at end of 1Q23. As the Bank's liquidity position remains strong across currencies and is above requirements, the Bank may consider debt buybacks, calls or exchanges of outstanding transactions during 2023.

Capital ratios well above targets

- Total equity amounted to ISK 210bn at the end of 1Q23, compared to ISK 219bn at YE22. The capital base was ISK 230bn at end of 1Q23, compared to ISK 222bn at year-end 2022. The increase is mostly due to a short-term reduction in buyback plans from ISK 15bn to ISK 5bn due to profitable loans growth and market circumstances. A dividend of ISK 12.3bn was approved at the AGM, in line with the Bank's dividend policy, and disbursed in March. This equates to approximately 50% of 2022 profits and is in line with the Bank's dividend policy.
- The financial stability board has announced an increase in the counter-cyclical buffer in Iceland from 2.0% to 2.5% effective from March 2024. This change will raise the Bank's overall capital requirement from 19.9% to 20.4% assuming no other changes.
- At the end of 1Q23, the Bank's total capital ratio was 23.2%, including the 1Q23 profit, compared to 22.2% at YE22. The corresponding Tier 1 ratio was 20.8%, compared to 19.8% at the YE22. The CET1 ratio was 19.9% (460bp above requirement), and above the Bank's target of having a 100-300bp CET1 capital buffer on top of regulatory requirements. The change in the total capital ratio from YE22 is due to Q1 profits and as well as a short-term reduction in buyback plans.
- Íslandsbanki uses the standardised method to calculate its REAs, which amounted to ISK 1.005bn at the end of 1Q23, compared to ISK 999bn at YE22. The rise in REA in the first quarter is a result of increase in loans to customers. The REA amounts to 64.8% of total assets at the end of 1Q23, compared to 63.8% at YE22.
- The leverage ratio was 12.9% at the end of 1Q23, including 1Q23 profit, compared to 12.1% at YE22.

Modest market risk profile

- The Bank's market risk derives mainly from aggregate balance sheet imbalances in interest rate, inflation, and currency positions, as well as the Bank's liquidity portfolio, which is managed by Treasury.
- The Bank is exposed to inflation risk because CPI-linked assets exceed CPI-linked liabilities. At the end of 1Q23, the Bank's consolidated net inflation imbalance amounted to ISK 34.5bn, compared to ISK 27.7m at YE22. The imbalances are managed via CPI-linked swaps, the issuance of CPI-linked covered bonds and CPI-linked deposit programmes.
- The currency imbalance was ISK 1.2bn (0.5% of the total capital base) at end of 1Q23, compared to ISK -1.6bn (0.7% of the total capital base) at YE22. The Bank's imbalances are strictly monitored and are within regulatory limits.

INVESTOR RELATIONS

An earnings conference call and webcast will take place on Friday 5 May 2023

Íslandsbanki will host a webcast in English for investors and market participants on Friday 5 May at 8.30 Reykjavík/GMT, 9.30 London/BST, 10.30 CET. Birna Einarsdóttir, CEO, and Jón Guðni Ómarsson, CFO, will give an overview of the first quarter 2023 financial results and operational highlights.

Participation is accessible **via this link**. A recording will be available after the meeting on the Investor Relations website. To participate in the webcast via telephone and to be able to ask questions verbally, please register **via this link**. There will be a list of dial-in numbers and a personal PIN. If there is no local dial-in number for your country, or if you would prefer to receive a call instead of dialling in, the Call Me option is available. Then select your country, enter your telephone number and click on the blue Call Me button to be connected.

Financial calendar

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

2Q23 results — 27 July 2023
3Q23 results — 26 October 2023

Please note that the dates are subject to change.

Additional investor material

All investor 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 can also be found.