BARCLAYS CAPITAL

RESEARCH

# Icelandic Banks: Skating hard, on thinning ice?

## Trades to exploit relval and CDS curve anomalies

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Figure 1: Key ratings

| | Senior debt | Short-term | Bank F.S. | Outlook |
|---|---|---|---|---|
| Iceland | Aaa/AA-/AA- | P-1/A-1+/F1+ | N/A | Stable |
| Islandsbanki | A1/NR/A | P-1/NR/F1 | C+/NR/B-C | Stable |
| Kaupthing | A1/NR/A | P-1/NR/F1 | C+/NR/B-C | Stable |
| Landsbanki | A2/NR/A | P-1/NR/F1 | C/NR/B-C | Stable |

## Summary


- The Icelandic banking system has grown rapidly in the past few years driven by a combination of strong domestic economic fundamentals, privatisation/de-regulation and consolidation. Three groups (Kaupthing, Islandsbanki and Landsbanki) represent over 80% of the country's banking assets.
- The performance of the three principal players has developed strongly in both relative and absolute terms, particularly since 2003, in response to loan growth, acquisitions and trading gains. Balance sheet credit matrices such as asset quality and regulatory capital ratios have also improved.
- Iceland is a small country (pop. 295,000) whose banks have enjoyed rapid growth (both organic and by acquisition) funded almost entirely via the wholesale (equity and debt) market. This has made the banks vulnerable to deterioration in confidence, something that is partly to blame for the recent underperformance in fixed income valuations.
- The three biggest banks trade wide for their ratings and, in our view, they should do since they are unusually vulnerable to macro-developments and/or sentiment changes. However, the CDS curve for the Icelandic banks is too flat, essentially pricing in too much bad news too early. *Among the trades that we recommend below, we would do 1-5s steepeners on Icelandic bank CDS. We would also go long Iceland banks versus Commerzbank and long Kaupthing versus Islandsbanki.*
- Icelandic banks will be reporting full-year 2005 results from 26 January onwards, starting with Kaupthing.

# Trade recommendations

**We believe that most of the value lies in the protection market**

Spreads in cash tend to be some 8 bp or so tighter than in CDS; hence, much of the opportunities for extracting value lie in the protection market, in our view. We have a hold recommendation on Kaupthing Tier 1, reflecting what we see as the limited potential spread upside here relative to CDS on the one hand, but the good carry on the other.

In the recommended trades below we chose Kaupthing as a proxy for Icelandic banks since it is the most liquid and the highest yielding. All trades are in senior protection.

**1) 1.1s-5s Iceland steepeners**

- **Sell 41mn KAUP 1 yr at 20 bp and buy 10mn 5 yr** at 49 bp for a completely DV01-neutral trade, which yields 29 bp of carry per €1mn notional of 5 yr Kaupthing protection. The trade would also outperform if the 1-5 yr curve steepens.

  Take advantage of what we see as the exaggerated levels on 1 yr where we see the risk as moderate. Also, these trades are positive carry, DV01 neutral and hence would not be affected by any parallel moves in the curve due to credit news or market widening.

**2) Iceland vs comparables**

- **1 yr CDS: Sell 10 mn KAUP 1 yr at 20 and buy 10 mn 1 yr CMZB at 6.75 for 13.25 bp of carry**. The trade is DV01 neutral and is hedged from any market moves. The trade would also outperform should Icelandic bank spreads tighten relative to those of other countries.

  Front-end trading is particularly cheap vs comparables, due to what we see as exaggerated near-term concerns. We see the material risks as weighed on the intermediate term

- **5 yr CDS: Sell 10 mn KAUP 5 yr protection at 43 and buy 10 mn CMZB 5 yr protection at 16.5 for 26.5 bp of carry**. The trade is DV01 neutral and is hedged from any market moves. The trade would also outperform should Icelandic bank spreads tighten relative to Commerzbank.

  This offers a more leveraged trade than the 1 yrs, but with greater carry. We would suggest an unwind in a year or so or monitor for when the risks of material deterioration becomes more acute.

**3) Kaupthing vs Islandsbanki**

- **Sell 10 mn KAUP 5 yr protection at 43 and buy 10 mn ISBAIR 5 yr protection at 37** to pick up 6 bp of carry. The trade hedges against Iceland as well as general market risk while retaining potential carry upside.

  Since the main risks facing Icelandic banks are more generic than micro right now, in our view, the banks should trade closer to each other. Investors may want to benefit from the spread differential between banks, while hedging against Iceland in general.

# Ratings and relative value: opposite ends

## Figure 2: CDS better value than cash

| | Issuer | Structure | Cpn (%) | Maturity (call) | Swaps |
|---|---|---|---|---|---|
| Cash | KAUP | Senior | FRN | 25 May 10 | E+29.7 |
| | | | FRN | 17 Aug 12 | E+36.2 |
| | (Findan) | | FRN | 23 Mar 10 | E+20.2 |
| | | Tier 1 | 5.901 | perp. (Jun '14) | Z+119 |
| | ISBAIR | Senior | FRN | 27 Jan 10 | E+24 |
| | LANISL | Senior | FRN | 19 Oct 10 | E+30.8 |
| | | | FRN | 20 Jun 12 | E+36.2 |
| CDS | KAUP | 5 yr Senior | | | 42/47 |
| | ISBAIR | 5 yr Senior | | | 30/35 |
| | LANISL | 5 yr Senior | | | 40/45 |

*Source: Barclays Capital. Cash offer spreads (bp).*

## Ratings – overly generous?

**Icelandic banks should be in the mid-to-low single-A category…**

We believe the Iceland banks, on balance are rated a little too highly. We believe that the rightful place for the banks would be one notch lower (please see Figure 3), in the mid-to-low single-A category.

## Figure 3: BarCap view of ratings

| | Actual ratings | BarCap rating |
|---|---|---|
| Iceland | Aaa/AA-/AA- | - |
| Islandsbanki | A1/NR/A | A2/NR/A- |
| Kaupthing | A1/NR/A | A2/NR/A- |
| Landsbanki | A2/NR/A | A3/NR/A- |

*Source: Barclays Capital.*

## Valuations: Much of the bad news already priced

**… but already trade at a significant discount to peers**

Taken purely on ratings, and assuming we are right about where we believe Icelandic bank senior ratings ought to be, Icelandic banks still trade at too much of a discount to comparables. This is partly driven by pure technical factors, such as the recent glut in senior supply, which the market has found difficult to digest. However, technicals aside, the market seems unclear as to how much of a discount it should apportion to Icelandic bank spreads. To price in none of the concerns we mention earlier in the report should mean Icelandic banks should trade 10-20 bp tighter in senior CDS, even factoring in our more conservative rating. However, if the macro risks assessed above become reality, and the banks make substantial losses at the same time as wholesale funding capacity dries up through lack of confidence in the system, then spreads should trade significantly wider.

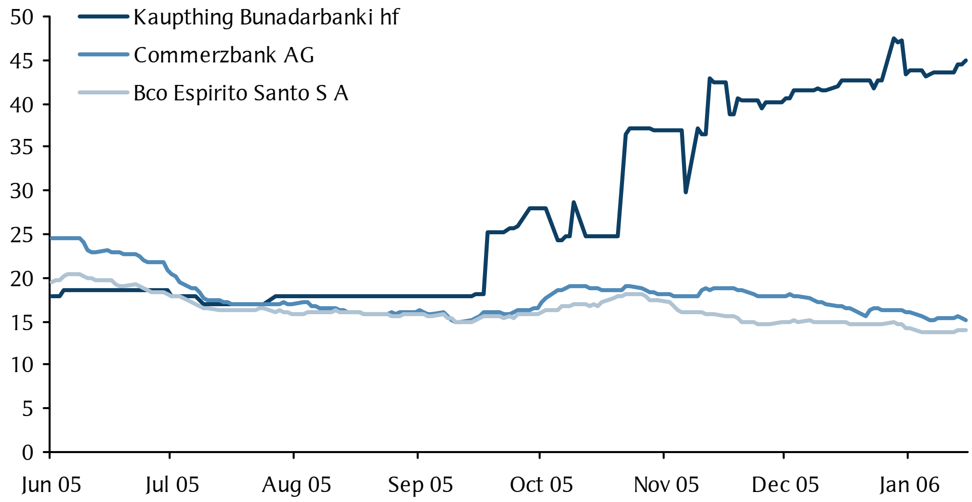
The bottom line, in our view, is that assuming our longer-term (and more conservative) view of the correct rating category for the banks is right, the banks are still trading cheaply. This suggests an invitation to invest. However, two factors prevent us from recommending aggressive buys:

- There is no reason to believe that there will be a catalyst for spread compression any time soon. The banks' FY 05 results, set to be published in the coming days, are likely to show continued strength, but lingering concerns over leverage, funding and sovereign risk remain.
- Even if the downside risk for ratings were measurable, there is no protection against the spread volatility that could return to one or all of the banks here if one or more risks we have run through became more acute.

**The carry available among the Icelandic banks remains compelling, especially in the short-end of CDS**

That said, in the absence of any immediate evidence to suggest a near-term deterioration in either macro dynamics in Iceland or micro fundamentals among the banks, we believe the carry available among the Icelandic banks remains compelling. *In CDS there is no cheaper group in Western Europe than in Iceland in Tier 1 there is probably nothing as nominally cheap as Kaupthing's Tier 1 outside of "core" capital and BPI.*

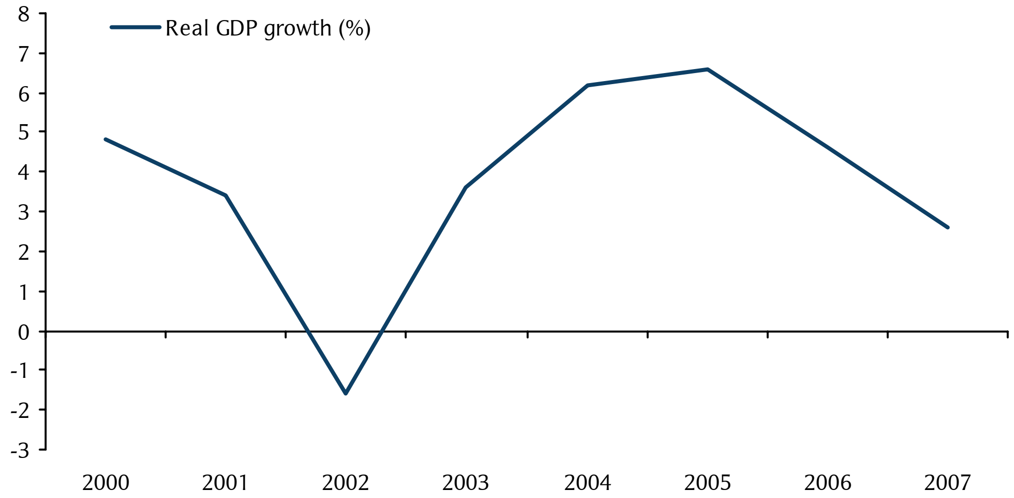
Figure 4: Icelandic bank 5 yr senior CDS: already at a discount




*Source: Markit.*

# Iceland sovereign – Performance peaked?

## Figure 5: Iceland economic performance




*Source: OECD.*

## Figure 6: Key economic statistics

| | 2003 | 2004 | 2005* | 2006E* | 2007E* |
|---|---|---|---|---|---|
| GDP ($mn) (with estimates based on growth) | 10,575 | 12,609 | 13,416 | 14,113 | 14,720 |
| Real GDP growth (%) | 3.6% | 6.2% | 6.6% | 4.6% | 2.6% |
| Current account balance (% of GDP) | -5.0% | -8.4% | -12.1% | -12.9% | -10.5% |
| Population | 290,868 | 293,233 | 295,573 | 297,894 | 300,191 |
| Unemployment (% of labour force) | 3.4% | 3.1% | 2.5% | 1.9% | 2.2% |
| Consumer prices (annual average % change) | 2.1% | 3.2% | 3.9% | 4.0% | 3.4% |
| ISK/USD (annual average) | 76.7 | 70.2 | 62.0 | 64.0 | 66.5 |
| Repo rate (%) | 5.3 | 8.25 | 10.5 | | |

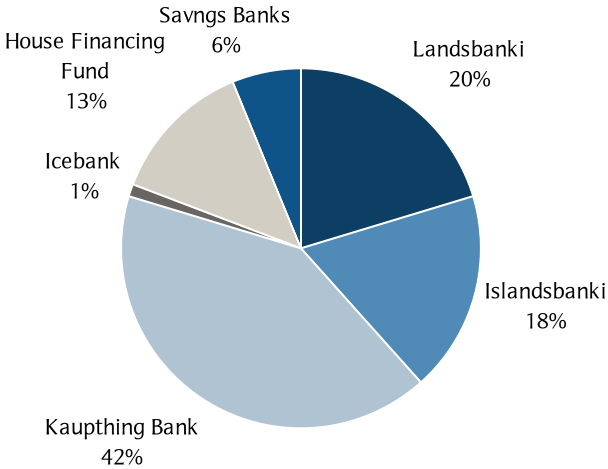
*Note:*includes estimates and projections. Source: OECD, Fitch, Iceland statistics.*

**Iceland's economy has experienced remarkable growth in the past few years**

The Icelandic economy has been growing at a remarkable pace in the past few years, with 2005 likely to have been a peak when the GDP growth rate was just shy of 7%. This year, the OECD estimates that the growth rate will begin to slow. While Iceland is not formally covered by Barclays Capital economists, we provide here some historical and forecast statistics for the country from a number of alternative sources. The OECD last published a review of Iceland at the end of 2005. In the wake of the strong performance, the questions for Iceland centre on the sustainability of growth, the ability to stoke inflationary pressures and how to moderate the speed of development without causing a shock to the economy.

Iceland's banking system is dominated by three listed banking groups that together make up a substantial majority of the system assets. As these are the groups that have issued the most publicly traded international fixed income product, we focus our analysis in this report on them. At the back of this publication, we provide greater detail on each of the three banks.

Figure 7: Total assets of banking sector




*Source: Moody's.*

# Bank performance, helped by acquisitions

In our view, one of the key risks surrounding the three large domestic banking groups is the sustainability of key credit matrices in a downturn. This is true of any system that has developed very rapidly; however, the question is particularly relevant for the Icelandic banks owing to the international nature of the expansion (especially in Norway, Denmark and the UK), as well as the wholesale funding orientation. A related concern is the likely limited ability of a small economy such as Iceland, in supporting one or more of the domestic banks, should this ever be required.

Figure 8: The three key banks summary stats

| USD mn | Kaupthing | Islandsbanki | Landsbanki | Lloyds | Nordea |
|---|---|---|---|---|---|
| Total assets | 37,279 | 21,284 | 18,435 | 537,173 | 376,655 |
| Market Cap. | 8,750 | 4,608 | 4,909 | 51,872 | 28,412 |
| Loans | 22,147 | 17,159 | 14,391 | 294,946 | 211,924 |
| Net income | 574 | 248 | 262 | 2,119 | 1,452 |
| | | | | | |
| Loans/deposits (%) | 317% | 332% | 324% | 128% | 166% |
| RoE (%) | 28% | 33% | 31% | 25% | 19% |
| Cost/income (%) | 35% | 42% | 40% | 58% | 56% |
| Tier 1 (%) | 9.20% | 9.40% | 12.90% | 7.80% | 7.00% |

*Source: Barclays Capital.*

## Strong profitability

2004 and 2005 have been record years for earnings generation for the banks driven by the following factors:

- **Loan growth:** Domestic economic growth and confidence has fuelled demand for credit from the corporate sector, while deregulation in mortgage lending has helped the three main banking groups obtain market share from the Housing Finance Fund (HFF).

- **Acquisitions:** All three banks have been active consolidators, most recently outside of Iceland in an attempt to diversify away from the small system.

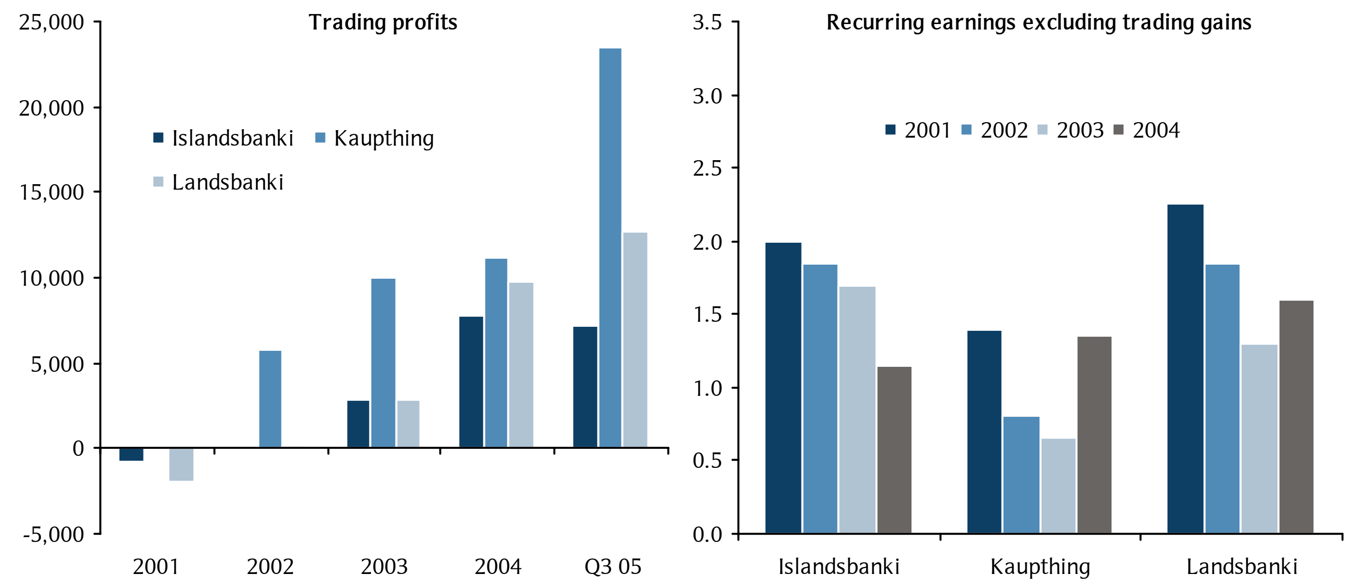
Figure 9: Recent major M&A transactions

| Kaupthing | Islandsbanki | Landsbanki |
|---|---|---|
| 2002 – Acquired JP Nordiska (Sweden). | 2003 – Acquired Icelandic insurer Sjova (has subsequently sold a majority stake). | 2000 – Acquired 70% stake (increasing to 100% in 2003) in Heritable Bank (UK). Total assets €680mn. |
| 2002 – Acquired Aragon (Sweden). | 2004 – Acquired Kredittbanken (Norway). Total assets of €432mn. | 2002 – Acquired 51% stake in SP Fjarmognon (leasing). |
| 2003 – Merger of Bunadarbanki and Kaupthing completed. | 2005 – Acquired BN Bank (Norway). Total assets of €5bn. | 2003 – Acquired Bunadarbanki Islands (renamed to Landsbanki Luxembourg) |
| 2004 – Acquired FIH (Denmark). Total assets of EUR9bn. | | 2005 – Acquired brokers Teather & Greenwood (UK), Kepler (France) and Merrion (Ireland). |
| 2005 – Acquired Singer & Friedlander (UK). Total assets of EUR4bn. | | 2005 – Acquired 41% of Burdaras' assets (c.500mn) following the group split-up. |

*Source: Barclays Capital, Fitch, Company websites, Iceland National Debt Management Agency.*

- **Trading profits/capital gains:** The recent strength in the Icelandic capital markets has boosted the banks' trading earnings and delivered gains on securities so that the proportion of this less dependable source of profits has grown substantially.

Figure 10: Trading profits rising… but pressure on recurring earnings

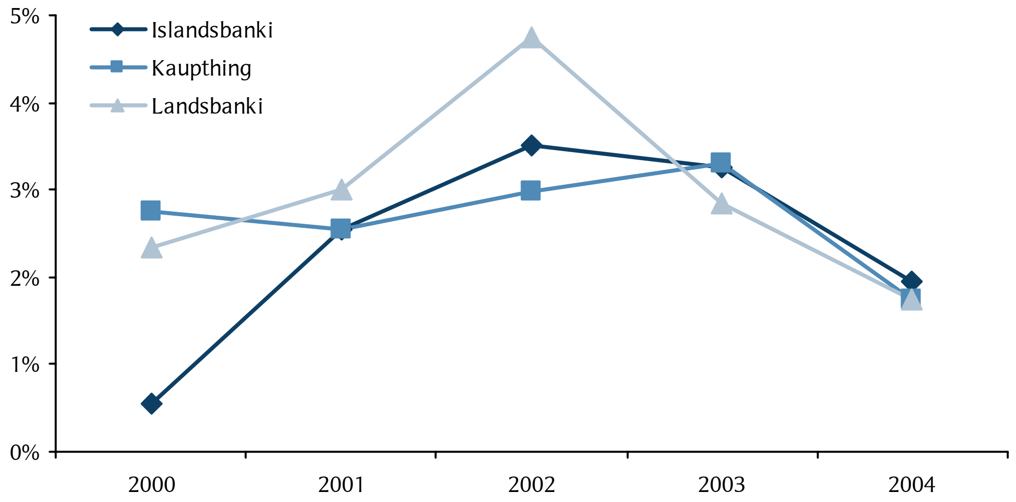



*Source: Moody's. Trading profits given in ISK mn. Recurring earnings given as a % of RWA.*

## Good asset quality measures

Kaupthing, Islandsbanki and Landsbanki all disclose strong asset quality ratios as measured by the non-performing loan ratio and large exposures. Although an improvement in these matrices should be expected in circumstances where the balance sheet is growing very rapidly, Icelandic banks have fairly rigorous pre-credit-extension procedures. At home, at least, much of the loan growth has come from mortgage lending following the opening up of the Housing Financing Fund (HFF) to competition.

## Figure 11: Asset-quality trends




*Source: Moody's.*

## Regulatory capital

Despite the risk-weighted asset growth, the banks' regulatory capital position remain fairly comfortable, and access to equity funding appears comfortable judging by Islandsbanki's 10 January ISK19bn (€252mn) equity issue which, according to Islandsbanki, was 56% oversubscribed. That said, the quality of the capital has deteriorated somewhat as banks have sought to issue into the fixed income Tier-1 market.

## Figure 12: Regulatory capital of the Big 3 (Q3 05)

| ISKmn | Kaupthing | Islandsbanki | Landsbanki |
|---|---|---|---|
| Equity | 183,865 | 76,047 | 100,825 |
| Deductions | -56,465 | -11,079 | -6,060 |
| Subordinated loans (Tier 1) | 26,968 | 19,850 | 22,195 |
| **Total Tier 1** | **154,368** | **84,818** | **116,960** |
| *Non-equity %* | *21%* | *31%* | *23%* |
| | | | |
| **Total Tier 2** | **50,553** | **26,322** | **13,356** |
| | | | |
| **Total Capital** | **204,921** | **111,140** | **130,316** |
| | | | |
| **Tier 1 ratio** | **9.2%** | **9.4%** | **12.9%** |
| **Total capital ratio** | **12.2%** | **12.3%** | **14.3%** |

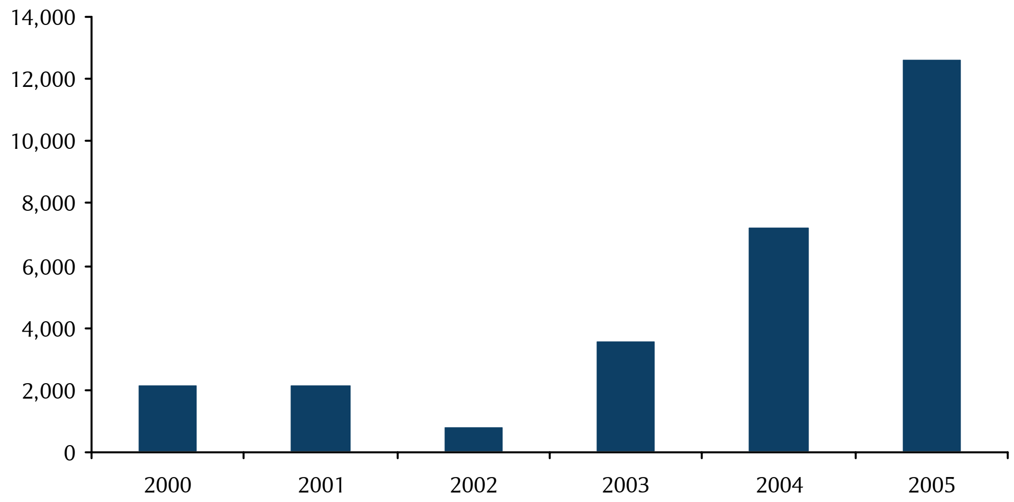
*Source: Company interim reports.*

# … But risks are also growing

## Overheated economy

Although Iceland's GDP growth is estimated (OECD) to continue to outperform much of the West in the immediate future, this is set to begin to slow from 2006 and according to the latest economic outlook report, the OECD suggests that Iceland continues to exhibit signs of overheating. The country is likely to require further monetary tightening (from already-high rates), to choke inflation and economic imbalances, according to the OECD, are now as marked as they were in the late 1990s. "An orderly unwinding of the imbalances will be challenging." (OECD)

Figure 13: Icelandic bank issuance (€ mn)




*Source: Bondware.*

## Cross shareholdings/equity market

Icelandic banks appear to have sought or attracted relatively limited amounts of outside, non-domestic capital to fund their recent expansion. The result is that the Icelandic banks system has an unusual amount of cross-shareholdings, which essentially means that the banks, as with other listed entities in Iceland, have substantial indirect investments in themselves, effectively self-financing. Principal shareholders for each bank are detailed in the individual summaries at the back of this report. Here, and for each bank, we give a few examples of the incestuous nature of equity funding.

**Kaupthing**

- Largest shareholder (21%): Exista (Dutch/Icelandic) investment company.
- Kaupthing owns 19% in Exista.

**Islandsbanki**

- Biggest shareholder (22.8%): Milestone/Sjova combined. Sjova is an insurance company that was until recently controlled by Islandsbanki. We understand Islandsbanki still owns 33% in Sjova.
- Second-largest shareholder: investment company FL Group (16% stake), is 32% owned by Landsbanki.
- Islandsbanki owns 10% of FL Group.

**Landsbanki**

- Largest shareholder Samson Holding (40%): an investment company beneficially owned by Gudmundsson (Chairman of Landsbanki) and Bjorgolfsson (previously Chairman of Burdaras).
- Almost 13% owned by combination of Landsbanki Luxemburg, Landsbanki Islands Ltd and LB Holding. As these companies are connected, this is effectively treasury stock.

To some extent, at least, some level of cross-ownership of the countries' larger listed assets is only to be expected in a country as small and fast-developing as Iceland. However, by Western system standards this is a fairly unusual arrangement that masks true ownership of resources (with associated corporate governance issues) and raises questions about the "real" nature of fresh equity and other capital. Just as importantly, however, cross-ownership and indirect self-ownership, if rife, leverages up the economy and its principal contributors. In a deteriorating economic climate, the effect can flip a virtuous circle into vicious cycle.

## Figure 14: Icelandic P/E ratios: room to disappoint

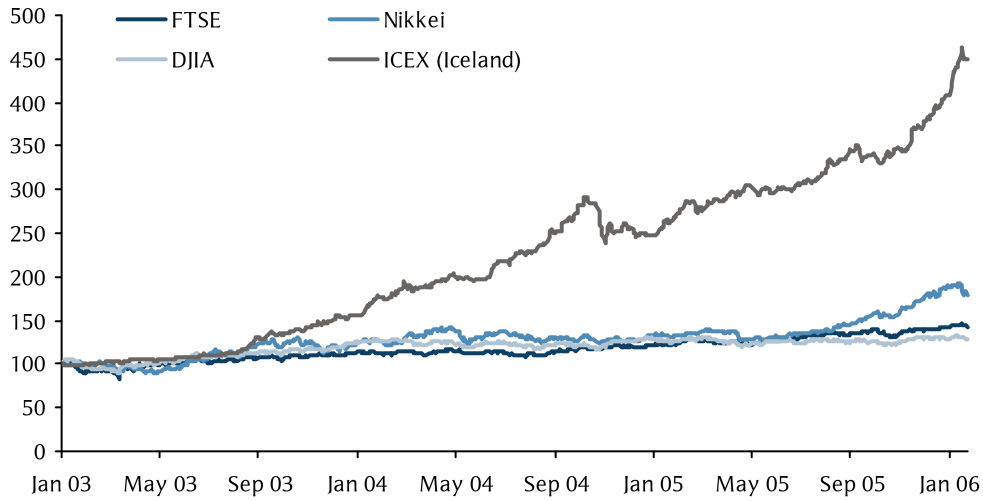
| | P/E |
|---|---|
| ICEX 15 (Iceland) | 17.98 |
| FTSE 100 | 18.90 |
| FTSE Banks | 12.61 |
| Bloomberg European Bank & Financial Services | 13.81 |
| | |
| Kaupthing | 26.10 |
| Islandsbanki | 17.69 |
| Landsbanki | 16.74 |
| | |
| Lloyds | 11.31 |
| Nordea | 11.02 |

*Source: Bloomberg.*

A rapid change in the dynamics of the economy would have a compounding negative impact on the domestic banking system. Demand for credit would slow, capital gains would become losses, securities trading revenues would drop and wholesale funding costs for debt and equity, could rise substantially. Judging by the substantial equity price outperformance of the Icelandic stock market, and the banks in particular, over recent years, it would not be entirely unsurprising to see a correction, however mild. In the best-case scenario, equities valuations will stabilise from rapid growth, but even here it is likely that secondary trading volumes will fall, and weaken the earnings profile of the banks that have benefited so obviously from the bull-run.

Kaupthing's recent reported interest in acquiring part of the catering business of the Compass group as part of a private equity consortium (potential £1bn reported price tag) exemplifies the growing appetite for market risk in Iceland, even if Kaupthing has stated that its private equity portfolio totalled only £155mn (0.7% total assets).

Figure 15: Iceland vs global indices (rebased to 100)




*Source: Bloomberg.*

## Contingent liabilities

We were a little concerned by the apparent growth in appetite for off-balance sheet risks among the Icelandic banks, particularly as exemplified by Kaupthing. For the latter, contingent liabilities have grown four-fold in the first nine months of 2005 to reach EUR7bn. This represents almost 3x book equity, and over 30% of the loan book. We understand from Kaupthing's management that of the EUR5.5bn increase in the period in question, EUR3.5bn was due to the ramping up of the CDO portfolio at the London-based group asset manager New Bond Street Asset Management. We understand also that the nature of the exposure is spread across a number of CDOs and that the average rating is single-A. The bank has stated that it does not own any equity traunches. Although we have found limited disclosure surrounding off-balance sheet items at the Landsbanki and Islandsbanki, and so cannot make a full assessment of relative growth or appetite here. However, we will continue to monitor associated risks at all three banking groups.

## Figure 16: Fundamental peer comparison

| ISK mn | Kaupthing | Islandsbanki | Landsbanki |
|---|---|---|---|
| **Balance sheet** | **9M 05** | **9M 05** | **9M 05** |
| Interbank deposits | 307,675 | - | - |
| Trading & MTM assets | 416,237 | 203,421 | 195,697 |
| **Loans** | **1,372,255** | **1,063,155** | **891,668** |
| Equity investments | 10,870 | 8,401 | 4,282 |
| Other assets | 202,793 | 43,808 | 50,611 |
| **Total assets** | **2,309,830** | **1,318,785** | **1,142,258** |
| | | | |
| Interbank funding | 59,847 | 40,022 | 138,693 |
| Customer Deposits | 432,549 | 320,305 | 275,295 |
| Debt securities issued | 1,413,417 | 774,557 | 531,417 |
| Subordinated debt | 88,891 | 48,116 | 47,224 |
| Other liabilities | 131,261 | 59,738 | 50,880 |
| **Equity** | **183,865** | **76,047** | **98,749** |
| **Total Liabilities** | **2,309,830** | **1,318,785** | **1,142,258** |
| | | | |
| **Income statement** | | | |
| Net interest revenue | 23,180 | 16,764 | 15,741 |
| Fees, commissions and other income | 24,767 | 6,662 | 13,214 |
| Trading | 20,599 | 3,830 | 5,365 |
| Operating expenses | -23,684 | -11,501 | -13,898 |
| Profit before loan losses | 44,862 | 15,755 | 20,422 |
| Loan loss provisions and write-offs | -2,221 | -1,560 | -4,392 |
| Other provisions | -380 | | -3,293 |
| Operating profit | 42,261 | 14,195 | 12,737 |
| Non-Operating items | 541 | 3,956 | 7,306 |
| **Pre-tax profit** | **42,802** | **18,151** | **20,043** |
| Taxation | -7,210 | -2,793 | -3,836 |
| Net income before minorities | 35,592 | 15,358 | 16,207 |
| | | | |
| **Ratios** | | | |
| Net interest margin | 1.60% | 2.24% | 2.23% |
| Non-int revenues/assets | 3.13% | 1.40% | 2.64% |
| Tot revenues/assets | 4.73% | 3.64% | 4.87% |
| Cost/income ratio | 35% | 42% | 40% |
| Pre Prov. Profit/Av. Assets | 3.10% | 2.10% | 2.90% |
| Provisions/loans | 0.25% | 0.26% | 0.78% |
| | | | |
| Customer loans/total assets | 59% | 81% | 78% |
| Customer deposits/loans | 32% | 30% | 31% |
| Equity/assets | 7.96% | 5.77% | 8.65% |
| | | | |
| Net ROA | 2.46% | 2.05% | 2.30% |
| Net ROE | 28% | 33% | 31% |
| | | | |
| Tier 1 capital ratio | 9.2% | 9.4% | 12.9% |
| Total capital ratio | 12.2% | 12.3% | 14.3% |

*Source: Company accounts.*

# Islandsbanki (A1/NR/A) Mkt Cap ISK271bn

## Ownership

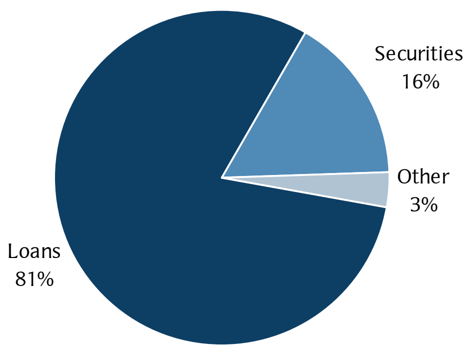
| Shareholders | % |
|---|---|
| Thattur/Milestone/Sjova | 23% |
| FL Group | 16% |
| Straumur-Burdaras | 5% |
| Arion | 5% |
| Raudatorg | 3% |

*Note: includes recent share issue. Source:: Iceland Debt Mngmnt Agency.*

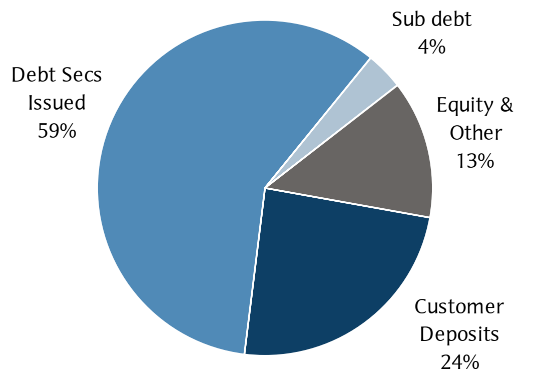
## Major subsidiaries & affiliates

- BN Bank
- FactoNor
- ISB Luxembourg
- Kredittbanken

## Asset mix



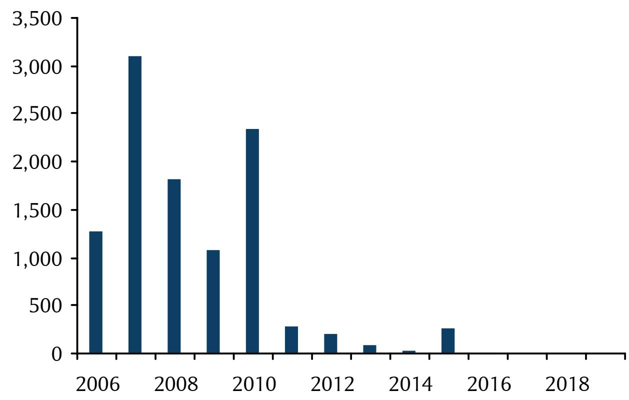

## Funding mix



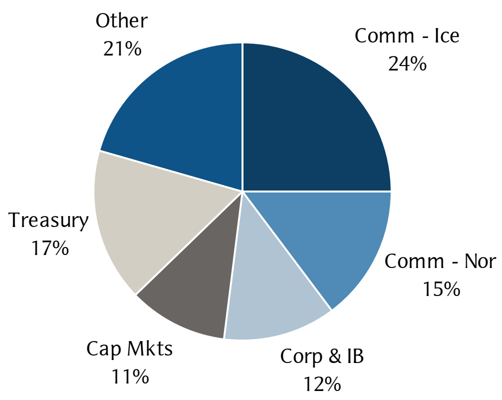

## Lending sector concentration

| Sector | % |
|---|---|
| Services | 36% |
| Retail | 23% |
| Fishing | 16% |
| Manufacturing | 14% |
| Commerce | 9% |
| Municip's | 2% |

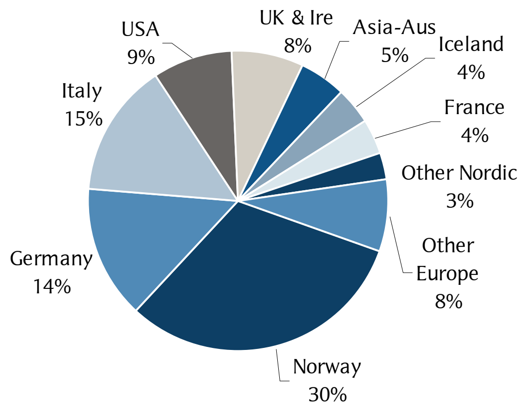
## Debt maturity (EUR mn)




## Earnings by division




## Funding mix by geography

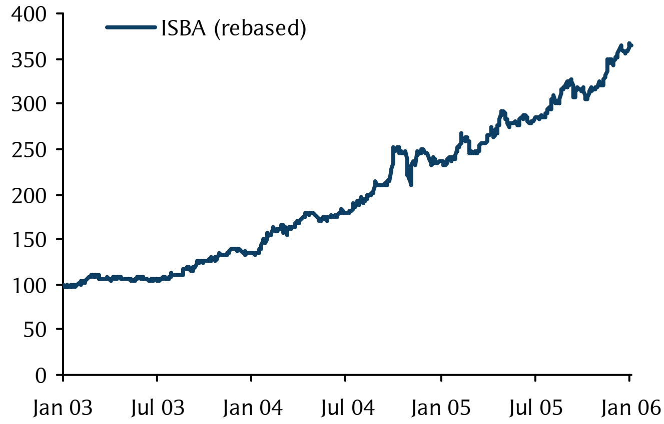



*Source: Company Reports & Presentations, Bloomberg, Moody's. Data as at 9M 05 unless otherwise stated.*

## Recent acquisitions

- 2003 – Acquired Icelandic insurer Sjova (has subsequently sold a majority stake).
- 2004 – Acquired Kredittbanken (Norway). Total assets of €432mn.
- 2005 – Acquired BN Bank (Norway). Total assets of €5bn.

## Stock price trend




## Asset details

- Geographic mix – Iceland 44%, Norway 40%, Corp & IB 16% (H1 05, Fitch).
- Large proportion of domestic loans in foreign currency (Moody's). If any late payments, FX is hedged.
- Large exposures (>10% of equity) declined to 63% of equity (from 100% in 2004, 169% in 2003. Moody's & Fitch).
- Having previously reduced fishing exposure, still important driver in Iceland. However, now have additional Norwegian fishing risk and shipping risk (via KredittBanken).

## Targets

- Tier 1 of 8% (previously 7%)
- Total capital ratio of 11% (previously 10%)
- Growth of 10-20% (previously 7-15%)
- Cost/income of <45% (previously <50%)
- Long-term growth of div/share – c.20-40% of net profit

## Market risk

- Securities make up c.16% of total assets.
- Bonds account for 65% of exposures, predominantly in the form of domestic government issues.
- Equities (28%) and derivatives (7%) make up the remainder.
- Of the equities, 88% are listed on ICEX (Iceland stock exchange).

## Off-balance sheet items

- Uses off-balance sheet products to hedge equity and bond exposures. Gives net positions of equity (long ISK14bn) and bonds (long ISK6bn) at Q3 05.

# Landsbanki (A2/NR/A) Mkt Cap ISK307bn

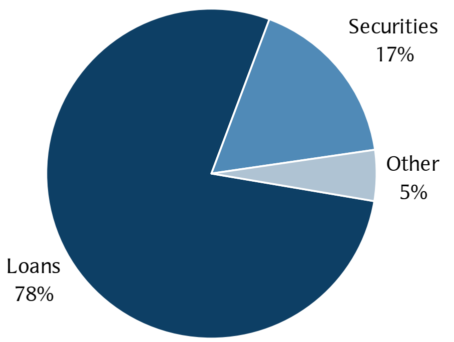
## Ownership

| Shareholders | % |
|---|---|
| Samson Holding | 40.17 |
| Landsbanki Íslands Ltd | 6.56 |
| Landsbanki Luxembourg S.A. | 5.06 |
| Arion Ltd | 2.96 |
| TM Insurance | 2.33 |

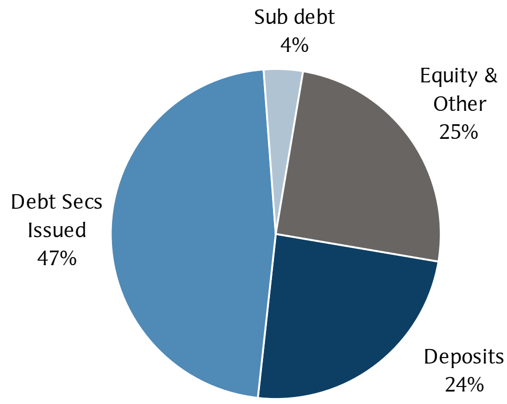
## Major subsidiaries & affiliates

- Heritable Bank
- Kepler Equities
- LIFIS (Life insurance)
- Teather & Greenwood
- VIS (Insurance)

## Asset mix




## Funding mix

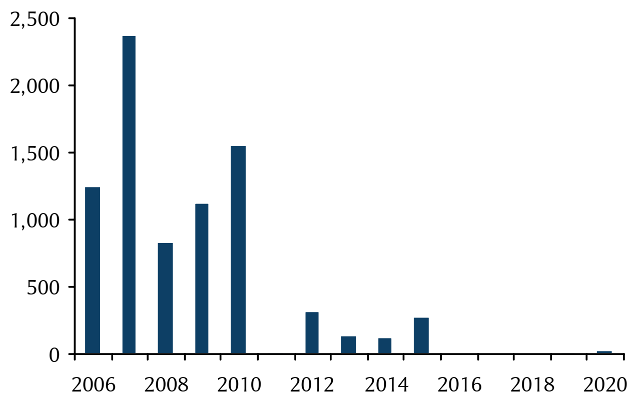



## Lending sector concentration*

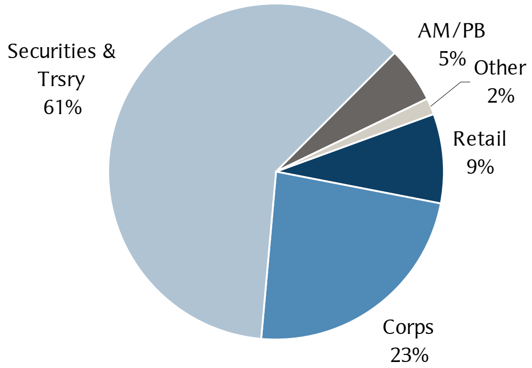
| Sector | % |
|---|---|
| Services | 45% |
| Individuals | 20% |
| Industry & contractors | 12% |
| Fishing | 12% |
| Commerce | 10% |

**as at end 2004*

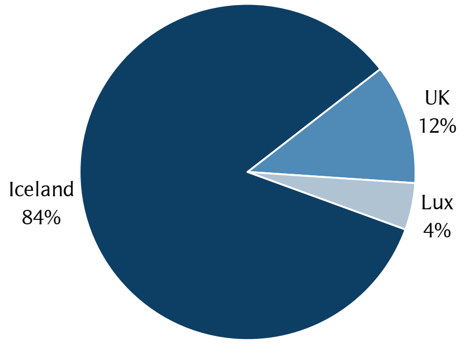
## Debt maturity




## Earnings by division




## Earnings by geography

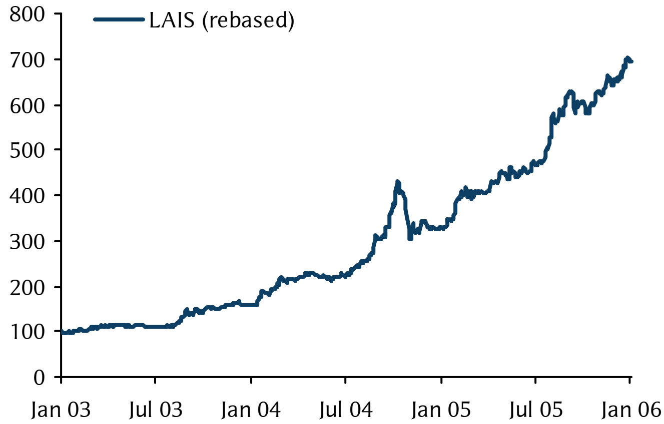



*Source: Company Reports & Presentations, Bloomberg, Moody's. Data as at 9M 05 unless otherwise stated.*

## Recent acquisitions

- 2000 – Acquired 70% stake (increasing to 100% in 2003) in Heritable Bank (UK). Total assets €680mn.
- 2002 – Acquired 51% stake in SP Fjarmognon (leasing).
- 2003 – Acquired Bunadarbanki Islands (renamed to Landsbanki Luxembourg).
- 2005 – Acquired brokers Teather & Greenwood (UK), Kepler (France) and Merrion (Ireland).
- 2005 – Acquired 41% of Burdaras' assets (c.500mn) following the group split-up.

## Stock price trend




## Asset details

- Loan portfolio is divided between Corporate lending (73%) and Retail (26%). 37% of overall lending is non-Icelandic (Fitch, Q3 05).
- Fishing no longer largest concentration (c.10%). Services now represent 46%. Includes financial services, holdco's and retail (Q3 05, Fitch).
- Sold 60% of its mortgage book in 2005 and lowered its LTV from 90% to 80% (Fitch).
- All of top 20 exposures (combined equity and lending) are large (>10%) and all Icelandic corporates.

## Targets

- RoE 15-17% in 2005. (Pre-tax between 18-20%).
- Cost/income ratio below 55%.
- Tier 1 ratio between 7-8%.
- Total capital ratio between 9-11%.
- Provisioning less than 1% of gross loans.

## Market risk

- FX risk is limited.
- Of trading assets, 53% are equities, 39% are bonds, with the rest in derivatives.
- Total equity portfolio was ISK117bn, (more than doubling, helped by Burdaras assets). Over half is hedged by forwards.
- Bond portfolio of ISK61bn, but ISK28bn hedged with forwards.

## Off-balance sheet items

- Guarantees of ISK20,663mn (-14% from end 2004).
- Unused credit commitments of ISK46,296mn (+470% from end 2004).
- Available overdrafts of ISK26,540mn.

# Kaupthing (A1/NR/A) Mkt Cap ISK530bn

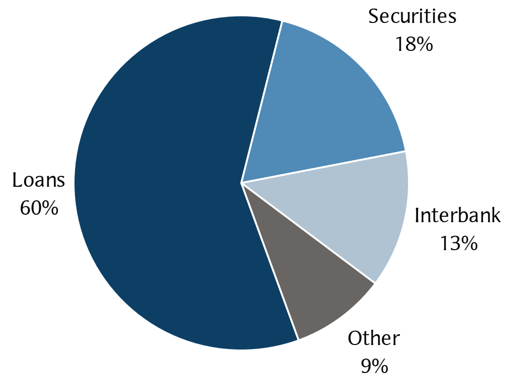
## Ownership

| Shareholders | % |
|---|---|
| Exista B.V. | 21.10 |
| Egla hf | 10.82 |
| Arion safnreikningur | 6.29 |
| Vátryggingafélag Íslands hf | 4.03 |
| Arion verðbréfavarsla - Safnr/sænsk bréf | 3.57 |

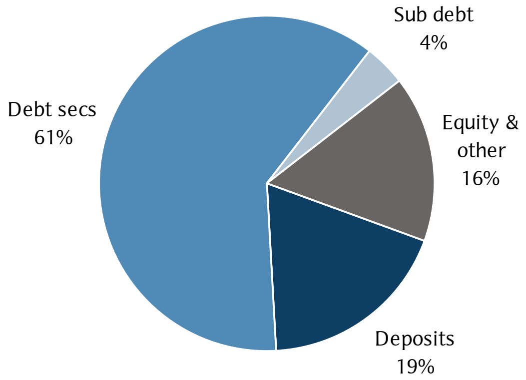
## Major subsidiaries & affiliates

- Arion (Custodian)
- Bunadarbanki Islands
- FIH Erhvervsbank
- Huurre Group (manufacturing)
- Kaupthing Bank Luxembourg
- Lysing
- Singer & Friedlander

## Asset mix



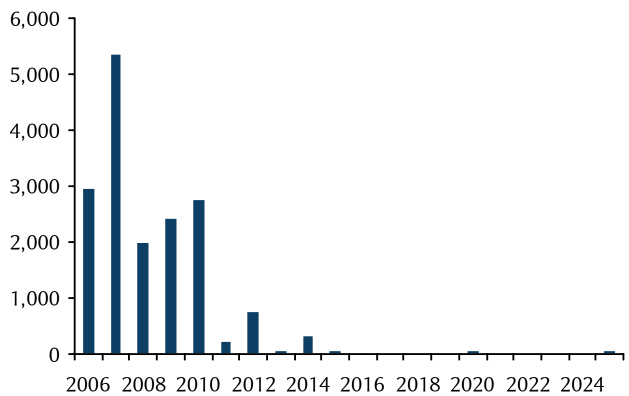

## Funding mix



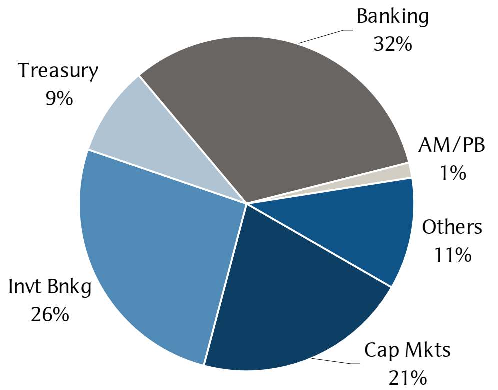

## Lending sector concentration

| Sector | % |
|---|---|
| Service | 23% |
| Industry | 20% |
| Retail | 18% |
| Real Estate | 14% |
| Trade | 13% |
| Holding cos | 11% |
| Transport | 1% |

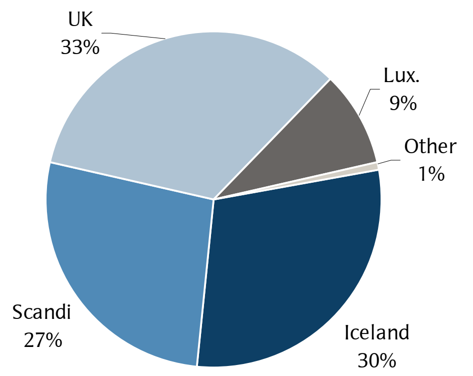
## Debt maturity




## Earnings by division




## Earnings by geography

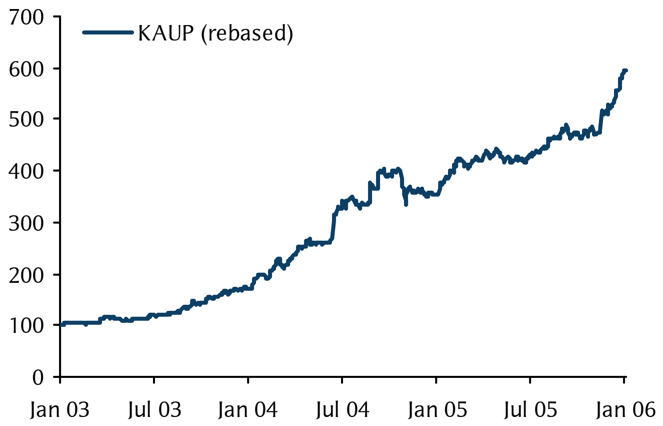



*Source: Company Reports & Presentations, Bloomberg, Moody's. Data as at 9M 05 unless otherwise stated.*

## Recent acquisitions

- 2002 – Acquired JP Nordiska (Sweden).
- 2002 – Acquired Aragon (Sweden).
- 2003 – Merger of Bunadarbanki and Kaupthing completed.
- 2004 – Acquired FIH (Denmark). Total assets of EUR9bn.
- 2005 – Acquired Singer & Friedlander (UK). Total assets of EUR4bn.

## Stock price trend




## Asset details

- Geographic mix – 40% of lending in Denmark, 25% in UK, 23% in Iceland (Fitch – Q3 05).
- 85% of lending non-ISK (Fitch - end 2004).
- Only 2 large exposures (>10% of equity), totalling 23% of equity (Fitch, Q3 05).

## Targets

- AM and PB business.
- Consolidate in North Europe. Focus growth on Finland, Luxemburg and UK.
- Lower operating costs, focusing in increasing income per employee.
- Return on Equity above 15%.

## Market risk

- 18% of assets consist of securities and hedging derivatives.
- Of these, 64% in bonds, 31% in shares and 5% in derivatives and other (Q3 05).
- Majority of shares are in listed Icelandic names.
- 43% of the bond portfolio is hedged, leaving a net exposure of ISK134bn (Fitch, H1 05).
- 29% of the equity portfolio is hedged. Net exposure is ISK77bn.
- Interest rate risk – 100bp rise in yield curve would cause a ISK3bn hit to P&L and ISK10bn M-T-M in the held-to-mat banking book (Fitch, Q3 05).

## Off-balance sheet items

- Guarantees of ISK468mn (Q3 05)
- Loan commitments of ISK90mn (Q3 05)
- Assets-under-Management of ISK1,200mn (Q3 05)

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