Iceland
Credit Analysis

# Landsbanki Islands

## Ratings

| Security Class | Current Ratings |
|---|---|
| **Foreign Currency** | |
| Long-Term IDR | A |
| Short-Term IDR | F1 |
| | |
| Individual | B/C |
| Support Rating | 2 |
| Support Rating Floor | BBB |
| | |
| **Sovereign Risk** | |
| Foreign Long-Term IDR | A+ |
| Local Long-Term IDR | AA+ |

## Outlook

| | |
|---|---|
| Foreign Long-Term IDR | Stable |
| Sovereign Foreign Long-Term | Stable |

## Financial Data

**Landsbanki Islands**

| | 30 Sep 07 | 31 Dec 06 |
|---|---|---|
| Total assets (USDm) | 45,157 | 30,323 |
| Total assets (ISKm) | 2,846,682 | 2,172,924 |
| Total equity (ISKm) | 179,971 | 149,457 |
| Operating profit (ISKm) | 35,345 | 46,053 |
| Published net income (ISKm) | 35,028 | 40,215 |
| Comprehensive income (ISKm) | 33,183 | 40,484 |
| Operating ROAA (%) | 1.88 | 2.57 |
| Operating ROAE (%) | 28.61 | 35.01 |
| Internal capital generation (%) | n.a. | 28.32 |
| Eligible capital/ | 9.93 | 12.83 |
| Tier 1 ratio (%) | 9.93 | 12.96 |

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## Related Research

- *The Icelandic Banks: Equipped to Weather the Current Liquidity Squeeze*

## Rating Rationale

- The ratings of Landsbanki Islands (Landsbanki) reflect its leading position in its domestic market, the growing diversification of its earnings, its prudent provisioning policies, comfortable capitalisation and marked improvement in its funding profile. They also take into account its still large equity portfolio and the potential volatility in its domestic market and in its capital-market related activities.
- Underlying profitability (excluding the large financial gains) is good despite the rapid increase in costs following the recent expansion in brokerage and investment banking activities in the UK and rest of Europe. In its home market, which still generates almost half of total net interest and commission income, Landsbanki is focusing on maintaining its large market shares by offering more services to its existing customers.
- Asset quality is good. The expected economic slowdown in Iceland, combined with higher interest rates, should lead to increasing levels of arrears. However, non-performing loans are still at cyclically low levels, and Landsbanki has been building a buffer in its loan impairment to cover for any increase in problem loans. Around 40% of lending is to Icelandic customers, and foreign lending is increasing.
- Market risk mainly arises from the bank's equity portfolio, which although reducing, still represents a large market risk. A large FX position has been built to hedge the capital ratios against the volatile ISK.
- Successful initiatives to attract customer deposits have resulted in a material change in the bank's funding profile. The high capital ratios support the bank's ratings in the current context of volatile markets and an expected economic slowdown in Iceland.

### Support

- The Icelandic authorities have no legal obligation to rescue banks in difficulty. However, given Landsbanki's domestic importance, Fitch Ratings believes that there is a high probability that support would be forthcoming, if required.

## Key Rating Drivers

- The Stable Outlook is based on the growing diversification of activities outside Iceland, which should support revenue generation and offset a potentially volatile domestic market, and progress made in integrating the overseas lending and investment banking franchise.
- Downward pressure on the ratings could arise if the bank were to report significant volatility in its overall profitability, driven by its potentially volatile capital-markets-driven businesses.

## Profile

Landsbanki is Iceland's second-largest bank by total assets but the largest in its domestic market, with strong market shares. Overseas, it has rapidly developed its UK and European corporate and investment banking franchise (mostly through acquisitions). It has recently bought four brokerage houses.

- Strong domestic position with a market share of around 30%
- Expansion in Europe through acquisitions: focus on corporate and investment banking services for mid-caps

## Profile

Landsbanki was established as a state bank in 1885, initially carrying out commercial banking activities. Between 1928 and 1957 it also fulfilled the functions of a central bank. Throughout its history, Landsbanki has played a key role in the development of the Icelandic economy and was fully privatised in 2002. Landsbanki is currently the second-largest bank in Iceland by total assets but has the largest domestic operations. It benefits from leading market shares of above 30% in many areas, supported by a strong national franchise serviced through the largest branch network in Iceland (nearly 40 branches). At end-September 2007, it employed 2,499 staff, of which 56% were in Iceland.

Landsbanki remains relatively dominated by its domestic market, where it acts as a universal retail and corporate bank. Iceland accounts for around 60% of the group's profit before tax, more than half of revenue and around 40% of lending (excluding Iceland-based international groups). Landsbanki has rationalised its branch network to gain efficiency in its fairly saturated domestic market. Its focus is on maintaining its large market shares (around 40% in corporate lending, 30% in retail banking and 34% in fund management) by offering a wider range of services to its existing customers.

Outside Iceland, Landsbanki has been building up a European lending platform, with operations focused on the UK (including Heritable Bank Limited (rated 'A'), a 100%-owned subsidiary focusing on real estate financing, and Landsbanki's London branch) and the Netherlands, through a branch in Amsterdam providing mostly structured and asset-backed financing to medium-sized enterprises. Further acquisitions complementing the existing European lending franchise cannot be ruled out. Landsbanki has also been building up a pan-European investment banking services platform for mid-caps, mainly through the acquisitions in recent years of several brokerage and corporate advisory companies: 50% of Irish Merrion Capital, Paris-based Kepler Equities (Kepler), UK Teather & Greenwood and Bridgewell Group (Bridgewell, completed in August 2007), the latter two were merged in Q307 to form Landsbanki Securities UK. These independent brokerage houses have provided Landsbanki with wide research coverage of mid-caps (around 900 names) in most of the major European countries and a distribution network mostly in Western Europe but also in New York, servicing institutional customers. The brokerage firms have maintained their local name but have adopted the group's logo and share their client base. As a result of these acquisitions and organic growth, Landsbanki now offers the full range of corporate and investment banking products, including M&A advisory, debt financing and placement capabilities, in most of Europe's major financial centres.

Landsbanki has structured its operations into four business units: retail banking (consisting mostly of Iceland but also Heritable Bank's residential mortgage lending), corporate banking (the focus is on mid-caps, structured and asset-backed financing), investment banking (including securities brokerage, corporate advisory, proprietary trading and treasury), and asset management/private banking (a large part of which is located in Luxembourg). The retail banking business unit accounted for only 12% of pre-tax profit in the first nine months of 2007 (9M07), reflecting Landsbanki's strong focus on corporate and investment banking.

### Ownership

Samson Holding ehf, an Icelandic holding company, owns around 41% of Landsbanki, while the next largest shareholders (mostly institutional investors) hold stakes of below 5%. Landsbanki's chairman is one of the three co-owners of Samson Holding ehf, along with his son, who acts as chairman of Straumur-Burdaras Investment Bank (rated 'BBB-').

- Underlying operating ROE around 20% in 9M07
- Profitability benefiting from lively fee-driven brokerage/investment banking
- Reported profit still boosted by large equity gains

## Presentation of the Accounts

Data in the attached spreadsheets are under IFRS. Bridgewell results are consolidated in Landsbanki's accounts from 10 August 2007.

# Performance

Over the past five years, Landsbanki has achieved rapid balance sheet and revenue growth, supported by a combination of acquisitions and organic growth. Profitability has benefited from a buoyant domestic market and large trading gains in the bank's equity portfolio, although reliance on these gains has gradually abated. While real GDP growth in Iceland was strong, at an average of nearly 5% during 2003-2006, the Icelandic economy is slowing down; Fitch expects a growth rate of 1.4% in 2007 and 2.5% in 2008.

Performance in 9M07 and 2006 continued to be characterised by strong growth, supported by the expansion in international activities. Revenue diversification has benefited from the build-up, mostly through acquisitions, of fee-generating brokerage/investment banking operations, although these are reliant on capital markets development. During 9M07, Iceland generated 48% of underlying income, excluding financial gains, reflecting the still large proportion of Iceland-related lending. The net position in inflation-linked assets in Iceland and reduction in the inflation rate had a slight negative impact on the overall net interest margin. UK and Ireland generated 26% of 9M07 underlying income, Luxembourg 8%, the remainder being mostly split between Scandinavia and Continental Europe. Around three-quarters of fee income related to the investment banking division, mainly generated by the brokerage activities. Landsbanki's reported profitability in 2006 and 9M07 continued to benefit from large trading gains in the bank's equity portfolio. Excluding financial gains, as well as the gain on the sale of a real estate company in Q107 (under 'Other Income and Expenses' in the spreadsheet), the underlying operating ROE and cost/income ratio were around 20% and 58% for 9M07, respectively. The turbulence in the global fixed-income markets in Q307 had a small impact on the bank's performance, with gains on the equity portfolio and in foreign exchange (see *Market Risk*) more than offsetting unrealised valuation losses of around ISK3.4bn in the fixed-income portfolio. The increase in the underlying cost/income ratio (from 51% in 9M06) is mostly attributable to the growing proportion of investment banking/brokerage activities, where the cost structure is by nature higher than that of more lending-orientated banking activities.

**Table 1: Icelandic Bank Peer Group Comparison**

| | Landsbanki ('A'/'B/C') | | Glitnir ('A'/'B/C') | | Kaupthing Bank ('A'/'B/C') | |
|---|---|---|---|---|---|---|
| (%) | 9M07 | 2006 | 9M07 | 2006 | 9M07 | 2006 |
| Net interest margin | 2.31 | 2.61 | 1.49 | 2.04 | 2.01 | 1.88 |
| Cost/income | 50.25 | 43.20 | 50.68 | 37.60 | 43.52 | 45.28 |
| Operating ROA | 1.88 | 2.57 | 1.51 | 2.26 | 2.12 | 2.09 |
| Operating ROE | 28.61 | 35.01 | 24.35 | 36.54 | 27.88 | 25.62 |
| Tier 1 capital ratio | 9.93 | 12.96 | 8.47 | 10.84 | 9.30 | 10.50 |
| Total equity (ISKbn) | 180.0 | 149.5 | 166.4 | 145.5 | 345.6 | 334.9 |

Source: Banks' interim and annual reports, figures adjusted by Fitch

## Investment Banking

Investment banking remains the largest contributor to profit, with net commission income representing slightly more than half of total revenue; the remainder is net financial income, mostly in the equity portfolio. This division has benefited the most from the recent acquisitions of brokerage houses, and its profit generation will remain to a large extent reliant on capital markets development. Net commission income in the division was up 61% in 9M07 yoy, on the back of external growth and a favourable environment. Costs as a percentage of revenue have increased between 9M06 and 9M07, reflecting further integration charges and the consolidation of new

**Table 2: Pre-Tax Profit by Division**

| (ISKm) | 9M07 | 9M06 |
|---|---|---|
| Retail banking | 5,064 | 5,189 |
| Corporate banking | 16,599 | 12,218 |
| Investment banking | 17,623 | 13,653 |
| Asset mgt & private banking | 2,592 | 2,294 |
| Eliminations | -2,243 | -1,116 |
| **Total** | **39,636** | **32,237** |

Source: Landsbanki's interim reports

- Credit risk mainly to the corporate sector but benefits from prudent provisioning
- Some concentration risk
- Market risk arising from reduced but still high exposure to equity market

operations with a higher cost/income ratio. Corporate banking in 9M07 generated a profit broadly comparable to that of investment banking; growth of 36% yoy in pre-tax profit was supported by favourable demand in the domestic market and growth in the London and Amsterdam platforms and in Heritable bank. Activity in leverage finance is likely to abate significantly as a result of the current market conditions. Retail banking was the only division not generating any profit growth in 9M07, despite growth in Heritable Bank's retail operations. Part of it is attributable to the slowdown of the Icelandic economy and the dampening effect of higher interest rates on demand for mortgage products. The higher impairment charge in the division in 9M07, though mostly collective impairment charge, also contributed to a flat profit generation. With a cost/income ratio of around 52%, the profitability of the retail banking division is sound and should benefit from further economies of scale as Heritable Bank's loan book grows. The asset management and private banking division benefits from the group's presence in Luxembourg and growth of 44% in assets under management during 9M07.

### Prospects

The expansion of Landsbanki's overseas activities has materially improved its income-generating capacity and the quality of its earnings. The growth in interest and fee income through acquisitions and expansion abroad has helped to reduce the bank's reliance on its volatile domestic market, although the latter remains the most profitable platform for the bank. Further consolidation of overseas activities, mostly capital-market driven to date, should help mitigate the potential volatility in these operations. Further acquisitions to strengthen Landsbanki's overseas operations cannot be excluded. This was illustrated in November 2007 by the preliminary offer for UK's Close Brothers Group made in conjunction with Cenkos Securities, under which Landsbanki seeks to acquire the target's banking business (Close Brothers Limited, rated 'A').

## Risk Management

Landsbanki's expansion strategy has so far been more focused on buying investment banking/brokerage boutiques rather than lending businesses. As a result, in comparison with its domestic peers, a larger part of its balance sheet remains related to Iceland. The bank is exposed to credit risk through its large loan book but also to market risk from its equity portfolio. Operational risk mainly arises in the integration of recently acquired businesses.

### Credit Risk

Credit risk is managed on a group basis from Reykjavik. Credit policies are approved by the board of directors and set by the group credit committee, which also approves underwriting standards and sectoral concentration limits, and grants credit approval authority. The credit control unit monitors the credit portfolio's risk profile and problem loans. Heritable Bank's management has retained significant independence in managing its own credit risk, and commitments of up to GBP10m are approved internally. Landsbanki adopted the standardised approach in 2007 for credit risk under Basel II but plans to move to the advanced internal ratings-based approach at a later stage, at least for its foreign exposure.

The loan portfolio accounted for around two-thirds of total assets at end-September 2007. Iceland-based customers represented 60% of total lending, of which at least one-third are large international companies, the UK and Ireland 21%, Luxembourg 13% and the remainder was mostly to customers in Scandinavia and Western Europe. The growth rate in 9M07 was broadly similar in both the corporate and retail loan books, at around 25% over the period. The corporate portfolio continued to represent more than three-quarters of total lending at end-September 2007; retail lending, mostly Icelandic but also to a smaller extent residential mortgage lending in the UK, accounted for 20%, and public entities for 2%.

Over the past few years, many Icelandic corporates have been expanding rapidly but they generally remain too small to access the capital markets for funding and therefore remain reliant on bank funding. Loans to companies in the service sector (including holding companies) represented around half of total corporate lending at end-September 2007, mirroring to a large extent the Icelandic corporate market; the fishing industry accounted for a stable 10%. Abroad, Landsbanki's London branch has been expanding rapidly in the European syndicated loan market and is also active in higher-margin (although under strong competitive pressure) but higher-risk leverage and acquisition finance, with a book representing around 15% of total lending. The leverage and acquisition finance book is spread across nearly 150 names, and the performance is sound, although two of the largest problem loans do originate from this book.

The exposure to the real estate sector through residential mortgages and loans to real estate companies is relatively limited. Residential mortgages represented around 11% of Landsbanki's loan portfolio at end-June 2007. Exposure to the real estate sector is mostly spread between Iceland and the UK. Heritable Bank's residential mortgages have grown rapidly, to represent around 57% of the UK bank's loan book at end-2006 (around ISK92bn), the remainder consisting in loans to real estate developers and asset finance. The underlying risk of around ISK47bn of Landsbanki's Icelandic mortgage book has been sold to an outside investor. The average loan/value ratio (LTV) is 61%; in Iceland, Landsbanki's maximum LTV is 80%. Landsbanki does offer mortgage loans to Icelandic retail customers in foreign currencies, but the maximum LTV is then 70%, and affordability criteria are tighter. This activity remains limited relative to the group at less than 10% of the parent's mortgage lending. The demand for residential mortgage lending in Iceland slowed at the end of summer 2007. Other lending to individuals includes mostly overdraft balances. Fitch is informed that loans granted to finance the purchase of shares accounted for less than 5% of retail lending. Reported related-party lending amounted to ISK54bn at end-September 2007.

Landsbanki has some concentration risk, including the fact that in a few cases the bank has equity holdings in its largest credit exposures. At end-June 2007, the eight largest combined exposures (equity holding and credit risk) were together greater than 160% of Landsbanki's Fitch eligible capital. The 20 largest exposures accounted for around 30% of total lending. These exposures are generally to diversified Iceland-based groups/holding companies.

## Loan Losses and Impairment

Asset quality indicators are good. Non-performing loans (90 days overdue) are small at 0.29% of gross loans at end-September 2007, despite a slight increase from historically low levels. Total overdue loans (ie from day one) accounted for a modest 0.75% of gross loans. At end-June 2007, around a quarter of the outstanding loan book had been granted during H107, illustrating a relatively unseasoned book. In Iceland, the impact of the expected economic slowdown and increases in interest rates on the borrowers remains to be seen. A large proportion of long-term lending in Iceland is CPI-indexed, limiting somewhat the impact of rising interest rates on borrowers. Reserve coverage is high, at more than 140% of total overdue loans at end-September 2007. Compared with peers, loan impairment charges might appear high at 39bp of gross loans in 9M07; however, Landsbanki's management has been building up loan impairment in light of its volatile domestic environment, and a large part of the 9M07 charges related to collective allowance. Loan impairment allowance represented 1.1% of gross loans at end-September 2007.

Other earning assets (29% of end-September 2007 total assets) include interbank exposure (around 5%), bonds (around 15%) and equity holdings (about 6.5%) as well as derivatives (around 2%). Landsbanki does not have any exposure to the US subprime sector or to US structured credit instruments. Interbank assets are with Icelandic and large foreign banks rated at least 'A'. At end-September 2007, around

ISK58bn bonds and ISK114bn equities related to collateralised forward securities sales to customers. The portfolio of listed bonds (EUR4.3bn or ISK382bn) is used for liquidity purposes and invested mostly in highly rated bank bonds (73% at end-September 2007), the remainder being government bonds (19%) and corporate bonds; a quarter was rated 'AAA', 46% 'AA', the rest being rated 'A' or 'BBB', with 2% non-rated. Nearly three-quarters of the bank's equity exposure (excluding where risk is hedged) were foreign shares, mostly in the UK and Scandinavia; there is concentration in its Icelandic portfolio. Unlisted equities increased to ISK32bn at end-September 2007 as a result of pharmaceutical company Actavis being taken private. Derivatives are used mainly for hedging purposes (mostly FX and interest rate swaps) and customer-driven business; counterparties are mostly large European banks.

### Market Risk

The assets and liabilities committee is responsible for the management of market risk. Landsbanki's biggest market risk arises from its equity exposure, followed by interest rate risk. The equity portfolio is closely monitored, in particular through a value-at-risk (VaR) model and stress-test scenarios. Landsbanki has set up a limit for its net equity exposure (ie excluding customer-driven collateralised forward equity sales) at 3% of total assets, roughly split one-third/two-thirds between unlisted and listed shares. Landsbanki's net equity exposure at end-September 2007 represented 34% of its Fitch eligible capital. The highest equity VaR in 9M07 reached ISK10.4bn (99% confidence level, 10-day holding period), ie 5% of end-September 2007 eligible capital.

The VaR limits set up for interest rate risk in Landsbanki's trading book are much lower than those for equity risk. Interest rate risk arises mainly from mismatches in inflation-linked assets (mostly the domestic mortgage lending book) and liabilities; a 100 basis point interest rate shift would result in a moderate profit/loss of around ISK2.8bn at end-September 2007. At end-September 2007, Landsbanki had a large net foreign currency position against the ISK (around EUR800m or ISK70bn), representing a high 32% of its Fitch eligible capital. It has built up this position since the beginning of July 2007, with approval from the Icelandic authorities, as a way to hedge its capital ratios against a depreciation of the ISK, given its large proportion of foreign currency assets. The financial effect of this position has been booked through the profit and loss account in Q307; however, the bank might use hedged accounting in the future (in line with the other Icelandic banks), reporting the financial impact in equity.

### Operational Risk

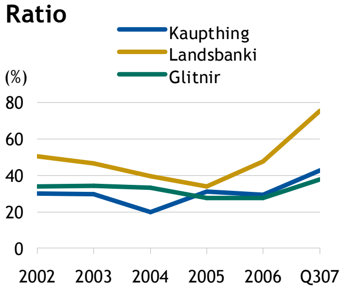
Landsbanki's rapid expansion abroad raises some integration risk. The bank has developed a risk matrix, in which the probability and severity of each risk category is assessed. It is close to completing the development of a Basel II compliant loss events database and has adopted the standardised approach to measure operational risk. A business continuity plan is in place.

## Funding and Capital

- No longer reliant on wholesale funding; rapid increase in deposits
- Good liquidity
- Good capitalisation

Of all the Icelandic banks, Landsbanki has over the past year been the most successful in raising customer deposits. At end-September 2007, customer deposits funded a comfortable 76% of customer loans, a staggering increase from a relatively low 34% at end-2005, resulting in a material shift in the bank's funding profile. Recent initiatives to attract deposits include UK internet saving account IceSave, launched in October 2006 (around GBP4.4bn of retail deposits at end-September 2007), and the acquisition of offshore platform Landsbanki Guernsey. Fitch expects future growth to slow down, the more so as competition for UK retail deposits has been increasing recently, given the wholesale market conditions. The guarantee of the IceSave interest rate beating the Bank of England base rate until at least October 2009, the limited single concentration levels and current initiatives to

**Icelandic Banks' Customer Deposits/Customer Lending Ratio**




Source: Fitch

convert existing accounts into term deposits should help support the future stability of this new retail deposit base. At end-September 2007, customer deposits were split 60% UK and Offshore, 17% Luxembourg and Amsterdam platforms, and Iceland 23%. The increase in customer deposits has taken a significant amount of pressure off the funding capacities of the bank, previously reliant on wholesale funding. Despite the marked increase in credit default spreads as a result of the turmoil on the fixed-income markets since summer 2007, Landsbanki's access to wholesale funding should benefit from effort made to diversify its investor base and limited refinancing needs in 2008.

Landsbanki's liquidity is good. At end-September 2007, the bank estimated its liquid assets at around EUR6.4bn (ISK560bn), consisting mainly of loans to financial institutions and unencumbered listed bonds, and around EUR9.7bn (ISK850bn) including assets eligible for securitisation after haircuts. Without taking into consideration these assets eligible for securitisation, Landsbanki would still be able to operate for about 12 months without access to the capital markets, even assuming that all term deposits are repaid at maturity.

Landsbanki's rapid organic and external growth has been supported by a continued strengthening of its capital base, both through capital issues and retained earnings. In August 2007, Landsbanki financed 90% of the price paid for Bridgewell by a new share issue. In addition, the dividend policy has historically been very moderate, with an average pay-out ratio in the past five years of below 25%. The Fitch eligible capital ratio stood at a good 9.9% at end-September 2007, with eligible capital including 26% of hybrid instruments, close to Fitch's tolerance level of 30%. In October 2007, capitalisation was strengthened further through a USD400m issue of hybrid Tier 1 instruments, improving the capital ratios by 120bp. Landsbanki's hybrid Tier 1 issues have been assigned 100% equity credit, based on — among other things — their permanent and non-cumulative features. The amount of hybrid instruments denominated in foreign currencies and the foreign currency position maintained by the bank contribute to limit the sensitivity of Landsbanki's capital ratios to volatility in the ISK. The implementation of Basel II had a minimal impact on the capital ratios.

**Balance Sheet Analysis**
**LANDSBANKI ISLANDS**

| | 30 Sep 2007 | | | | 31 Dec 2006 | | 31 Dec 2005 | |
|---|---|---|---|---|---|---|---|---|
| | 9 Months - 3rd Quarter USDm Original | 9 Months - 3rd Quarter ISKm Original | As % of Assets Original | Average ISKm Original | Year End ISKm Original | As % of Assets Original | Year End ISKm Original | As % of Assets Original |
| A. LOANS | | | | | | | | |
| 1. Private | 5,913.7 | 372,800.0 | 13.10 | 335,967.5 | 299,135.0 | 13.77 | 244,634.0 | 17.41 |
| 2. Corporate | 23,092.4 | 1,455,743.0 | 51.14 | 1,301,360.5 | 1,146,978.0 | 52.79 | 745,434.0 | 53.04 |
| 3. Government | 503.5 | 31,740.0 | 1.11 | 20,316.0 | 8,892.0 | 0.41 | 7,670.0 | 0.55 |
| 4. Other | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| 5. Loan Impairment | 312.5 | 19,699.0 | 0.69 | 18,155.0 | 16,611.0 | 0.76 | 13,144.0 | 0.94 |
| 6. Loan Impairment (memo) | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| 7. Less: Loans from the Insurance Business | 0.0 | 0.0 | 0.00 | 0.0 | 0.0 | 0.00 | n.a. | - |
| **TOTAL A** | **29,197.1** | **1,840,584.0** | **64.66** | **1,639,489.0** | **1,438,394.0** | **66.20** | **984,594.0** | **70.05** |
| B. OTHER EARNING ASSETS | | | | | | | | |
| 1. Loans and Advances to Banks | 2,131.6 | 134,379.0 | 4.72 | 174,998.5 | 215,618.0 | 9.92 | 86,919.0 | 6.18 |
| 2. Government Securities | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| 3. Trading Assets | 8,611.9 | 542,897.0 | 19.07 | 422,688.5 | 302,480.0 | 13.92 | 205,007.0 | 14.59 |
| 4. Derivatives | 777.6 | 49,019.0 | 1.72 | 48,937.5 | 48,856.0 | 2.25 | 18,575.0 | 1.32 |
| 5. Other Securities and Investments | 226.5 | 14,278.0 | 0.50 | 7,139.0 | 0.0 | 0.00 | 0.0 | 0.00 |
| 6. Equity Investments | 1,182.3 | 74,533.0 | 2.62 | 50,003.5 | 25,474.0 | 1.17 | 38,938.0 | 2.77 |
| 7. Insurance | 0.0 | 0.0 | 0.00 | 0.0 | 0.0 | 0.00 | n.a. | - |
| **TOTAL B** | **12,930.0** | **815,106.0** | **28.63** | **703,767.0** | **592,428.0** | **27.26** | **349,439.0** | **24.86** |
| **C. TOTAL EARNING ASSETS (A+B)** | **42,127.1** | **2,655,690.0** | **93.29** | **2,343,256.0** | **2,030,822.0** | **93.46** | **1,334,033.0** | **94.92** |
| **D. TANGIBLE FIXED ASSETS** | **160.9** | **10,142.0** | **0.36** | **7,982.5** | **5,823.0** | **0.27** | **4,260.0** | **0.30** |
| E. NON-EARNING ASSETS | | | | | | | | |
| 1. Cash and Due from Banks | 768.4 | 48,440.0 | 1.70 | 40,054.5 | 31,669.0 | 1.46 | 16,611.0 | 1.18 |
| 2. Other | 2,100.4 | 132,410.0 | 4.65 | 118,510.0 | 104,610.0 | 4.81 | 50,556.0 | 3.60 |
| **F. TOTAL ASSETS** | **45,156.8** | **2,846,682.0** | **100.00** | **2,509,803.0** | **2,172,924.0** | **100.00** | **1,405,460.0** | **100.00** |
| G. DEPOSITS & MONEY MARKET FUNDING | | | | | | | | |
| 1. Due to Customers - Current | 11,659.0 | 734,984.0 | 25.82 | 482,319.0 | 229,654.0 | 10.57 | 113,834.0 | 8.10 |
| 2. Due to Customers - Savings | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| 3. Due to Customers - Term | 10,390.8 | 655,038.0 | 23.01 | 554,115.0 | 453,192.0 | 20.86 | 220,329.0 | 15.68 |
| 4. Deposits with Banks | 1,707.6 | 107,645.0 | 3.78 | 77,048.0 | 46,451.0 | 2.14 | 44,730.0 | 3.18 |
| 5. Other Deposits and Short-term Borrowings | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| **TOTAL G** | **23,757.4** | **1,497,667.0** | **52.61** | **1,113,482.0** | **729,297.0** | **33.56** | **378,893.0** | **26.96** |
| H. OTHER LIABILITIES | | | | | | | | |
| 1. Derivatives | 911.0 | 57,427.0 | 2.02 | 42,383.0 | 27,339.0 | 1.26 | 30,590.0 | 2.18 |
| 2. Trading Liabilities | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| 3. Fair Value Portion of Debt | 795.0 | 50,119.0 | 1.76 | n.a. | n.a. | - | n.a. | - |
| 4. Insurance | 0.0 | 0.0 | 0.00 | 0.0 | 0.0 | 0.00 | n.a. | - |
| **TOTAL H** | **1,706.0** | **107,546.0** | **3.78** | **67,442.5** | **27,339.0** | **1.26** | **30,590.0** | **2.18** |
| I. OTHER FUNDING | | | | | | | | |
| 1. Long-term Borrowing | 13,520.2 | 852,316.0 | 29.94 | 980,973.0 | 1,109,630.0 | 51.07 | 789,855.0 | 56.20 |
| 2. Subordinated Debt | 448.9 | 28,299.0 | 0.99 | 28,982.0 | 29,665.0 | 1.37 | 26,674.0 | 1.90 |
| 3. Other Funding | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| **TOTAL I** | **13,969.1** | **880,615.0** | **30.93** | **1,009,955.0** | **1,139,295.0** | **52.43** | **816,529.0** | **58.10** |
| **J. NON-INTEREST BEARING** | **2,009.3** | **126,665.0** | **4.45** | **97,056.0** | **67,447.0** | **3.10** | **43,432.0** | **3.09** |
| K. HYBRID CAPITAL | | | | | | | | |
| 1. Hybrid capital accounted for as equity | 860.1 | 54,218.0 | 1.90 | 57,153.5 | 60,089.0 | 2.77 | 22,400.0 | 1.59 |
| 2. Hybrid Capital accounted for as debt | n.a. | n.a. | - | n.a. | n.a. | - | n.a. | - |
| **L. TOTAL LIABILITIES** | **42,301.9** | **2,666,711.0** | **93.68** | **2,345,089.0** | **2,023,467.0** | **93.12** | **1,291,844.0** | **91.92** |
| M. EQUITY | | | | | | | | |
| 1. Common Equity | 2,796.2 | 176,271.0 | 6.19 | 159,246.5 | 142,222.0 | 6.55 | 108,268.0 | 7.70 |
| 2. Minority Interest | 55.3 | 3,485.0 | 0.12 | 4,330.0 | 5,175.0 | 0.24 | 3,557.0 | 0.25 |
| 3. Revaluation Reserves | 3.4 | 215.0 | 0.01 | 1,137.5 | 2,060.0 | 0.09 | 1,791.0 | 0.13 |
| **TOTAL M** | **2,854.9** | **179,971.0** | **6.32** | **164,714.0** | **149,457.0** | **6.88** | **113,616.0** | **8.08** |
| **MEMO:CORE CAPITAL** | **2,459.7** | **155,057.0** | **5.45** | **145,188.0** | **135,319.0** | **6.23** | **102,445.0** | **7.29** |
| **MEMO: ELIGIBLE CAPITAL** | **3,319.7** | **209,275.0** | **7.35** | **201,294.0** | **193,312.9** | **8.90** | **124,845.0** | **8.88** |
| **N. TOTAL LIABILITIES & EQUITY** | **45,156.8** | **2,846,682.0** | **100.00** | **2,509,803.0** | **2,172,924.0** | **100.00** | **1,405,460.0** | **100.00** |
| Exchange Rate | | USD1 = ISK 63.0400 | | | USD1 = ISK 71.6600 | | USD1 = ISK 62.9800 | |

**Income Statement Analysis**
**LANDSBANKI ISLANDS**

| | 30 Sep 2007 | | 31 Dec 2006 | | 31 Dec 2005 | |
|---|---|---|---|---|---|---|
| | Income Expenses ISKm Original | As % of Total AV Earning Assts Original | Income Expenses ISKm Original | As % of Total AV Earning Assts Original | Income Expenses ISKm Original | As % of Total AV Earning Assts Original |
| 1. Interest Income | 145,938.0 | 8.30 | 135,465.0 | 8.05 | 67,510.0 | 6.64 |
| 2. Interest Expense | 105,335.0 | 5.99 | 91,611.0 | 5.45 | 43,441.0 | 4.27 |
| **3. NET INTEREST REVENUE** | **40,603.0** | **2.31** | **43,854.0** | **2.61** | **24,069.0** | **2.37** |
| 4. Net Fees & Commissions | 29,708.0 | 1.69 | 28,367.0 | 1.69 | 16,725.0 | 1.64 |
| 5. Net Insurance Revenue | 0.0 | 0.00 | 0.0 | 0.00 | n.a. | - |
| 6. Other Operating Income | 10,486.0 | 0.60 | 17,291.0 | 1.03 | 19,034.0 | 1.87 |
| 7. Personnel Expenses | 26,919.0 | 1.53 | 23,803.0 | 1.41 | 12,682.0 | 1.25 |
| 8. Other Operating Expenses | 13,704.0 | 0.78 | 14,131.0 | 0.84 | 8,286.0 | 0.81 |
| **9. PRE-IMPAIRMENT OPERATING PROFIT** | **40,174.0** | **2.29** | **51,578.0** | **3.07** | **38,860.0** | **3.82** |
| 10. Loan Impairment Charge | 4,829.0 | 0.27 | 5,525.0 | 0.33 | 6,210.0 | 0.61 |
| 11. Other Credit Impairment and Provisions | n.a. | - | n.a. | - | n.a. | - |
| **12. OPERATING PROFIT** | **35,345.0** | **2.01** | **46,053.0** | **2.74** | **32,650.0** | **3.21** |
| 13. Other Income and Expenses | 4,291.0 | 0.24 | -1,359.0 | -0.08 | -1,869.0 | -0.18 |
| **14. PUBLISHED PRE-TAX PROFIT** | **39,636.0** | **2.26** | **44,694.0** | **2.66** | **30,781.0** | **3.03** |
| 15. Taxes | 4,608.0 | 0.26 | 4,479.0 | 0.27 | 5,764.0 | 0.57 |
| 16. Profit/(Loss) from Discontinued Operations | n.a. | - | n.a. | - | n.a. | - |
| 17. Change in Value of AFS investments | -1,864.0 | -0.11 | 0.0 | 0.00 | 1,864.0 | 0.18 |
| 18. CurrencyTranslation Differences | 19.0 | 0.00 | 269.0 | 0.02 | -53.0 | -0.01 |
| 19. Other Gains/(Losses) not in Published Net Income | n.a. | - | n.a. | - | n.a. | - |
| **20. FITCH COMPREHENSIVE INCOME** | **33,183.0** | **1.89** | **40,484.0** | **2.41** | **26,828.0** | **2.64** |
| 21. Total Gains/(Losses) not in Published Net Income | -1,845.0 | -0.10 | 269.0 | 0.02 | 1,811.0 | 0.18 |
| 22. IFRS Dividends included in Fitch Interest Expense | n.a. | - | n.a. | - | n.a. | - |
| **23. PUBLISHED NET INCOME** | **35,028.0** | **1.99** | **40,215.0** | **2.39** | **25,017.0** | **2.46** |

**Ratio Analysis**
**LANDSBANKI ISLANDS**

| | | 30 Sep 2007 | 31 Dec 2006 | 31 Dec 2005 |
|---|---|---|---|---|
| | | 9 Months - 3rd Quarter | Year End | Year End |
| | | ISKm | ISKm | ISKm |
| | | Original | Original | Original |
| **I. PERFORMANCE** | | | | |
| 1. Net Interest Margin | % | 2.31 | 2.61 | 2.37 |
| 2. Loan Yield | % | 9.44 | 9.04 | 6.88 |
| 3. Cost of Funds | % | 6.44 | 5.82 | 4.59 |
| 4. Costs/Average Assets | % | 2.16 | 2.12 | 1.96 |
| 5. Costs/Income | % | 50.25 | 43.20 | 36.20 |
| 6. Pre-Impairment Operating ROAA | % | 2.13 | 2.88 | 3.63 |
| 7. Operating ROAA | % | 1.88 | 2.57 | 3.05 |
| 8. Pre-impairment Operating ROAE | % | 32.52 | 39.21 | 51.02 |
| 9. Operating ROAE | % | 28.61 | 35.01 | 42.87 |
| **II. CAPITAL ADEQUACY** | | | | |
| 1. Internal Capital Generation | % | 26.86 | 28.32 | 30.97 |
| 2. Core Capital/Total Assets | % | 5.49 | 6.26 | 7.34 |
| 3. Eligible Capital/Regulatory Weighted Risks | % | 9.92 | 12.69 | 11.72 |
| 4. Eligible Capital+Eligible Revaluation Reserves/Regulatory Weighted Risks | % | 9.93 | 12.83 | 11.89 |
| 5. Tier 1 Regulatory Capital Ratio | % | 9.93 | 12.96 | 11.89 |
| 6. Total Regulatory Capital Ratio | % | 11.22 | 14.84 | 13.12 |
| 7. Free Capital/Equity | % | 74.60 | 69.65 | 68.63 |
| **III. LIQUIDITY (year end)** | | | | |
| 1. Liquid Assets/Deposits & Money Mkt Funding | % | 36.35 | 29.42 | 26.93 |
| 2. Loans/Deposits | % | 132.41 | 210.65 | 294.64 |
| **IV. ASSET QUALITY** | | | | |
| 1. Loan Impairment Charge/Gross Loans (av.) | % | 0.39 | 0.45 | 0.81 |
| 2. Total Credit Impairment/Pre-impairment Operating Profit | % | 12.02 | 10.71 | 15.98 |
| 3. Loan Impairment/Gross Impaired Loans | % | 363.12 | 559.29 | n.a. |
| 4. Individual Loan Impairment/Gross Impaired Loans | % | n.a. | n.a. | n.a. |
| 5. Impaired Loans Gross / Loans Gross | % | 0.30 | 0.21 | n.a. |
| 6. Impaired Loans Net/Eligible Capital | % | -6.82 | -7.06 | n.a. |
| 7. Net Charge-offs/Gross Loans (av.) | % | n.a. | n.a. | n.a. |