STEFNIR

Asset Management Company

Interim Financial Statements

1 January - 30 June 2017

Stefnir hf.
Borgartun 19
105 Reykjavík

Reg. no. 700996-2479

Contents

Report and endorsement of the Board of Directors and the Managing Director

The purpose of Stefnir hf. is to operate UCITS, investment funds and institutional investors' funds. The company also manages the assets of several partnerships limited by shares that have been established for private equity investments. Stefnir is Iceland's largest fund manager with assets of ISK 377 billion under active management. Stefnir is a subsidiary of Arion Bank hf. and the A-part of the Financial Statements is part of the Consolidated Financial Statements of the Bank and its subsidiaries.

The Interim Financial Statements of the company are divided in two: part A which includes the Interim Financial Statements of Stefnir hf. and part B which includes the Interim Financial Statements of UCITS, investment funds and institutional investors' funds. The Interim Financial Statements have been prepared in accordance with the Annuals Account Act, the Financial Undertakings Act and the rules of the Financial Supervisory Authority on the accounts of UCITS management companies.

Activities in the first half of 2017

The company reported earnings of ISK 683 million in the period according to the income statement. The company's equity at the end of the period was approximately ISK 2.2 billion according to the balance sheet. The capital ratio, calculated according to the Financial Undertakings Act, is 74.3 %, the minimum allowed by law being 8.0%.

At the beginning and end of the period, the company's share capital was ISK 43.5 million and was entirely owned by Arion Bank hf. and related companies.

Highlights of the first half of 2017

Stefnir's annual general meeting was held on 23 February 2017 and a decision was taken to pay a dividend of ISK 890 million to the shareholders. The board of directors of Stefnir was elected at the meeting and comprises the following members: Hrund Rudolfsdóttir, chairman, Kristján Jóhannsson, vice chairman, and Jökull Heiddal Úlfsson, Ragnhildur Sophusdóttir and Thórdur Sverrisson who are board directors.

Assets under active management decreased from the end of 2016 by ISK 31 billion to ISK 377 billion. The performance of the Icelandic equities markets, funds reaching maturity, the merger of funds and the redemption of assets by clients are the main reasons for the decrease in assets under management during the first half of 2017. Assets under management remain well distributed between asset classes and the company's revenue structure is also good.

The following institutional investor funds managed by the company were dissolved during the first half of 2017: Stefnir Multi Strategy and OFAN VÍ. The UCITS KMS Global Equity Fund merged with the UCITS KF Global Value. The investment fund Stefnir – Asset Management Fund merged with the investment fund Stefnir – Managed Balanced Fund.

Returns on the funds managed by Stefnir were in most cases satisfactory in the first half of 2017, with the exception of the investment fund Stefnir – Icelandic Growth Fund which yielded a negative 0.8% return. The company's other core funds were up 2.4% to 5.5%. KF Global Value yielded a return of 3.6% in euros, the fund's trading currency. Owing to the appreciation of the Icelandic króna in the first half of the year, the fund yielded a return of 1.1% in the first half of 2017.

The main news on the domestic financial market during the first half of 2017 was the decision by the Central Bank of Iceland on 14 March to amend certain rules which resulted in the capital controls being almost entirely lifted. The Central Bank of Iceland had already taken significant steps towards lifting the capital controls in the autumn of 2016. Stefnir believes these changes represent a great opportunity for investors and the company, as the company has managed international UCITS with excellent results over the last 20 years.

Risk management and corporate governance

Risk management and active internal control are mainstays of the responsible operation of a fund management company. The board of directors of Stefnir discusses the risks in the company's operating environment. The risks facing the company have been systematically analyzed and measured. The board is regularly informed of and discusses opinions provided by Risk Management and Internal Control. Measures to manage and mitigate possible risk factors are vital to the operational security of the company. The outsourcing of projects and the monitoring of this is one of the critical components of measuring and mitigating risk. The company has also prepared a written business continuity plan concerning the risks which may disrupt or stop the company's operations temporarily and has presented it to Stefnir's employees.

Report and endorsement of the Board of Directors and the Managing Director, cont.

Outlook, risk factors and events taking place after the publication of the accounts

Stefnir regularly assesses the operational viability of its funds with respect to product development, the merging and dissolving of funds, and its actions are guided by the interests of unit holders. It is clear that there will be some consolidation of the company's fund offering in the future. The emphasis will remain on innovation as changes to legislation and a growing regulatory framework in recent periods have made it more difficult for smaller funds, partly owing to higher operating expenses.

The UCITS Stefnir – International Equities ISK and EUR and Stefnir – Scandinavian Fund will be merged on 31 August 2017 under the name of the latter fund. The merger will simplify the product offering of international funds and will also improve efficiency. Unit holders will experience the greater benefits of being members of a larger fund.

Endorsement of the board of directors and the managing director

The board of directors and managing director of Stefnir hf. hereby attest the company's interim financial statement for the period 1 January to 30 June 2017 by signing below.

Reykjavik, 21 August 2017

The Board of Directors:

Managing Director:

Review Report on Interim Financial Statements

To the Board of Directors and Shareholder of Stefnir hf.

We have reviewed the accompanying Interim Financial Statement of Stefnir for the period of 1 January to 30 June 2017, which comprise the endorsement and signatures of the board of directors and the managing director, income statement, balance sheet, statement of cash flows, and a summary of significant accounting policies and other explanatory notes.

Management's and the Board of directors Responsibility for the Financial Statements

Management and the board is responsible for the preparation and fair presentation of this interim financial information in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Auditor's Responsibility

Our responsibility is to express a conclusion on this interim financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements, ISRE 2410. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim financial information does not give a true and fair view of the financial position of the entity as at 30 June 2017 and of its financial performance and its cash flows in the period, in accordance with Icelandic Financial Statements Act, Act on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS.

Reykjavik, 21 August 2017

Deloitte ehf.

Páll Grétar Steingrímsson
State Authorized Public Accountant

Pétur Hansson
State Authorized Public Accountant

Interim Statement of Income

for the period 1 January to 30 June 2017

	Note	2017 1.1 - 30.6.	2016 1.1 - 30.6.
Operating income			
Management and performance based fees	4	1,375,830	940,241
Financial income	10	98,809	190,993
Operating income		1,474,639	1,131,234
Financial expense	10	(32,854)	(190,570)
Net operating income		1,441,785	940,664
Operating expense			
Salaries and related expense	11	321,000	312,907
Safe keeping commission		104,100	94,500
Other expense		186,420	136,065
Operating expense		611,520	543,472
Earnings before tax		830,265	397,192
Income tax	12	(161,388)	(75,239)
Net earnings	16	668,877	321,953

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Interim Statement of Financial Position
as at 30 June 2017

	Note	30.6.2017	31.12.2016
Assets			
Securities with variable income		1,684,095	2,025,457
Securities with fixed income		68,450	182,075
Total Securities	5, 13	1,752,545	2,207,532
Receivable from Arion Bank hf.		175	60,524
Accounts receivables	7	873,290	845,976
Total Receivables		873,465	906,500
Tax assets	9, 17	28,114	40,360
Other assets		81,779	51,491
Cash and cash equivalents	8	92,783	29,650
Total Other Assets		202,676	121,501
Total Assets		2,828,686	3,235,533
Equity			
Share capital		43,500	43,500
Statutory reserve		10,875	10,875
Fair value equity reserve		47,929	33,818
Retained earnings		2,125,156	2,360,390
Total Equity	16	2,227,460	2,448,583
Liabilities			
Payable to Arion Bank hf.		47,086	289,880
Accounts payable		27,603	5,151
Other liabilities		329,218	302,782
Tax liabilities	17	197,319	189,137
Total liabilities		601,226	786,950
Total Equity and Liabilities		2,828,686	3,235,533

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Interim Statement of Cash Flows

for the period 1 January to 30 June 2017

	Note	2017 1.1 - 30.6.	2016 1.1 - 30.6.
Cash flows from operating activities			
Net earnings	16	668,877	321,953
Non-cash items included in net earnings:			
Valuation changes of securities		(59,167)	179,116
Income tax recognised in profit or loss		161,388	75,238
		771,098	576,307
Changes in operating assets and liabilities		(191,158)	(128,136)
Income tax paid	17	(140,960)	(107,238)
Net cash from operating activities		438,980	340,933
Investing activities			
Change in Securities with variable income		422,600	665,028
Change in Securities with fixed income		91,553	6,558
Investing activities		514,153	671,586
Finance activities			
Dividend paid	16	(890,000)	(1,000,000)
Finance activities		(890,000)	(1,000,000)
Net change in cash and cash equivalents		63,133	12,519
Cash and cash equivalents at the beginning of the period		29,650	82,232
Cash and cash equivalents at the end of the period	8	92,783	94,751

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Notes to the Interim Financial Statements

Accounting policies

1. General information

Stefnir hf. is a limited liabilty entity and operates in accordance with Act. 2/1995 on Limited Liabilty Companies and Act. 161/2002 on Financial Undertakings. The address of Stefnir's registered office is at Borgartún 19, Reykjavík and its ID no. is 700996-2479.

Stefnir is a subsidiary of Arion Bank hf., ID no. 581008-0150, Borgartún 19, Reykjavík.

2. Basis of preparation

The Interim Financial Statements of Stefnir hf., A-part, are prepared in accordance with law on Financial Statements, law on Financial Undertakings and Rules on the Financial Statements of management companies of UCITS. The Interim Financial Statements are prepared on the historical cost basis except for Securities that are valued at fair value. The Interim Financial Statements are presented in Icelandic króna (ISK), rounded to the nearest thousand unless otherwise stated. The Interim Financial Statements of Stefnir hf. are part of the Consolidated Financial Statements for the parent company with information on operations and financial position of the Consolidated company.

3. Use of estimates and judgements

The preparation of Financial Statements requires management to make judgements, estimates and assumptions that affect the reported amounts of assets, liabilities, income and expenses in the Financial Statements presented. Use of available information and application of judgement are inherent in the formation of estimates. Actual results in the future could differ from such estimates and the differences may be material to the Financial Statements.

4. Management and performance based fees

The company earns asset management fees for the operations of Stefnir's Securities Funds, Investment Funds and Professional Investors' Funds. The fee is a fixed percentage of the net assets, total assets or subscriptions of each fund and includes the following operating expenses of the funds; salaries of the employees of the operating company, marketing and management. Fees are also earned from the operation of special purpose entites that have been established for enterprise investments. Additionally the company earns fees for the asset management of foreign funds that are in custody of foreign entities. Performance fees are earned if certain conditions are met.

5. Securities

a. Securities with variable income

Securities owned by the company are trading assets. Fund units and shares in special purpose entities are measured at cost at the end of the period. Listed fund units are measured at market value at end of the period.

b. Securities with fixed income

Bonds that are listed on regulated securities market which is active and price generating are measured at market price at each time. The expression “active and price generating” means that the closing price of a bond is not based on old trades, trading with an insignificant portion of the total issuance or does not reflect the fair value of the bond as valued by specialists. If the issuer of a bond is expected to default, the bond is valued at the expected recoverable amount taking into account priority order of claims.

A bond where the issuer is deemed viable but is not listed on an active and price generating securities market is measured at present value of future cash flow. The choice of yield curve used for each bond is based on general risk and the circumstances on the market at the end of the period.

For a bond where the issuer is not deemed viable the methods described above are deviated from and the bond is measured at expected recovery value and no interest income is realised. The estimate of expected recovery value takes into account the experience of the recovery from similar issuers, the financial statements of the issuer and statements issued by it. If the issuer is in administration, has defaulted or stated that payments of the bond will not be made the expected recovery is measured 0-1% and the bond entered into a collection process. If new information is received from issuers that have previously been fully provisioned for, the bond is re-valued, which might change the valuation of the bond to higher value. Due to significant uncertainty about the valuation of bonds the final recovery might vary considerably from the valuation at end of the period.

6. Foreign currency transactions

Transactions in foreign currencies are translated to Icelandic króna at exchange rates at the dates of transactions, according to Reuter. Assets and liabilities denominated in foreign currency are translated at exchange rate at the end of the period. Net foreign assets at 30 June amount to ISK 593 millions and are specified as follows:

	EUR	USD	GBP	Other
Assets	568,702	72	28,829	141
Liabilities	(4,433)	0	0	0
Net balance 30.6.2017	564,269	72	28,829	141
Net balance 31.12.2016	563,211	5,890	28,555	145
Exchange rate of ISK 30.6.2017	116.35	101.98	132.59	
Exchange rate of ISK 31.12.2016	119.18	112.9	139.38	

7. Receivables

Recivables are measured at nominal value deducted by impairment.

8. Cash

Cash consists of cash and deposits whth credit institutions.

9. Tax assets

The calculation of derferred tax asset is based on the difference between Statement of Financial Position items as presented in the tax return on the one hand, and in the Financial Statements on the other. This difference is due to the fact that tax assessments are based on premises that differ from those governing the Financial Statements, mostly because of time difference in impairment of securites and foreign exchange gain and loss are distributed over three years in the tax return.

10. Net financial income

	2017 1.1 - 30.6.	**2016 1.1 - 30.6.**
Net financial income is specified as follows:		
Valuation change in securities assets	92,848	(170,072)
Dividend received	0	182,694
Foreign exchange gain (loss)	(32,824)	(20,470)
Interest income	5,961	8,299
Interest expense	(30)	(28)
Net financial income	65,955	423

11. Salaries and related expenses and personnel

Salaries	248,590	242,066
Salary related expenses	72,410	70,841
Salaries and related expenses	321,000	312,907
Number of employees at the end of the period	20	22
Average number of employees during the period	20	23

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12. Income tax expense	2017 1.1 - 30.6.	2016 1.1 - 30.6.
Current tax expense	149,142	57,932
Deferred tax expense	12,246	17,307
Total Income tax expense	161,388	75,239

13. Securities

Securities with variable income are specified as follows:	30.6.2017	31.12.2016
Fund units issued by funds operated by Stefnir hf.	1,552,588	1,918,168
Shares in investment companies	131,463	107,245
Shares in companies	44	44
	1,684,095	2,025,457
Securities with fixed income are specified as follows:		
Listed on NASDAQ OMX Iceland:		
Issued by public entities	5,902	7,065
Unlisted:		
Issued by public entities	2,713	2,626
Isued by others	59,835	172,384
	68,450	182,075
Securities total	1,752,545	2,207,532

14. Related parties

Stefnir hf. has a related party relationship with the parent company, Arion Bank hf. and its subsidiaries and associates, funds under management, The Board of Directors and key management personnel at Stefnir.

No unusual transaction took place with related parties during the period. Transaction with related parties have been conducted on an arm's length basis.

Transactions with related parties 1 January to 30 June 2017:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	92,687	249,291	142,708	47,086
Funds in operation	1,033,349	0	284,646	0
	1,126,036	249,291	427,354	47,086

Transactions with related parties 1 January to 30 June 2016:

	Revenue	Expense	Receivables/ Assets	Liabilities
Arion bank consolidated	99,904	216,929	148,213	304,965
Funds in operation	1,143,124	0	211,321	0
	1,243,028	216,929	359,535	304,965

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15. Assets under Management

Assets under Management in funds in operation by Stefnir at the end of the period amount to ISK 377 billions compared to ISK 408 billions at year end 2016.

16. Equity

a. Share capital amounts to ISK 43.5 million at year end, unchanged from year end 2016, with par value of ISK 1 per share.

b. Changes in eqity are specified as follows:

	Share capital	Statutory reserve	Fair value equity reserve	Retained earnings	Total
Equity 1.1.2016	43,500	10,875	0	2,652,889	2,707,264
Dividend paid	0	0	0	(1,000,000)	(1,000,000)
Net earnings	0	0	0	741,319	741,319
Fair value equity reserve ...	0	0	33,818	(33,818)	0
Equity 31.12.2016	43,500	10,875	0	2,394,208	2,448,583
Equity 1.1.2017	43,500	10,875	0	2,394,208	2,448,583
Dividend paid	0	0	0	(890,000)	(890,000)
Net earnings	0	0	0	668,877	668,877
Fair value equity reserve ...	0	0	47,929	(47,929)	0
Equity 30.6.2017	43,500	10,875	47,929	2,125,156	2,227,460

According to the Financial Statements Act No. 3/2006 fair value changes of financial assets from the initial reporting, shall be transferred from retained earnings to a fair value equity reserve, net of tax. The fair value equity reserve is not subject to dividend payments. The fair value equity reserve shall be released in accordance with fair value changes recognized when financial asset is sold or redeemed or the assumptions for the fair value change is no longer in force.

c. Return on assets, presented as the ratio between net earnings and the average balance of assets according to the Balance Sheet, was 44.1% during the first half of 2017. Return on assets for the same period in 2016 was 19.9%.

d. Equity at end of the period is ISK 2.227 million or 78.7% of total assets. The Capital adequacy ratio of the company which is calculated according to Article 84 of the Act on Financial Undertakings is 65.0%, exceeding the minimum legal requirement of 8%. Comparison figures have been changed accordingly. The ratio is calculated as follows:

	30. 6. 2017.	31. 12. 2016.
Total equity	2,227,460	2,448,583
Tax asset	(28,114)	(40,360)
Total own funds for solvency purposes	2,199,346	2,408,223
Total capital requirements are specified as follows:		
Credit risk	197,233	209,162
Market risk	47,465	47,824
Capital requirement	244,698	256,986
Capital requirement due to fixed overheads	270,792	270,792
Capital adequacy ratio	65.0%	71.1%

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17. Tax assets (liabilities)

Changes in tax assets and liabilities are specified as follows:

	30. 6. 2017.	31. 12. 2016.
Tax assets at the beginning of the year	(148,777)	(247,696)
Income tax recognised in Statement of Income	(161,388)	(177,473)
Income tax paid	140,960	276,392
Net tax assets (liabilities) at the end of the period	(169,205)	(148,777)
Specified as follows:		
Current tax	(197,319)	(189,137)
Deferred tax asset	28,114	40,360
Net tax assets (liabilities) at the end of the period	(169,205)	(148,777)
Deferred tax assets are attributable to the following:		
Tax loss carried forward	0	0
Securities	20,226	25,646
Deferred foreign exchange gain and loss	11,328	18,948
Provision	(8,435)	(9,228)
Other items	4,995	4,994
Deferred tax asset at the end of the period	28,114	40,360
Tax liabilities are attributable to the following:		
Unpaid income tax from previous year	48,177	0
Income tax using the Icelandic corporation tax rate	149,142	189,137
Tax liabilities at the end of the period	197,319	189,137

In the case of any discrepancy between the English and the Icelandic texts, the Icelandic versions shall prevail and questions of interpretation will be addressed solely in the Icelandic language.

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