Press Release

Consolidated Unaudited Interim Financial Statements 9M19

Íslandsbanki hf.

30. October 2019

Hagasmári 3
201 Kópavogur

First 9 months of 2019 (9M19) financial highlights

- Profit after tax amounted to ISK 6.8bn (9M18: ISK 9.2bn) generating a 5.1% annualised return on equity (9M18: 7.1%).
- Earnings from regular operations were ISK 8.7bn (9M18: ISK 9.9bn) with 7.3% annualised return on equity from regular operations normalised for 16% CET1 (9M18: 9.0%).
- Net interest income was ISK 25.2bn (9M18: ISK 23.6bn), an increase of 6.5% between years and the net interest margin was 2.8% (9M18: 2.9%).
- Net fee and commission income was ISK 9.7bn (9M18: ISK 8.7bn), up by 11% from the same period last year.
- Loan impairment charges and net valuation changes generated a loss of ISK 2,078m for 9M19, compared to ISK 1,881m gain for 9M18.
- Administrative costs grew by approximately 2.3% between years and totalled ISK 20.8bn (9M18: ISK 20.2bn).
- The cost to income ratio for the Group for the period was 61.3% compared to 65.6% for the same period in 2018, while the same ratio for the parent company was 55.3% and in line with the Bank's 55% long term target.
- Loans to customers grew to a total of ISK 909.2bn at the end of September. Total new lending during the first three quarters of 2019 amounted to ISK 162.7bn, split across business segments.
- Deposits from customers stood at ISK 610.3bn at the end of September, an increase of 5% in 2019.
- The Bank's liquidity position is strong in both the Icelandic króna and foreign currencies and exceeds all internal and external requirements. Capital ratios are high and in line with the Bank's long-term targets.

Third quarter 2019 financial highlights

- Profit after tax was ISK 2.1bn (3Q18: 2.1bn), generating a 4.7% annualised return on equity (3Q18: 4.9%).
- Earnings from regular operations were ISK 3.0bn (3Q18: 2.9bn) and annualised return on equity for regular operations normalised for 16% CET1 was 7.9% (3Q18: 8.1%).
- Net interest income amounted to ISK 8.4bn (3Q18: ISK 8.3bn) with 2.7% net interest margin (3Q18: 3.0%).
- Net fee and commission income were ISK 3.1bn (3Q18: ISK 2.9bn).

Key figures and ratios

		9M19	9M18	3Q19	3Q18	2018
PROFITABILITY	ROE 16% CET1 (regular operations)[1]	**7.3%**	9.0%	**7.9%**	8.1%	8.0%
	ROE (after tax)	**5.1%**	7.1%	**4.7%**	4.9%	6.1%
	Net interest margin (of total assets)	**2.8%**	2.9%	**2.7%**	3.0%	2.9%
	Cost to income ratio[2]	**61.3%**	65.6%	**59.7%**	62.1%	66.3%
	After tax profit, ISK m	**6,795**	9,241	**2,086**	2,111	10,645
	Earnings from regular operations, ISK m[3]	**8,692**	8,979	**2,986**	2,928	12,042

		30.9.2019	30.6.2019	31.3.2019	31.12.2018	30.9.2018
BALANCE SHEET	Total assets, ISK m	**1,233,855**	1,229,976	1,205,228	1,130,403	1,162,639
	Loans to customers, ISK m	**909,175**	894,446	873,530	846,599	835,582
	Deposits from customers, ISK m	**610,281**	615,869	611,303	578,959	608,646
	Customer deposit / customer loan ratio	**67.1%**	68.9%	70.0%	68.4%	72.8%
CAPITAL	Total equity, ISK m	**177,984**	175,784	173,621	176,313	174,630
	Tier 1 capital ratio	**19.0%**	18.8%	19.1%	20.3%	19.9%
	Total capital ratio	**21.4%**	21.4%	20.9%	22.2%	21.7%
	Leverage ratio	**13.6%**	13.4%	13.5%	14.6%	14.0%

1. Return from regular operations and corresponding ratios on normalized CET1 of 16%, adjusted for risk free interest on excess capital.
2. Calculated as (Administrative expenses + Contribution to the Depositors' and Investors' Guarantee Fund – One off items) / (Total operating income – one off items).
3. Earnings from regular operations is defined as earnings excluding one-off items e.g. bank tax and one-off costs and income.

Birna Einarsdóttir, CEO of Íslandsbanki

In the first three quarters of the year, fee and commission income grew strongly (11%) year-on-year, as did interest income (6.5%), and the Bank's loan book grew by 7.4%.

However, downward value adjustments, which stem in part from the cooling of the economy, have weakened the outcome, and the return on equity for the period is below the Bank's target.

In a positive development over the three-quarter period, the Bank's expense ratio has been on the decline relative to the same period in 2018. At the parent company level, the expense ratio is currently very close to the long-term target of 55%, but efforts to streamline operations will continue.

The Bank's liquidity remains strong and well above supervisory benchmarks, and its capital ratio is consistent with the long-term target.

The Bank recently awarded a total of ISK 30.5m in Entrepreneurship Fund grants to nine projects. In the selection of grant participants, priority was given to projects that foster the success of the four UN Sustainable Development Goals to which the Bank has committed in its strategy.

We are determined to be a positive force in the society and will continue to make every effort to be a leader in this endeavour.

First 9 months of 2019 (9M19) operational highlights

- A fully automated online mortgage application and evaluation procedure for individuals was introduced by the Bank.
- In June, Íslandsbanki issued a SEK 500 m 10NC5 Tier 2 bond. This was the Bank's third Tier 2 bond issue and with this transaction the Bank reached its Tier 2 target which is an important milestone in optimising its long-term capital composition.
- Íslandsbanki published new reports on the Icelandic tourism and real estate sectors in May and October.
- Íslandsbanki released a new macro-economic forecast in June 2019 which was published during the bank's annual Financial conference at the Hilton Nordica Hotel in September
- Riaan Dreyer was appointed Managing director of Information Technology at the Bank.
- S&P Global Ratings affirmed Íslandsbanki's rating of BBB+/A2 in July but changed the outlook from stable to negative in line with other Icelandic banks.
- In August, the Nordic CEOs for Sustainable Future, an alliance of the leaders of the Nordic region´s leading businesses, met in Reykjavik with the prime ministers of the five Nordic countries to discuss a collaborative approach to address sustainability challenges. Íslandsbanki is a proud member of the group.
- The Íslandsbanki Reykjavík Marathon was held on 24 August. A high point in the calendar for the Bank for several years, the Bank´s sponsorship of the event helped the 15 thousand runners raised ISK 167m for good causes and is the single largest charity event in Iceland.
- In October 2019, the Icelandic Financial Supervisory Authority (FME) lowered the minimum requirement for total capital for Íslandsbanki from 19.3% to 18.8%. The decrease is credited to the Bank's lower risk profile.

INCOME STATEMENT

ISKm	9M19	9M18	Δ	3Q19	3Q18	Δ
Net interest income	**25,190**	23,643	1,547	**8,412**	8,301	111
Net fee and commission income	**9,713**	8,749	964	**3,090**	2,939	151
Net financial income (expense)	**23**	(325)	348	**(598)**	(420)	(178)
Net foreign exchange gain (loss)	**46**	(75)	121	**147**	(8)	155
Other operating income	**1,217**	1,664	(447)	**44**	64	(20)
Total operating income	**36,189**	33,656	2,533	**11,095**	10,876	219
Salaries and related expenses	**(12,083)**	(11,453)	(630)	**(3,720)**	(3,501)	(219)
Other operating expenses	**(8,698)**	(8,732)	34	**(2,698)**	(2,962)	264
Administrative expenses	**(20,781)**	(20,185)	(596)	**(6,418)**	(6,463)	45
Contribution to the Depositor's and Investors' Guarantee Fund	**(720)**	(874)	154	**(210)**	(295)	85
Bank tax	**(2,714)**	(2,541)	(173)	**(900)**	(944)	44
Total operating expenses	**(24,215)**	(23,600)	(615)	**(7,528)**	(7,702)	174
Profit before net impairment on financial assets	**11,974**	10,056	1,918	**3,567**	3,174	393
Net impairment on financial assets	**(2,078)**	1,881	(3,959)	**(230)**	(53)	(177)
Profit before tax	**9,896**	11,937	(2,041)	**3,337**	3,121	216
Income tax expense	**(3,071)**	(3,616)	545	**(1,292)**	(1,136)	(156)
Profit for the period from continuing operations	**6,825**	8,321	(1,496)	**2,045**	1,985	60
Discontinued operations, net of income tax	**(30)**	920	(950)	**41**	126	(85)
Profit for the period	**6,795**	9,241	(2,446)	**2,086**	2,111	(25)

Income higher compared to same period last year

- Total income increased by 7.5% between years and amounted to ISK 36.2bn in 9M19.
- Net interest income totalled ISK 25.2bn, an increase of 6.5% from the previous year mainly due to an increase in the loan book. The net interest margin was 2.8%, which is at comparable levels to 9M18. 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 9.7bn, compared to ISK 8.7bn in 9M18. Overall net fee income grew by 11% between years, partly due to higher fees and commissions from one of the Bank's fee generating subsidiaries.
- Core income (net interest income and net fee and commission income) contributed 96.4% to the Bank's total operating income during the first nine months of 2019. The Bank remains focused on strong core earnings and stable long-term income.
- The Bank recorded a net financial gain of ISK 23m in 9M19, compared to a loss of ISK 325m in 9M18.
- Other operating income totalled ISK 1.2bn in 9M19, as opposed to ISK 1.6bn in 9M18. This income is primarily attributed to the settlement of the Bank's claim deriving from the acquisition ofByr savings bank in 2011.

Cost to income ratio on downward trend and parent company at 55% C/I target

- Administrative expenses grew by ISK 596m year-on-year, or 3%.
- The number of FTEs at the close of the period excluding seasonal employees was 784 (835 in 9M18) in the parent company and 1,022 (1,075 in9M18) for the Group.
- The cost-to-income (C/I) ratio at end-September was 61.3%, compared with 65.6% in 9M18. The C/I ratio excludes the bank tax and other one-off cost items. The C/I in the parent company was 55.3% for the same period, which is in line with the Bank's long-term target of 55%.
- The after-tax loss from discontinued operations was ISK 30m in 9M19, compared with ISK 920m gain in 9M18.

Negative net impairment on financial assets reflects changes in economic outlook

- Loan impairment charges and net valuation changes generated a loss of ISK 2,078m in 9M19, compared to ISK 1,881m gain in 9M18, explained by specific impairments for specific customers, less favourable economic environment and an unfavourable ruling in a court case.

Taxes and levies continue to affect profitability

- The tax on the profit for the period amounted to ISK 3.1bn, compared to ISK 3.6bn in 9M18. The effective tax rate was 31.0%, compared to 30.3% in 9M18. The bank tax accounted for ISK 2,714m in 9M19, compared with ISK 2,541m in 9M18. 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 ISK 720m, an ISK 154m decrease from the previous year. Total taxes and levies amounted to ISK 7.5bn in 9M19 compared to ISK 7.6bn in 9M18.

Quality of loan portfolio still measures highly by international comparison

- At the end of the reporting period, the ratio of impaired loans and advances was 2.3% for the Group compared to a 3.0% weighted average for European banks at the end of June 2019. When only taking into account the quality of loans to customers, the NPL ratio was at 2.8% at the end of September.

Profitability marked by negative net impairments

- Profit after tax was ISK 6.8bn in 9M19 (9M18: ISK 9.2bn) and annualised return on equity (after tax) was 5.1% in 9M19 (9M18: 7.1%). Earnings from regular operations were ISK 8.7bn, (9M18: ISK 9.9bn) and annualised return on equity from regular operations normalised for 16% CET1 was 7.3% in 9M19, compared to 9.0% in 9M18. Regular earnings fell by ISK 1.2bn between years, mainly explained by an increase in loan imapairment charges and net valuation changes.

BALANCE SHEET

Assets – growing balance sheet through continued loan growth

- The balance sheet grew by 9.2% from year-end 2018, to ISK 1,234bn with loans to customers growing by 7.4%, or ISK 62.6bn. Demand for new credit came from all of the Bank's business segments but was concentrated mostly in Corporate & Investment Banking. Mortgage loans rose by ISK 24.9bn from year-end 2018. New lending amounted to ISK 162.7bn in 9M19, as opposed to ISK 175.6bn in the previous year, a decrease of 7.3%. Outstanding loans to the tourism industry in Iceland have decreased proportionately and are now 11% of the loan portfolio which is well diversified.

- 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% at end September 2019 and is unchanged from year-end 2018. The Bank's asset encumbrance ratio was 17.6% at end-September 2019 compared to 18% at the end 2018.

- Three items – cash and balances with the Central Bank, bonds and debt instruments, and loans to credit institutions – amounted to about ISK 269bn, were ISK 230bn of which are liquid assets.

Assets, ISK m	**30.9.2019**	31.12.2018	Δ
Cash and balances with Central Bank	**129,115**	135,056	(5,941)
Loans to credit institutions	**66,409**	41,577	24,832
Bonds and debt instruments	**73,899**	69,415	4,484
Derivatives	**5,438**	4,550	888
Loans to customers	**909,175**	846,599	62,576
Shares and equity instruments	**19,200**	13,074	6,126
Investment in associates	**687**	682	5
Property and equipment	**9,442**	5,271	4,171
Intangible assets	**4,709**	5,002	(293)
Other assets	**15,781**	9,177	6,604
Total Assets	**1,233,855**	1,130,403	103,452

Liabilities – successful funding through deposits and capital issuance

- Total liabilities amounted to ISK 1,056bn, an increase of 10.7% from year-end 2018. The Bank maintained strong liquidity levels throughout 2019, and all regulatory and internal metrics were well above set limits at the end of the period.

- At the end of September 2019, the Bank's liquidity coverage ratio (LCR) for all currencies was 174% for the Group, 484% in foreign currencies and 103% in Icelandic kronur. The net stable funding ratio (NSFR) for the Group in all currencies was 117% and the NSFR in foreign currencies for the Group was 163%.

— Deposits from customers increased by 5.4% from year-end 2018, to ISK 610bn. Deposits are still the Bank's main source of funding and concentration levels are monitored closely. The increase was mainly due mainly to a rise in domestic financial entities and corporations. The ratio of customer deposits to customer loans fell to 67.1% at end-September 2019, compared to 68.4% at end 2018.

Liabilities & Equity, ISK m	**30.9.2019**	31.12.2018	Δ
Deposits from Central Bank and credit institutions	**31,808**	15,619	16,189
Deposits from customers	**610,281**	578,959	31,322
Derivative instruments and short positions	**7,910**	5,521	2,389
Debt issued and other borrowed funds	**331,938**	300,976	30,962
Subordinated loans	**21,993**	16,216	5,777
Tax liabilities	**10,127**	7,150	2,977
Other liabilities	**41,814**	29,649	12,165
Total Liabilities	**1,055,871**	954,090	101,781
Total Equity	**177,984**	176,313	1,671
Total Liabilities and Equity	**1,233,855**	1,130,403	103,452

— In June, Íslandsbanki issued a 10NC5 SEK 500m Tier 2 bond. This was the Bank's third Tier 2 bond issue and with this transaction the Bank reached its Tier 2 target which is an important milestone in optimising its long-term capital composition.

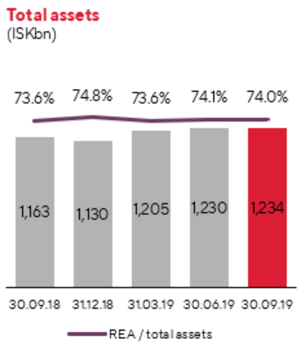
— In April, the Bank issued a EUR 300m 3-year benchmark fixed rate bond at a spread of 130 basis points over 3-year mid swaps. The transaction was issued concurrently with a tender to buy back EUR 300m of the Bank's outstanding EUR 500m 2020 benchmark bond.

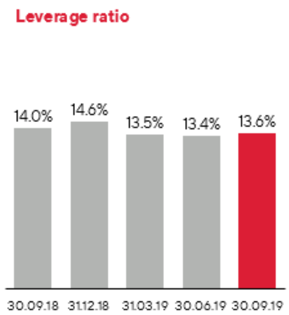
Equity

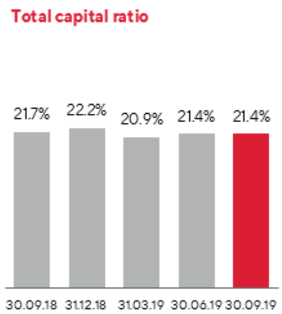
— Total equity amounted to ISK 178bn as of September 2019, compared to ISK 176.3bn at the end of 2018. Of that total, ISK 2.4bn is attributable to non-controlling interests. At the Bank's AGM in March shareholders approved the Board's proposal to pay dividends amounting to ISK 5.3bn. The nominal value 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 21.4%, compared to 22.2% at year-end 2018. That is line with the Bank's total capital ratio target which is currently the Bank´s regulatory capital requirement in addition to the Bank´s management buffer. The Bank's Tier 1 ratio was 19.0% as of 30 September 2019, compared to 20.3% at year-end 2018. In October 2019, the Icelandic Financial Supervisory Authority (FME) lowered the minimum requirement for total capital for Íslandsbanki from 19.3% to 18.8%. The decrease is credited to the Bank's lower risk profile.

- In light of recent changes to regulatory requirements and an updated assessment of the business environment, the Bank decided to revise its management buffer from 0.5-1.5% to 0.5-2.0%. It is worth noting that the FME increased the countercyclical capital buffer from 1.25% to 1.75%, in May 2019 and will increase it further by 0.25% in February 2020.







- Íslandsbanki uses the standardised method to calculate its risk exposure amount (REA), which amounted to ISK 912.8bn at the end of September 2019, or 74% of total assets. The leverage ratio was 13.6% at the end of September compared to 14.6% at year end 2018, indicating low leverage.

Ratings

- Íslandsbanki is rated by S&P Global Ratings (S&P). In July S&P affirmed Íslandsbanki's BBB+/A-2 rating but changed the outlook to negative.

- In its report, S&P refers to Íslandsbanki's stable domestic market position and acknowledges the Bank's success in introducing new digital products and improving its IT infrastructure, placing Íslandsbanki well ahead of many other European banks. S&P also notes the Bank's exceptional capitalisation, strong liquidity levels and robust asset quality.

- S&P's rational for the change to negative outlook is mostly derived from its view that Iceland's operating environment will remain challenging, affected by the 2019 economic recession, declining interest rates, still-high taxation, and stiff competition from pension funds in mortgage lending, and thus contributing to the declining profitability of the Bank.

INVESTOR RELATIONS

Investor call in English on Thursday 31st October at 9.00 AM (GMT)

The Bank will host an investor call in English at 9.00 AM (GMT) on Thursday, 31st October. 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.

Financial calendar

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

Q4/Annual 2019 results – 12 February 2020
Annual General Meeting – 19 March 2020
Q1/2020 results – 6 May 2020
Q2/2020 results – 29 July 2020
Q3/2020 results – 28 October 2020

Please note that the dates are subject to change.

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/en/landing/about/investor-relations