

Best in class, but not for the faint-hearted

■ Initiation of coverage on Landsbanki with a Neutral rating and ISK32 PT

Landsbanki is the second largest of the Icelandic banks. It is a corporate and investment bank with operations in Iceland, the UK and Ireland, and continental Europe. Its earnings streams have a lot in common with those of domestic competitors Kaupthing and Glitnir: balance sheet expansion has been aggressive, while acquisitions have been more focused (brokerages Kepler, Teather, Merrion), although their merit over the cycle has yet to be proven.

■ Most defensive among the Icelandic banks

We consider Landsbanki's risk profile to be above the European banks' average. Among the Icelandic banks, its profile is the most attractive in the current market environment, in our opinion, given its higher level of deposit funding (loan/deposits 142%). Consequently, we rate Landsbanki Neutral, and believe that its underperformance relative to Kaupthing and Glitnir of c3% YTD is undeserved.

■ What does the price reflect relative to the level of risk?

There are two central issues for the investment case: (1) to what extent will slowing balance sheet growth in 2008 weigh on results?; and (2) how much of the potential deceleration in capital market earnings, rising credit provisions and ISK decline is already in the price? Year-to-date share price performance of -18% compares with -16% for Glitnir and -14% for Kaupthing. We are 19% below consensus for 2009E, and our forecasts put the stock on 8.2x PER for 2008E – in line with the European banks sector.

■ Valuation: Neutral, price target ISK 32

We rate Landsbanki Neutral with a price target of ISK32 (based on GGM). The next catalyst is the first-quarter results on 6 May. Landsbanki is our preferred pick among the Icelandic banks.

Highlights (Iskm)	12/05	12/06	12/07E	12/08E	12/09E
Revenues	60,979	89,425	110,026	117,713	126,695
Pre-tax profits	30,783	44,693	45,555	45,728	44,488
Net income	25,019	38,905	38,800	38,576	37,436
EPS (UBS, Isk)	2.7	3.7	3.6	3.5	3.4
Net DPS (UBS, Isk)	0.3	0.3	0.5	0.5	0.5

Profitability & Valuation	5-yr hist av.	12/06	12/07E	12/08E	12/09E
ROE %	-	0.3	0.2	0.2	0.2
P/Op x	-	5.4	6.2	6.0	5.5
P/BVPS x	-	1.9	1.8	1.6	1.4
PE (UBS) x	-	6.8	7.9	8.1	8.3
Net dividend yield %	-	1.2	1.8	1.7	1.7

Source: Company accounts, Thomson Financial, UBS estimates. (UBS) valuations are stated before goodwill, exceptional and other special items. Valuations: based on an average share price that year, (E): based on a share price of Isk28.60 on 19 Feb 2008 17:35 EST

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Global Equity Research

Iceland

Banks, Ex-S&L

12-month rating **Neutral**
Prior: *Not Rated*

12m price target Isk32.00/US\$0.47

Price Isk28.60/US\$0.42

RIC: LAIS.IC BBG: LAIS IR

20 February 2008

Trading data (local/US\$)

52-wk range	Isk44.60-27.45/US\$0.74-0.40
Market cap.	Isk320bn/US\$4.72bn
Shares o/s	11,193m (ORD)
Free float	59%
Avg. daily volume ('000)	35,010
Avg. daily value (Iskm)	1,157.3

Balance sheet data 12/07E

Shareholders' equity	Isk184bn
P/BVPS x	1.8
Tier one capital ratio	10.1%

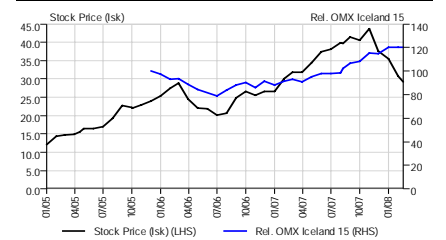
Forecast returns

Forecast price appreciation	+11.9%
Forecast dividend yield	1.7%
Forecast stock return	+13.6%
Market return assumption	18.7%
Forecast excess return	-5.1%

EPS (UBS, Isk)

	12/07E		12/06	
	From	To	Cons.	Actual
Q1	-	1.3	1.2	1.3
Q2	-	1.1	1.1	0.6
Q3	-	0.8	1.1	0.5
Q4	-	0.4	0.6	1.3
12/07E	-	3.6	3.6	
12/08E	-	3.5	3.3	

Performance (Isk)



Source: UBS

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ANALYST CERTIFICATION AND REQUIRED DISCLOSURES BEGIN ON PAGE 27.

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I would like to thank *Preeti Jasrasaria* for her assistance.

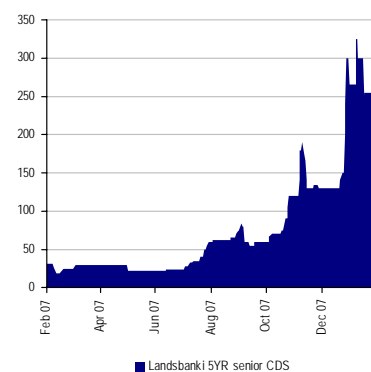
Investment Thesis

We initiate coverage on Landsbanki with a Neutral rating and ISK32 price target.

Landsbanki is our preferred pick in the Icelandic banks sector, where we would recommend that investors take only a very selective exposure for the moment, as CDS spreads remain at elevated levels. Landsbanki's comparably low loan/deposit ratio of 142% means it stands out in the Icelandic banks context: Kaupthing is at 238% and Glitnir at 272%.

The key risks to our investment case are funding, the young corporate loan book and potential acquisitions. We consider Landsbanki to be best in class, but it is not for the faint-hearted.

Chart 1: Landsbanki five-year senior CDS



Source: UBS Delta

Why Landsbanki is our preferred Icelandic bank

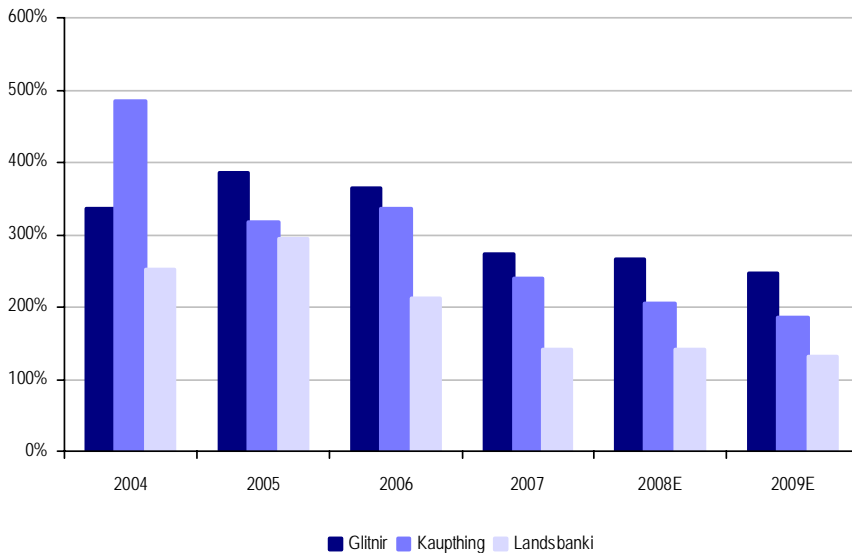
- (1) **Positioning:** Landsbanki is the second largest bank in Iceland – behind Kaupthing and just ahead of Glitnir Bank – in terms of balance sheet size and profits. Corporate and investment banking earnings accounted for 77% of pre-tax profits at year-end 2007. The mix is unlikely to change in favour of retail banking and we believe that this is likely to be as good as it gets.
- (2) **Equity investments:** The bank's equity portfolio accounts for 2.1% of total balance sheet assets – in line with 2006's standing and equivalent to 25% of profits.
- (3) **Funding constraints:** Significantly higher funding costs in 2008 mean that loan and investment flow will be slower and on a more selective basis. However, deposit funding is the highest among the Icelandic banks. With a loan/deposit ratio of 142%, it is in line with those of many other European banks, and significantly better than those of Kaupthing and Glitnir. In addition, only about €750m of debt will mature in 2008. Both factors will make Landsbanki's life easier, in our opinion.
- (4) **Expansion strategy - a pan-European broker:** Landsbanki has pursued a more measured expansion strategy outside its home market of Iceland relative to its peers. More recently, it has withdrawn from a hostile attempt to buy Close Brother's corporate banking book, which has reduced the investment risk. Landsbanki places more emphasis on acquiring brokerage and specialist investment banking boutiques than the other two Icelandic banks. Examples are Kepler, Teather & Greenwood and Merrion. The rationale for this is to use local platforms with an established brand name with which to build their corporate banking platforms.

Need to know...our sector view

- (1) **Sector stance:** We are underweight Icelandic banks in a European context, given the dependence on corporate banking and capital market earnings.
- (2) **Interest rates** in Iceland remain at stifling levels, ie, 13.75% (last raised in November), and the inflation forecast in the November issue of the Monetary Bulletin assumed an unchanged policy rate through mid-2008.

- (3) **Local Icelandic shareholdings:** We see domestic Icelandic shareholdings and cross-shareholdings as a risk factor, given that holding companies have significant stakes in the Icelandic banks. In the case of Landsbanki, Samson Holdings holds 40.7% of the bank.

Chart 2: Icelandic banks loan to deposit ratios



Source: Company reports, UBS estimates

UBS versus consensus

We are 19% below consensus for 2009E, but note that consensus in the case of Landsbanki is too small to be meaningful.

Table 1: UBS EPS forecasts versus consensus

ISK per share	2008E	2009E
UBS EPS for Landsbanki	3.27	3.17
Consensus	3.26	3.94
%	0%	-19%

Source: UBS estimates, Reuters

Earnings forecasts

We forecast earnings per share to fall 1% in 2008, which is the least negative performance for the Icelandic banks, and based on 7% customer loan growth, driving 12% NII growth on the back of higher average balances in 2007 (41% customer loan growth in 2007). Expected customer loan growth of 7% may slow during the year, primarily as a function of funding opportunities.

Our forecast of 5% fee and commission income growth in 2008 is based on the integration of Bridgwell. On a like-for-like basis, it would have been down year on year.

We forecast financial income to fall 5% in 2008 – a reflection of year-to-date equity market performance, which is particularly relevant for its portfolio of Nordic financials, and has had an impact on third- and fourth-quarter results already.

2008E EPS to fall 1% – the least negative performance for the Icelandic banks

Following significantly negative operating leverage in 2007 (revenues up 23% versus costs 49% higher), we expect costs to rise 6% against revenues 7% higher in 2008, leaving marginally positive operating leverage. If past cycles provide any guidance in a continually cooling environment, delivering positive operating jaws may not be achievable. What is important to realise, in our view, is that the spectacular years of earnings surprises in 2004-06 are behind us, as they were a reflection of growth from a low base and particularly high risk appetite.

The spectacular years of earnings surprises in 2004-06 are behind us

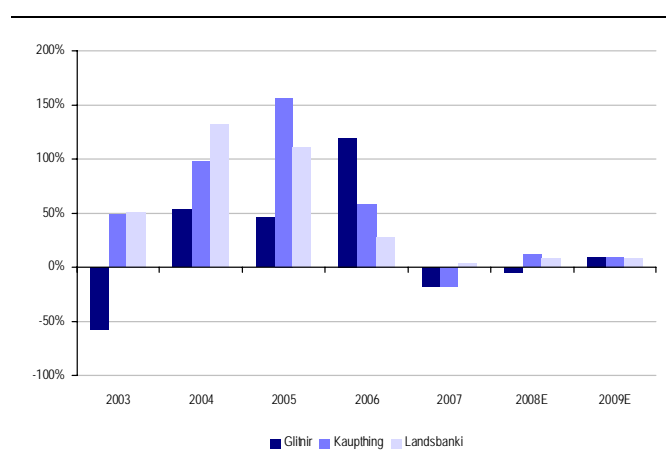
Table 2: Nordic bank peers of Landsbanki, Kaupthing and Glitnir

Country	Bank	UBS Rating	Price (lc)	PT (lc)	Up-/downside, %	Price performance			EPS growth			PBV 2008E	PER		
						2006	2007	2008	06/05	07E/06	08/07E		2007E	2008E	2009E
Iceland	Landsbanki	Neutral	29.0	32.0	10.3%	8%	32%	-18%	34%	-2%	-4%	1.6x	10.4x	8.3x	8.3x
	Kaupthing	Sell	720.0	650.0	-10.0%	17%	-17%	-16%	53%	-21%	-11%	1.3x	8.7x	8.7x	8.6x
	Glitnir	Sell	18.1	17.0	-6.3%	35%	-10%	-14%	98%	-23%	-10%	1.4x	11.2x	11.0x	11.3x
Sweden	Swedbank	Buy	173.0	260.0	50.3%	15%	-28%	-6%	-7%	6%	0%	1.5x	7.4x	6.8x	6.3x
	Nordea	Sell	91.9	90.0	-2.19%	28%	-2%	-15%	43%	-6%	-22%	1.5x	8.9x	10.8x	11.0x
	SEB	Neutral	152	180.0	18.4%	33%	-24%	-8%	52%	7%	-13%	1.6x	7.5x	8.4x	8.1x
	SHB	Neutral	183.5	220.0	19.9%	5%	-2%	-11%	19%	-4%	-5%	1.6x	9.8x	9.6x	9.0x
Denmark	Danske Bank	Neutral	179.0	195.0	8.9%	13%	-22%	-10%	14%	0%	-10%	1.5x	7.8x	8.8x	8.4x
Norway	DnB Nor	Neutral	78.5	85.0	8.3%	23%	-9%	-5%	15%	-2%	-2%	1.3x	9.0x	8.8x	8.3x

Source: UBS estimates

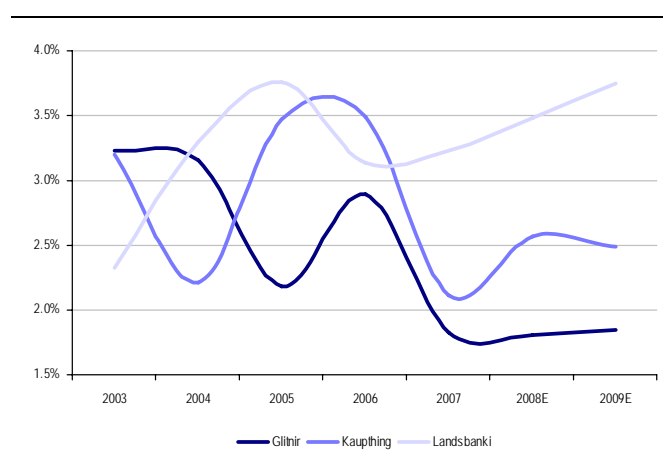
Landsbanki has achieved a relatively more stable delivery of gross operating profits (GOP) than Kaupthing and Glitnir. The margin over RWA tells us that Landsbanki is better than its peers, but may have more to suffer if brokerage income slows.

Chart 3: GOP delivery, 2003-09E



Source: Landsbanki, UBS estimates

Chart 4: GOP/RWA, 2003-09E



Source: Landsbanki, UBS estimates

Upcoming catalysts

- **28 February: Monthly economic indicators by the Icelandic central bank**
- **6 May: Publication of first quarter 2008 results.**

Landsbanki valuation

We value Landsbanki using a Gordon Growth model with a price target of ISK32, given that it appears to have the safest profile among the Icelandic banks, and its growth and expansion over the past couple of years has been more measured. In addition, much of the potential slowdown in capital market-related earnings appears to be already in the price and there is no subprime exposure to worry about. As long as credit provisions develop in line with those of other European banks, we believe that the risk to the book value is acceptable. Should provisions rise 50% faster than expected, our sensitivity analysis shows that profit before tax (PBT) could be 26% lower in 2010.

Our valuation approach assumes that, as suggested by Landsbanki's accounts, we take core revenues (ex equity holdings) and add to these the value of equity investments at book value.

- **Core business:** Our valuation of the core business is based on our estimated return on core equity, which is 20.2% for 2008. Our CoE of 12% assumes a risk premium reflective of the high current CDS spreads. The risk premium incorporated accounts for the macro imbalances and the risk inherent in any business model when loan book growth has been very rapid. Our long-term growth rate is 3%, as we believe that Landsbanki has entered a period of slower growth more in line with its European peers.
- **Equity investments:** Our equity investments valuation takes the current portfolio size and conservatively applies a 1x PBV to the assets, which we believe is appropriate since approximately two-thirds of the portfolio (the listed equities) is kept on a mark-to-market basis in the accounts.

Table 3: Core income and valuation, ISK bn

Core income (ex-investments) adjustments pre tax	2008E
NII (cost of carry)	5,753
Net gain on equity, securities and FX	-16,605
Total pre-tax adjustments	-10,852
Core income (PBT)	34,875
Tax (rate at group level)	13%
Tax	-4,534
Core income	30,342
Minorities	-1,208
Core net attributable profits	29,134
RoCore net attributable profits	13.7%
Equity implied for core earnings	154,831
Core net attributable profits	29,819
RoCoreE	19%
Equity investment income	8,756
% of total net profits	22.7%
Total assets	3,297,731
% of total balance sheet	0.3%

Source: UBS estimates

Landsbanki appears to have the safest profile among the Icelandic banks

Table 4: Valuation, ISK bn

Valuation based on core income	2008E
Return on core equity	19.0%
Average ROE on core income	18.1%
CoE	12.0%
Long-term growth	3.0%
Implied PBV	1.90
BVPS ex equity holdings	14.22
II A – PB multiple used	2008E
Price target (ex equity holdings)	26.99
Equity holdings	57,966
Equity holdings a share	5.3
PBV multiple	1x
Price target (equity holdings on 1x PBV)	5.3
Price target	32
Upside/downside	10.3%

Source: UBS estimates

Risk factors

- Funding:** The key risk factor for Landsbanki – as for the other Icelandic banks – at this point is funding. While Landsbanki does not need access to capital markets over the next year, ultimately the Icelandic banks will need access to normal wholesale funding again. This need will become more pressing as we move towards the end of the year, as in 2009 more outstanding debt matures than in 2008 (€2.25bn versus €0.75bn).
- Customer loans:** Another potential risk factor for Landsbanki is the very rapid growth in customer loans – a book that has yet to be tested in a recession. We note that Landsbanki's portfolio is young and has not gone through periods of high stress. Loan growth of around 50% since 2004 is significantly above the European banks' average. If provisions were to rise 50% faster than anticipated, the impact on PBT would be 26% by 2010, all else being equal. Provisions during the last downturn reached 170bp on a much smaller portfolio. The portfolio is largely corporate loan related with retail mortgages taking a small share, essentially confined to Iceland itself.
- Acquisition:** Landsbanki has been somewhat less aggressive than the other two Icelandic banking peers to increase its foreign operations through acquisitions, which we view as positive. This has reduced the risk of losing focus as well as execution risk. However, we understand from discussions with management that the acquisition risk at Landsbanki likely remains above average.

Major shareholders

The largest shareholder in Landsbanki is Samson. This is a fund controlled by a successful Icelandic entrepreneur, who we believe will support the company's long-term growth.

Landsbanki

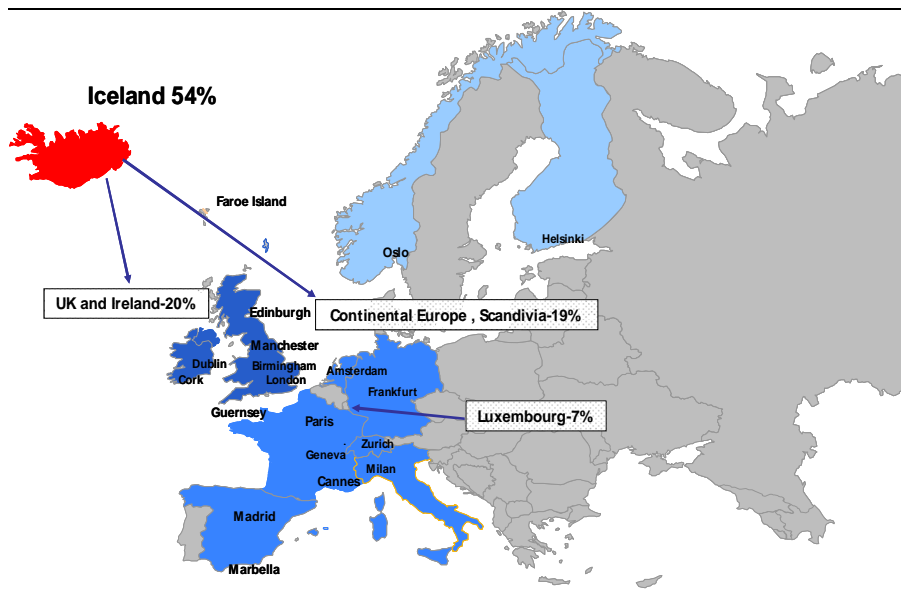
An emerging pan-European brokerage and corporate banking model

Landsbanki's core markets are the UK and Ireland, where 20% of the loan portfolio resides, followed by Europe and Scandinavia at 15%, and the US and Canada at 9%. That said, Iceland still dominates, accounting for 56% of the total customer loan portfolio.

Iceland dominates, accounting for 56% of the total customer loan portfolio

In terms of gross operating profit, the split is more skewed towards continental Europe (including Luxembourg): it accounts for 26% of gross operating profits, due to Landsbanki's pan-European brokerage businesses and wealth management operations through its Luxembourg branch.

Chart 5: Landsbanki geographical footprint and operating income split, 2007



Source: Landsbanki, UBS

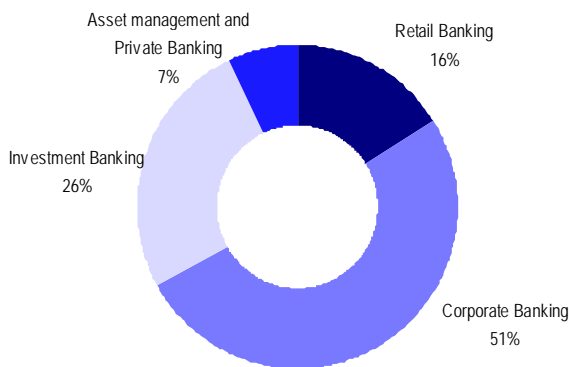
Capital market- and corporate banking-focused business model

That said, Landsbanki's business model is based on corporate banking and capital markets in Iceland, the UK and Ireland, and continental Europe: 77% of pre-tax profits originated from corporate and institutional banking (CIB) areas in 2007, which is unlikely to change, in our opinion, as its retail activities are predominantly focused on Iceland. The only other retail market outside Iceland is the UK where Landsbanki is active through Icesave, its online deposit-gathering platform.

Some 77% of pre-tax profits originated from corporate and institutional banking areas in 2007

Not surprisingly, Landsbanki's earnings streams have much in common with those of Kaupthing and Glitnir, as all three banks share the constraint of a tiny, consolidated home market. Compared with the other two banks, Landsbanki has been equally aggressive in expanding its balance sheet, but, in our view, it has made more focused acquisitions in the field of European brokerage houses (Kepler, Teather & Greenwood & Merrion Securities are examples).

Chart 6: Landsbanki PBT, 2007



Source: Landsbanki, UBS

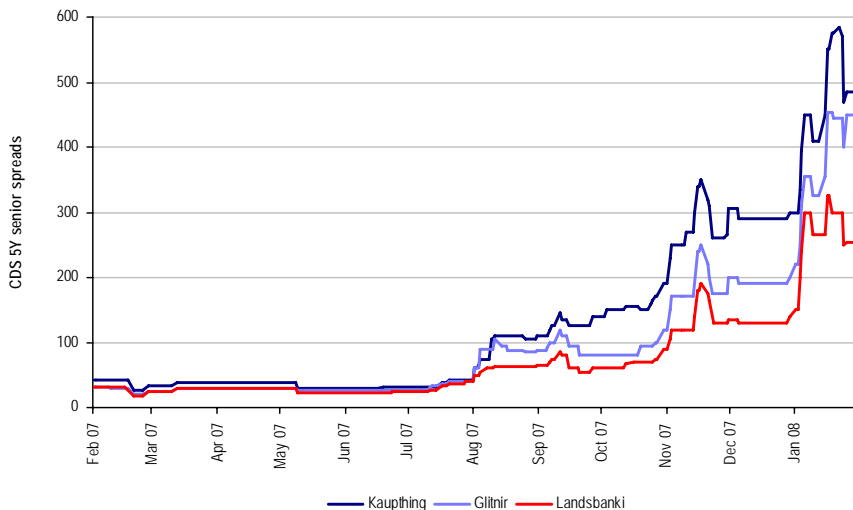
Most defensive among the Icelandic banks

We consider Landsbanki’s risk profile to be above the European banks’ average. Among the Icelandic banks, its profile is the most attractive in the current market environment, in our opinion. Comparatively high CDS spreads are reflective of uncertainties about funding markets, rapid (perhaps too rapid) growth of the loan book in recent years, and the subdued outlook for the local and global economy.

Landsbanki has a superior risk profile to the European banks’ average

CDS spreads have to fall further before we can talk about a normalisation of the funding risk.

Chart 7: Icelandic banks five-year senior CDS spreads

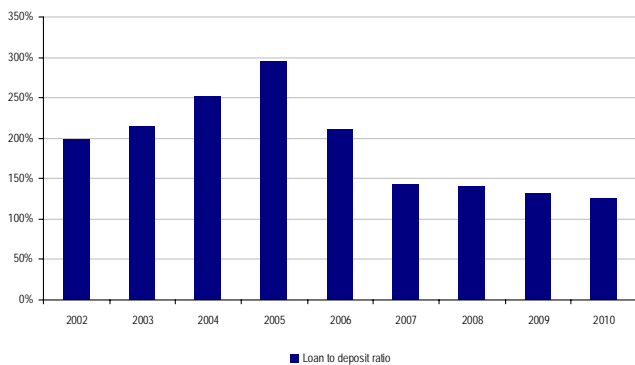


Source: UBS Delta

Deposits now a priority

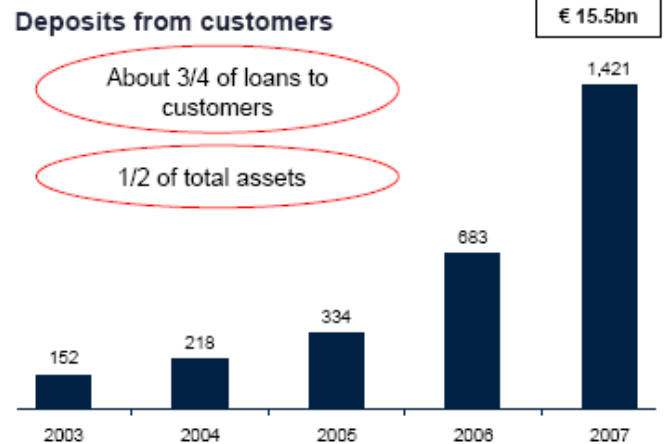
Deposit taking has become a priority at Landsbanki since the mini crisis of confidence in second quarter 2006. It has been first in targeting UK retail and corporate deposits, and now has the lowest loan/deposit ratio, at 142% in 2007.

Chart 8: Loans to deposits



Source: Landsbanki , UBS

Chart 9: Deposits now a priority

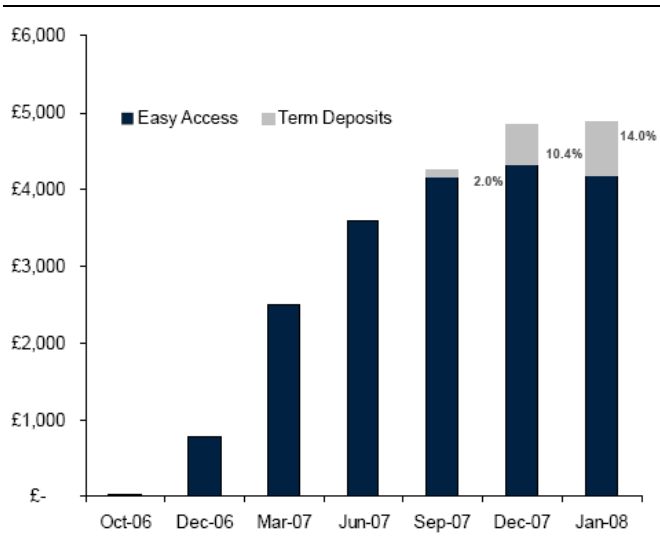


Source: Landsbanki , UBS

Icesave is Landsbanki’s deposit-gathering platform in the UK. Its proposition of guaranteeing above-average savings rates, which were most recently also significantly above ING Direct’s, helped to diversify funding in 2007. We would note, however, that Landsbanki is no longer alone in its endeavours, as deposits as a way of providing stable funding have been rediscovered right across Europe. Not least, it is now also competing head-on with Kaupthing’s online savings offer, called ‘Edge’. These factors and negative press reports may have contributed to the levelling off of deposit inflows in recent months.

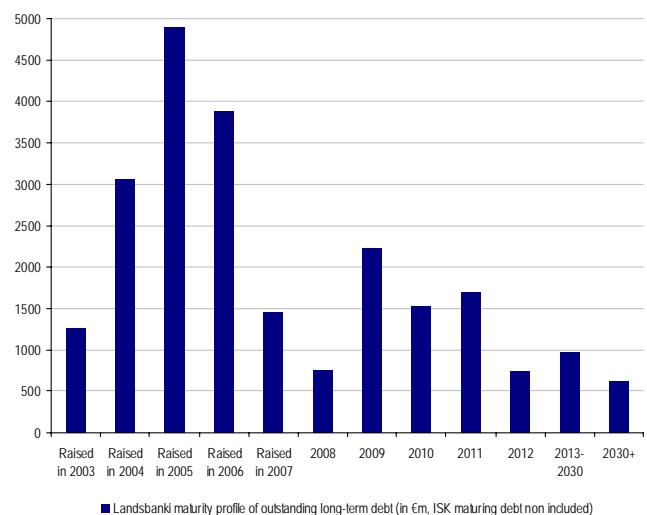
Landsbanki is no longer alone in its endeavours, as deposits as a way of providing stable funding have been rediscovered right across Europe

Chart 10: Icesave deposit development



Source: Landsbanki

Chart 11: Landsbanki’s maturity profile of outstanding long-term debt (€m, ISK maturing debt not included)



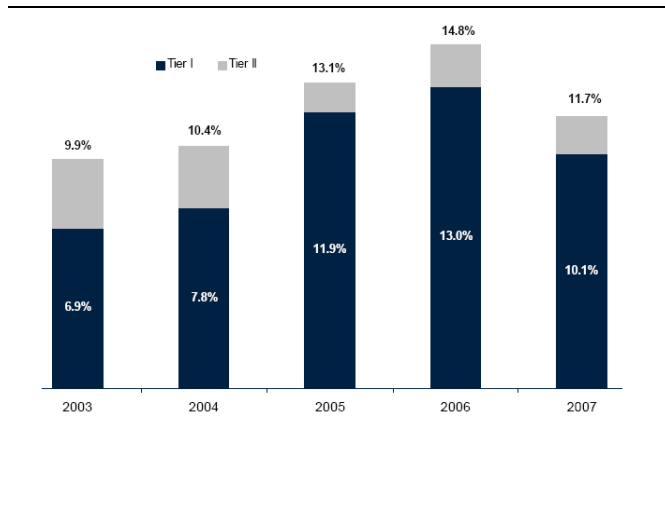
Source: Landsbanki , UBS

Capital remains above the European average

Tier I capital at year-end 2007 declined to 10.1%, but was best in class relative to Kaupthing (9.6%) or Glitnir (8.1%). We argue that balance sheet growth will slow in 2007, and, therefore, we are least concerned about Landsbanki consuming more capital than it generates. Based on our 7% customer loan growth forecast, the Tier I ratio should increase by 80bp to 10.9%.

The resilience of the franchise can also be seen from the Icelandic regulator’s stress test for year-end 2007, where the Tier I ratio drops to 8.8% under relatively severe model assumptions.

Chart 12: Regulatory capital ratios for Landsbanki



Source: Landsbanki , UBS

Chart 13: Regulatory capital stress test

	CAD		Tier 1
Pre FME Stress Test	11.7%		10.1%
A 35% fall inn domestic stock prices and 25% fall in foreign stock prices	-0.63%	11.07%	-0,65%
A 20% increase in loan default losses	-0.25%	10.82%	-0,25%
A 7% fall in bond prices	-0.29%	10.53%	-0,30%
A 20% depreciation of the ISK	-0.02%	10.51%	-0,10%
<i>Change</i>		1.2%	1.3%
Post FME Stress Test 31.12.2007	10.5%		8.8%

Source: Landsbanki , UBS

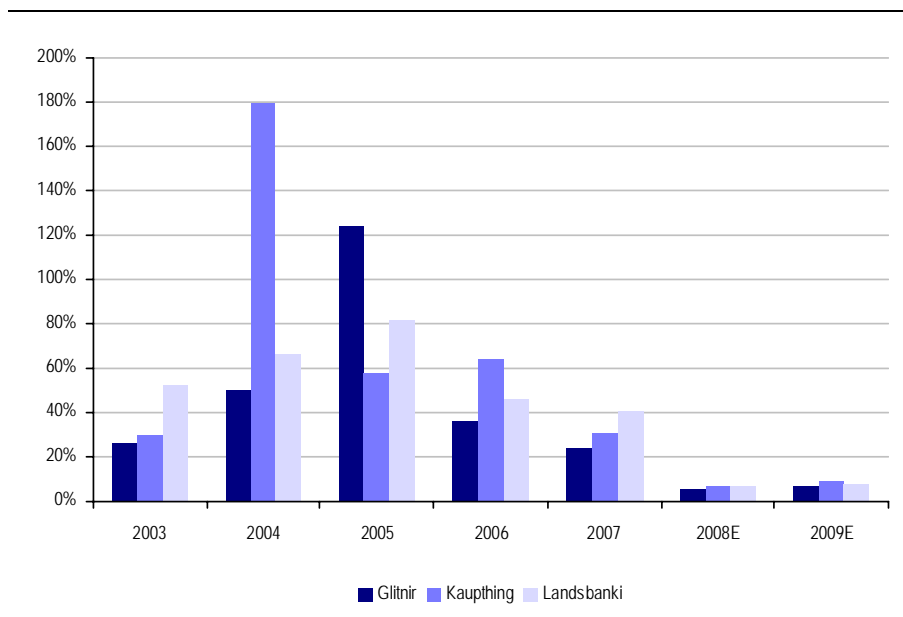
Balance sheet growth to slow

We believe one of the key issues for the investment case this year – not only for Landsbanki, but for all other Icelandic banks – is how much the slowdown in balance sheet growth in 2008 will weigh on results.

We forecast 7% customer loan growth, driving 12% NII growth on the back of higher average balances in 2007. Customer loan balances grew 41% in 2007. For all three Icelandic banks, we estimate that balance sheet growth will be the slowest in years, as risk appetite is at its lowest level in 10 years and banks have become more selective in lending to riskier projects.

Balance sheet growth will be the slowest in years for all three Icelandic banks

Chart 14: Customer loan growth history and forecasts



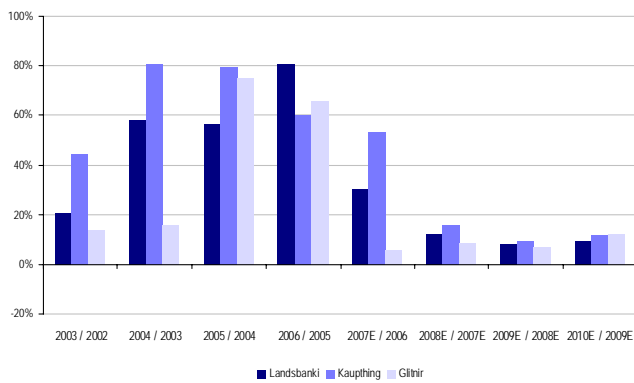
Source: UBS estimates, company data

Sustainability of revenues

Investment banking earnings are an important contributor to earnings. Some 77% of pre-tax profits in 2007 were generated within Landsbanki's CIB units. This source of income should slow in 2008, but due to the integration of Bridgewell in mid-2007, it should remain less affected relative to those of other banks.

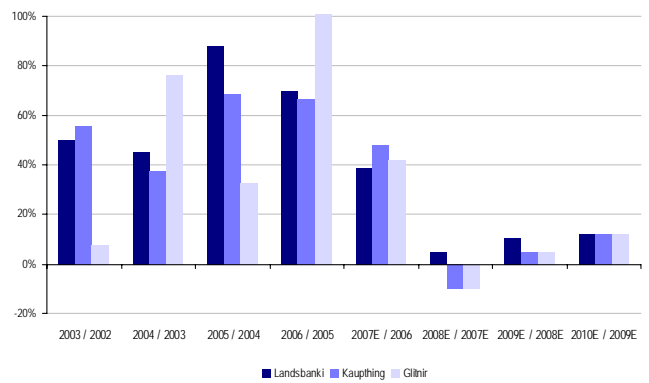
We forecast significant deterioration in net interest income over the forecast period, reflecting the slowdown in total customer loan growth, shown above. For fee and commission (F&C) income, we expect a slightly more positive outcome, partly due to the integration of Bridgewell (UK investment banking boutique).

Chart 15: F&C income trends – Landsbanki and peers



Source: UBS estimates

Chart 16: NII trends – Landsbanki and peers



Source: UBS estimates

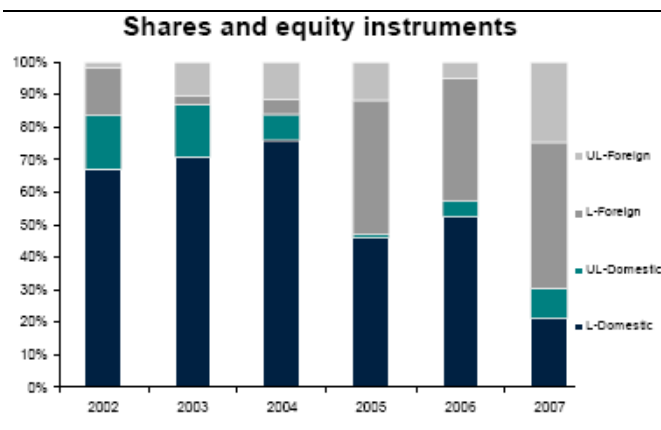
Equity investments supported by markets

Since 2000, Iceland has seen tremendous performance in its stock market. Landsbanki benefited from this development by building up a c€10m equity portfolio by fourth quarter 2007. Expressed in terms of shareholder equity, this accounts for 40% of the equity base. Landsbanki sees its equity investments as an integral part of its business activities.

Equity investments are an integral part of Landsbanki's business activities

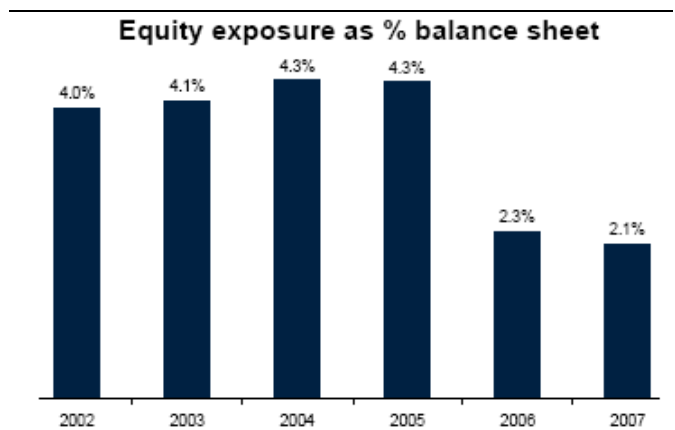
The portfolio is focused on Iceland, Sweden and the UK. Few comments were made about the average age of investments at our meetings with management. The listed portion of the portfolio is held on a mark-to-market basis.

Chart 17: Domestic equity versus foreign equity investments



Source: Landsbanki

Chart 18: Equity exposure as a percentage of total assets



Source: Landsbanki

At year-end 2007, the listed part of the portfolio accounted for 69% of the investment portfolio, and the composition was two-thirds foreign and one-third domestic.

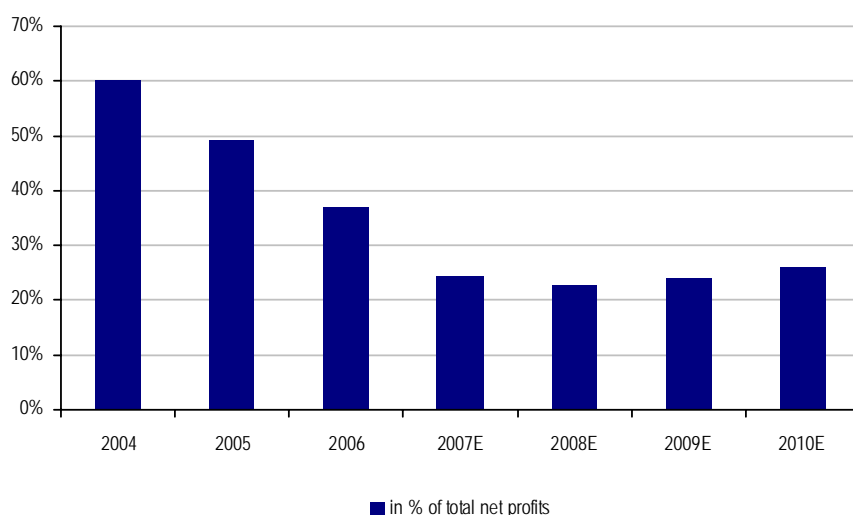
Table 5: Landsbanki's listed and unlisted equity investments, as of fourth quarter 2007

ISK billion	Total	Foreign	Domestic
Listed equity investments	44.8	28.9	6.1
Unlisted equity investments	19.7	13.5	15.9
Total	64.4	42.4	22.0

Source: Company reports, UBS

We forecast profits generated from equity investments to contribute around 25% of total profits.

Chart 19: Equity investment income as a percentage of total profits



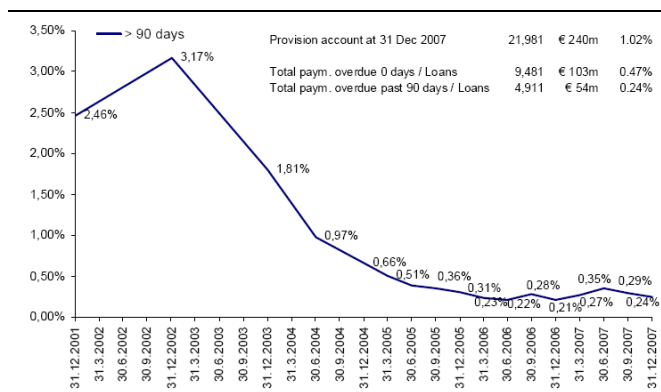
Source: Landsbanki, UBS estimates

Outlook for provisions

Credit provisions remain at very low levels and are likely to rise. At 34bp at year-end 2007, the impairment charge over total customer loans was the likely absolute low point of the past cycle, in our opinion. We see impairment charges rising to 50bp in 2008, 70bp in 2009 and 90bp in 2010. If provisions were to rise 50% faster than anticipated, then the impact on PBT would be 26% by 2010 on expected profits, all else being equal.

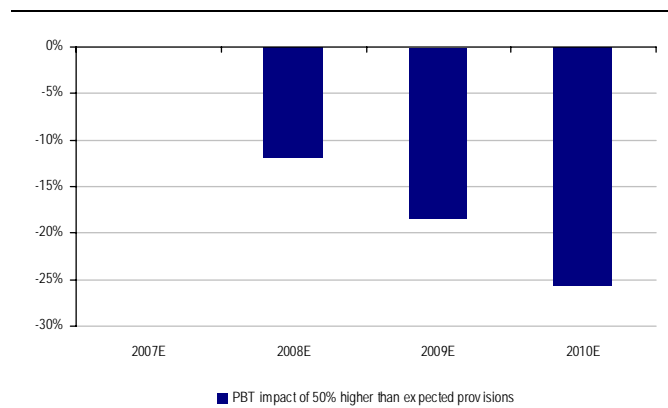
Provisions during the last downturn reached 170bp on a much smaller portfolio. We note that Landsbanki's portfolio is young and has not gone through periods of high stress. The portfolio is largely corporate loan related with retail mortgages taking a small share, essentially confined to Iceland itself.

Chart 20: Landsbanki NPL trends, 2001-07



Source: Landsbanki

Chart 21: Scenario: PBT impact of a 50% higher-than-forecast impairment change (%), 2008-10E



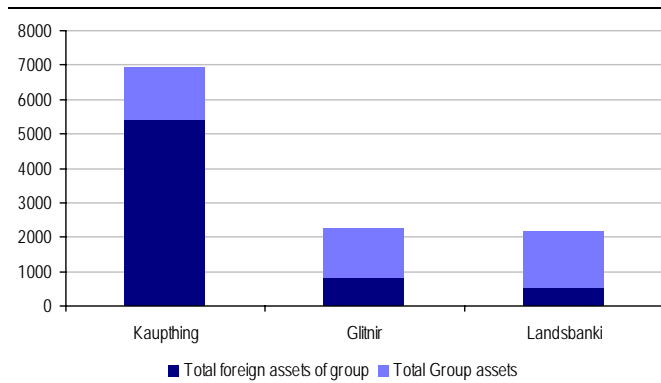
Source: UBS estimates

Acquisition risk

Landsbanki has been somewhat less aggressive than the other two Icelandic banking peers to increase its foreign operations through acquisitions, which we view as positive. This has reduced the risk of losing focus as well as execution risk. However, we understand from discussions with management that the acquisition risk at Landsbanki likely remains above average, but perhaps not for the immediate future as funding makes capital raising difficult and markets are sceptical about the merits of acquisitions in the near term.

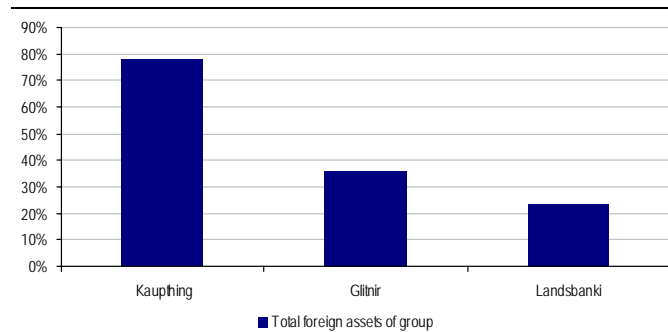
The acquisition risk at Landsbanki likely remains above average

Chart 22: Icelandic banks foreign assets versus total group assets (YE 06)



Source: Sedlabanki, UBS

Chart 23: Total foreign assets as a percentage of group assets at the Icelandic banks



Source: Sedlabanki, UBS

Landsbanki has acquired mainly brokerage firms in the UK (Teather & Greenwood), Ireland (Merrion), France and continental Europe (Kepler), adding to its own Nordic brokerage operations. While these acquisitions came at a reasonable price similar to those acquisitions undertaken by Kaupthing and Glitnir, this is likely only the first step. The next phase will be to complement these platforms with corporate banking operations, through the hiring of teams or acquisitions. Landsbanki has recently abandoned a joint bid with Cenkos for Close Brothers, in which Landsbanki was interested in the corporate banking assets. We believe that consolidation of its existing franchise should have priority over yet another attempt to acquire corporate banking assets.

Consolidation of its existing franchise should have priority over yet another attempt to acquire corporate banking assets

If Landsbanki credibly demonstrates that its loan portfolio is indeed safe, and credit quality and revenue trends are at least average or better than those of other European banks, then we are convinced that disposals by franchises in not such a comfortable position or in need of capital will allow Landsbanki to snap up portfolios or banks at much cheaper valuations than in the case of a hostile bid.

Table 6: Total assets of Icelandic banks' foreign subsidiaries

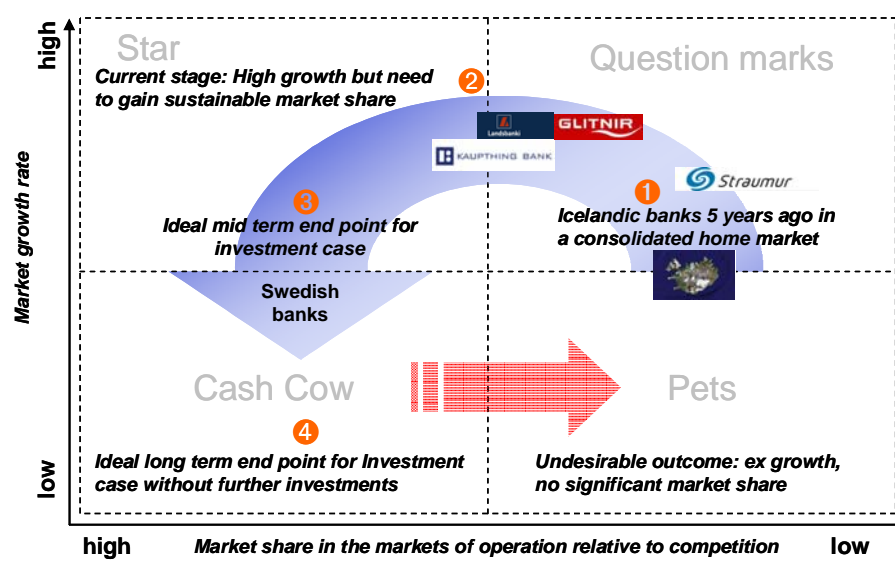
YE 06, ISK bn	Kaupthing		Glitnir		Landsbanki
FIH	1,222	FIM (AuM €8.5bn)*	4.4	Bridgewell*	n/A
UK Singer & Friedlaender	536	BNbank	557	Lux	303
Lux	478	Lux	153	Heritable Bank	122
Sweden	180	Bank Norway	67	Kepler Equities	44
Robe Bank Belgium	25	AB	20	Guernsey	17
Finance	44	Other	8.4	Teather & Greenwood	17
Oyj	22			Other	13
Norway	14				
Norvestia Oyj	16				
	Kaupthing		Glitnir		Landsbanki
Total foreign assets of group	5,409	Total foreign assets of group	810	Total foreign assets of group	516
Total group assets	6,927	Total group assets	2,250	Total group assets	2,173

Source: UBS estimates, Note: (*) acquired in 2007

The challenge: Sustainable growth

The main challenge for Landsbanki and the Icelandic banks is to develop their regional platforms into integrated business models, which can sustainably deliver attractive returns, based on meaningful market shares. They are no longer small enough to operate below everyone's radar, but not yet big enough to compete with the larger local and international CIB banks.

Chart 24: The challenge: Evolution of sustainable business models



Source: UBS estimates based on BCG growth matrix

Competitive environment

International corporate and investment banks tend to cover only the larger corporates and institutions, usually with super-regional teams, partly or wholly based in London. Local partnerships have so far had a limited regional impact. Apart from the focus on size, there is also a lack of depth in individual country coverage. Icelandic banks have been successfully snapping up businesses that were below the radar of the bulge-bracket investment banking firms or large European wholesale banks. In addition, they have benefited from the fact that corporate banking and broking businesses have gone out of favour in recent years. Consequently, the Icelandic banks are now getting to a size where they are firmly on the radar screens of the local Nordic banks.

Icelandic banks are now getting to a size where they are firmly on the radar screens of the local Nordic banks

Table 7: Icelandic banks' main competitors by region

	Iceland	Nordic region	Benelux and Germany	UK and Ireland
Kaupthing		SEB	ABN AMRO	
	Glitnir	Nordea	Fortis	
	Landsbanki	Carnegie	NG	Niche investment banks
	Straumur	SHB	Barclays	
		Danske	RBS	
		Alfred Berg	Deutsche Bank	
Glitnir	Kaupthing,	Nordea		
	Landsbanki	DnBNor	N/A	N/A
	Straumur	SEB		
Landsbanki	Kaupthing	SEB		
	Glitnir	Nordea	Local and international brokers	Local and international brokers
	Straumur	Carnegie		
		SHB		

Source: UBS estimates

Building a pan-European footprint

The four large Icelandic banks – Landsbanki, Kaupthing, Glitnir, and Straumur – have reached a relatively advanced stage in terms of developing their pan-European footprint. Forced to look abroad for further business opportunities, they were too small until very recently to be taken seriously by competitors even in the neighbouring Nordic region.

Chart 25: Regional footprint of the four Icelandic banks

	IB				CM				Treasury				Corp. banking				Retail banking				AM & PB				Currency group	Geography
	Kaupthing	Gjaltir	Landsbanki	Straumur	Kaupthing	Gjaltir	Landsbanki	Straumur	Kaupthing	Gjaltir	Landsbanki	Straumur	Kaupthing	Gjaltir	Landsbanki	Straumur	Kaupthing	Gjaltir	Landsbanki	Straumur	Kaupthing	Gjaltir	Landsbanki	Straumur		
Iceland	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	ISK	Eurozone countries
UK	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	■	●	▲	◆	GBP	
Ireland			▲				▲				▲				▲				▲				▲			
Netherlands	■			◆	■		▲	◆	■		▲	◆	■		▲	◆	■		▲	◆	■		▲	◆		
Belgium	■				■				■				■				■				■					
Germany	■				■		▲		■				■				■				■					
France							▲																			
Italy							▲																			
Finland	■	●		◆	■	●		◆	■				■			◆	■	●			■	●		◆		
Sweden	■	●		◆	■	●		◆	■				■				■	●			■	●				
Denmark	■	●		◆	■	●		◆	■	●			■	●			■	●			■	●				
Norway	■	●		◆	■	●		◆	■	●			■	●			■	●			■	●				
Luxembourg					■				■	●	▲		■	●			■	●			■	●	▲			
Switzerland							▲				▲															
US & Canada		●			■		▲			●				●	▲						■					
Russia & CEE				◆		●		◆														●		◆		

■ Kaupthing ● Gjaltir ▲ Landsbanki

Source: Company disclosure, UBS estimates

Earnings and valuation assumptions

We base our earnings forecast on the following principal assumptions:

- **Global GDP growth of ~2-3% in 2008.**
- **Equity markets of -10% in 2008.**
- **A return to more normal conditions in credit markets.**
- **A stable currency until mid-2008.** Subsequently, we expect easing by the Icelandic Central Bank and the ISK to decline further. There is the potential for a rate cut earlier than that if inflation pressures start to recede over the next few months. In the most recent interest rate decision on 14 February, the central bank decided to leave rates unchanged, at 13.75%, citing inflationary pressures.
- **Landsbanki is a well-run bank with good management,** which has developed the bank from a regional into a pan European player.

Based on these assumptions, we believe that the valuation of Landsbanki reflects our scenario for only modest upside potential in the current environment. The downside risks at this point cannot easily be dismissed. We see the following risk factors limiting the upside potential or creating downside risk.

- **GDP revisions are falling.**
- **Interest rates and inflation pressures** in Iceland create the risk of a sharp adjustment, either through a slowdown in domestic demand or the currency.
- **Credit markets** are currently not working in an orderly fashion and the questions remains how long it will take for them to return to normality.
- **High F&C dependency:** The investment case is also linked to the capital markets where 71% of Landsbanki's fee and commission income is derived, mainly from securities brokerage activities.
- **Landsbanki's equity portfolio:** The earnings base of Landsbanki is c25% dependent on the smooth realisation of equity investments, which Landsbanki sees as a core business activity.

Table 8: Landsbanki listed and unlisted equity investments, as of fourth quarter 2007

ISK billion	Total	Foreign	Domestic
Listed equity investments	44.8	28.9	6.1
Unlisted equity investments	19.7	13.5	15.9
Total	64.4	42.4	22.0

Source: Company reports, UBS

- Landsbanki is well managed and has enjoyed extremely favourable conditions over the past four years. These conditions have now changed.

UBS forecasts for Landsbanki

Chart 26: Landsbanki P&L forecasts

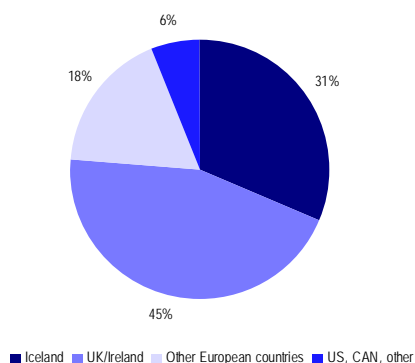
Profit & Loss in ISKm	Forecasts							in %							Forecasts		
	2004	2005	2006	2007E	2008E	2009E	2010E	2002/2001	2003/2002	2004/2003	2005/2004	2006/2005	007E/2006	08E/2007E	09E/2008E	10E/2009E	
Net Interest Income	14,734	22,996	41,491	54,052	60,601	65,449	71,340	-12%	21%	58%	56%	80%	30%	12%	8%	9%	
Loans and advances to customers	542,215	984,593	1,438,395	2,022,738	2,164,330	2,337,476	2,547,849		52%	66%	82%	46%	41%	7%	8%	9%	
<i>NI yield over customer loans</i>																	
Net Commission Income	8,891	16,726	28,366	39,369	41,337	45,471	50,928	13%	50%	45%	88%	70%	39%	5%	10%	12%	
Net Financial Income	9,842	21,257	19,568	16,605	15,775	15,775	17,037		68%	178%	116%	-8%	-15%	-5%	0%	8%	
Total Income	33,467	60,979	89,426	110,026	117,713	126,695	139,304	14%	36%	76%	82%	47%	23%	7%	8%	10%	
Salaries and Related Cost	7,794	12,682	24,458	37,688	39,949	43,145	47,028	5%	29%	38%	63%	93%	54%	6%	8%	9%	
Other Administrative Cost	6,667	8,284	14,130	19,827	21,215	22,700	24,516	5%	25%	29%	24%	71%	40%	7%	7%	8%	
Total Expenses	14,460	20,967	38,588	57,515	61,164	65,845	71,544	5%	27%	34%	45%	84%	49%	6%	8%	9%	
GOP	19,007	40,012	50,838	52,511	56,549	60,850	67,760	31%	51%	133%	111%	27%	3%	8%	8%	11%	
Loans and advances to customers	542,215	984,593	1,438,395	2,022,738	2,164,330	2,337,476	2,547,849		52%	66%	82%	46%	41%	7%	8%	9%	
Impairment	4,485	9,230	6,144	6,956	10,822	16,362	22,931	25%	63%	-4%	106%	-33%	13%	56%	51%	40%	
Impairments over customer loans (in bp)	83	94	43	34	50	70	90										
PBT	14,522	30,782	44,694	45,555	45,728	44,488	44,829	33%	43%	314%	112%	45%	2%	0%	-3%	1%	
Tax Rate	12%	19%	10%	12%	13%	13%	13%										
Income tax	1,798	5,764	4,479	5,605	5,945	5,783	5,828	-5378%	-4%	293%	221%	-22%	25%	6%	-3%	1%	
Net Profit	12,724	25,018	40,215	39,950	39,783	38,704	39,002	12%	47%	317%	97%	61%	-1%	0%	-3%	1%	
Minority interest	149	277	1,309	1,150	-1,208	-1,268	-1,331	-58%	120%	51%	86%	373%	-12%	5%	5%	5%	
Attributable net profit	12,574	24,740	38,906	38,800	38,576	37,436	37,670	16%	46%	325%	97%	57%	0%	-1%	-3%	1%	
Adjustments	0	0	0	0	0	0	0										
Adj net attributable profit	12,574	24,740	38,906	38,800	38,576	37,436	37,670	16%	46%	325%	97%	57%	0%	-1%	-3%	1%	
Source: UBS estimates																	
	2004	2005	2006	2007E	2008E	2009E	2010E	2002/2001	2003/2002	2004/2003	2005/2004	2006/2005	007E/2006	08E/2007E	09E/2008E	10E/2009E	
Earnings per share (diluted)	1.6	2.6	3.5	3.4	3.3	3.2	3.2										
Earnings per share (stated)	1.6	2.7	3.7	3.6	3.5	3.4	3.5				68%	34%	-2%	-4%	-3%	1%	
Earnings Per Share(adjusted)	1.6	2.6	3.5	3.4	3.3	3.2	3.2				71%	34%	-1%	-2%	-3%	1%	
Stock Price	11.9	25.0	26.9	28.5	28.5	28.5	28.5	6%	65%	107%	110%	8%	6%	0%	0%	0%	
PE (diluted)	7.7x	9.6x	7.7x	8.4x	8.7x	9.0x	8.9x										
PE (stated)	7.4x	9.1x	7.3x	7.9x	8.0x	8.3x	8.2x										
Dividends	1,635	3,216	3,306	5,820	5,786	5,615	5,651			121%	97%	3%	76%	-1%	-3%	1%	
DPS	0.20	0.34	0.30	0.51	0.49	0.48	0.48				68%	-13%	72%	-4%	-3%	1%	
Dividend yield	1.7%	1.4%	1.1%	1.8%	1.7%	1.7%	1.7%										
No. of shares (fully diluted incl stock options)	8098	9,495	11,181	11,419	11,792	11,792	11,792				17%	18%	2%	3%	0%	0%	
No. of shares	7831	9,020	10,608	10,702	10,890	10,890	10,890				15%	18%	1%	2%	0%	0%	

Source: UBS estimates

Lending skewed towards Iceland

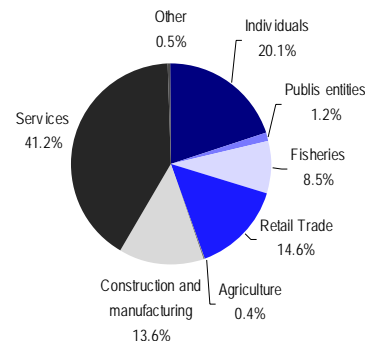
When we look at lending, the Icelandic segment dominates and includes loans made to Icelandic corporates investing abroad. Two-thirds of total loans originate in Iceland, but only around half are strictly related to Icelandic projects. In terms of the sectoral divide, services account for most of the loan book, ie, 42% in total.

Chart 27: Lending by geography



Source: Landsbanki, UBS

Chart 28: Lending by sector



Source: Landsbanki, UBS

Chart 29: Landsbanki balance sheet

Balance sheet in ISKm	Reported						Forecasts			in %				Forecasts		
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2004/2003	2005/2004	2006/2005	2007/2006	2008/2007	2009/2008	2010/2009
ASSETS																
Cash and cash balances with Central Bank	8,145	11,642	18,237	16,611	31,669	81,559	97,871	117,445	140,934	57%	-9%	91%	158%	20%	20%	20%
Loans and advances to financial institutions	10,748	37,130	72,060	86,919	215,618	162,929	174,334	188,281	205,226	94%	21%	148%	-24%	7%	8%	9%
Loans and advances to customers	214,787	326,400	542,215	984,593	1,438,395	2,022,738	2,164,330	2,337,476	2,547,849	66%	82%	46%	41%	7%	8%	9%
Financial assets at fair value and associates	36,337	63,744	64,730	218,894	376,809	667,941	734,735	918,419	1,148,024	2%	238%	72%	77%	10%	25%	25%
Other assets	7,808	9,323	39,900	98,443	110,432	122,379	134,617	148,079	162,886	328%	147%	12%	11%	10%	10%	10%
Total Assets	277,824	448,239	737,141	1,405,460	2,172,924	3,057,546	3,305,886	3,709,699	4,204,919	64%	91%	55%	41%	8%	12%	13%
Liabilities																
Deposits from financial institutions	30,665	43,840	63,476	144,596	141,105	337,915	364,948	419,690	482,644	45%	128%	-2%	139%	8%	15%	15%
Deposits from customers	108,306	152,320	215,730	334,163	682,846	1,421,410	1,535,123	1,765,391	2,030,200	42%	55%	104%	108%	8%	15%	15%
Wholesale borrowing	108,479	209,357	375,084	689,989	1,014,976	835,985	919,584	1,011,542	1,112,696	79%	84%	47%	-18%	10%	10%	10%
Subordinated loans	8,216	13,090	22,570	49,074	89,754	111,890	123,079	135,387	148,926	72%	117%	83%	25%	10%	10%	10%
Other liabilities	5,057	6,389	21,572	74,022	94,785	166,342	182,976	201,274	221,401	238%	243%	28%	75%	10%	10%	10%
Equity	16,309	22,382	37,705	110,059	144,282	180,008	212,797	244,618	276,638	68%	192%	31%	25%	18%	15%	13%
Minority interests	792	862	1,004	3,557	5,175	3,996	4,396	4,835	5,319	16%	254%	45%	-23%	10%	10%	10%
Total Liabilities and equity	277,824	448,239	737,141	1,405,460	2,172,924	3,057,546	3,342,902	3,782,738	4,277,823	64%	91%	55%	41%	9%	13%	13%

Source: UBS estimates

Chart 30: Landsbanki break-up analysis

Break-up Analysis	Reported					Forecasts				Growth yoy in %				in % of group				
	2004	2005	2006	2007	2008	2005/2004	2006/2005	2007/2006	2008/2007	2004	2005	2006	2007	2008				
Revenues																		
Retail Banking	9,619	13,664	17,974	21,218	24,698	42%	32%	18%	16%	29%	22%	20%	19%	21%				
Corporate banking	7,876	14,456	25,323	38,425	42,557	84%	75%	52%	11%	24%	24%	28%	35%	36%				
Investment banking	13,519	28,511	39,809	40,338	45,246	111%	40%	1%	12%	40%	47%	45%	37%	38%				
Asset management and private banking	2,454	4,348	6,320	9,412	8,979	77%	45%	49%	-5%	7%	7%	7%	9%	8%				
Other operations	0	0	0	0	0					0%	0%	0%	0%	0%				
Group	33,467	60,979	89,426	110,026	117,713													
Sum of Parts	33,468	60,979	89,426	109,393	121,480													
						Growth yoy				in % of group								
Expenses																		
Retail Banking	6,594	8,272	8,752	10,650	11,183	25%	6%	22%	5%	46%	39%	23%	19%	18%				
Corporate banking	2,078	4,155	6,003	10,086	10,691	100%	44%	68%	6%	14%	20%	16%	18%	17%				
Investment banking	2,246	5,906	19,101	27,662	30,428	163%	223%	45%	10%	16%	28%	49%	48%	50%				
Asset management and private banking	1,653	2,208	3,239	6,032	6,032	34%	47%	86%	0%	11%	11%	8%	10%	10%				
Other operations	1,890	425	1,493	3,086	5,375	-78%	251%	107%	74%	13%	2%	4%	5%	9%				
Group	14,460	20,967	38,588	57,515	61,164													
Sum of Parts	14,461	20,966	38,588	57,516	63,709													
						Growth yoy				in % of group								
Provisions																		
Retail Banking	2,870	2,026	1,200	2,417	5,756	-29%	-41%	101%	138%	64%	22%	20%	35%	53%				
Corporate banking	1,385	3,268	3,642	3,766	6,135	136%	11%	3%	63%	31%	35%	59%	54%	57%				
Investment banking	4	3,033	1,307	762	1,854	75725%	-57%	-42%	143%	0%	33%	21%	11%	17%				
Asset management and private banking	235	902	5	11	54	284%	-99%	120%	388%	5%	10%	0%	0%	0%				
Other operations	0	0	0	0	0													
Group	4,485	9,230	6,144	6,956	10,822													
Sum of Parts	4,494	9,229	6,154	6,956	13,799													
						Growth yoy				in % of group								
PBT																		
Retail Banking	156	3,366	8,022	8,151	7,759	2058%	138%	2%	-5%	1%	11%	18%	18%	17%				
Corporate banking	4,413	7,032	15,678	24,573	25,731	59%	123%	57%	5%	30%	23%	35%	54%	56%				
Investment banking	11,269	19,572	19,401	11,914	12,964	74%	-1%	-39%	9%	78%	64%	43%	26%	28%				
Asset management and private banking	566	1,237	3,086	3,369	2,893	119%	149%	9%	-14%	4%	4%	7%	7%	6%				
Other operations	-1,890	-425	-1,493	-3,086	-5,375	-78%	251%	107%	74%	-13%	-1%	-3%	-7%	-12%				
Group	14,522	30,782	44,694	45,555	45,728													
Sum of Parts	14,514	30,782	44,694	44,921	43,972													
						Growth yoy				in % of group								
Net Income																		
Retail Banking	137	2,736	7,218	7,091	6,750	1897%	164%	-2%	-5%	1%	11%	19%	18%	17%				
Corporate banking	3,867	5,715	14,107	21,379	22,386	48%	147%	52%	5%	31%	23%	36%	55%	58%				
Investment banking	9,874	15,907	17,457	10,365	11,279	61%	10%	-41%	9%	79%	64%	45%	27%	29%				
Asset management and private banking	496	1,005	2,777	2,931	2,517	103%	176%	6%	-14%	4%	4%	7%	8%	7%				
Other operations	-1,656	-345	-1,343	-2,716	-4,569	-79%	289%	102%	68%	-13%	-1%	-3%	-7%	-12%				
Group	12,574	24,740	38,906	38,800	38,576													
Sum of Parts	12,717	25,018	40,215	39,050	38,363													

Source: UBS estimates

Chart 31: Landsbanki divisional figures

Divisionals in ISKm	Reported					Forecasts				in %							
	2004	2005	2006	2007	2008	2005 / 2004	2006 / 2005	2007 / 2006	2008 / 2007	Q3 2006	Q4 2006	Q1 2007	Q2 2007	Q3 2007	Q4 2007		
Retail Banking																	
Net Interest Income	6,838	10,466	15,145	18,360	21,586	53%	45%	21%	18%	4,170	4,116	3,928	4,657	4,710	5,065		
NII / Total Assets	4.6%	4.0%	4.1%	4.5%	3.8%												
Net Commission Income	2,781	3,131	2,860	2,964	3,112	13%	-9%	4%	5%	724	625	595	839	755	775		
Net Financial Income	0	66	-32	-106	0	#DIV/0!	-148%	231%	-100%	-24	-22	-23	-11	-21	-51		
Operating Income	9,619	13,664	17,974	21,218	24,698	42%	32%	18%	16%	4,871	4,719	4,500	5,486	5,442	5,790		
Operating Expenses	6,594	8,272	8,752	10,650	11,183	25%	6%	22%	5%	2,966	1,913	2,307	2,773	2,878	2,692		
GOP	3,025	5,392	9,222	10,568	13,515	78%	71%	15%	28%	1,905	2,806	2,193	2,713	2,564	3,098		
Impairment	2,870	2,026	1,200	2,417	5,756	-29%	-41%	101%	138%	509	-27	502	889	1,015	11		
in bps	193	77	32	46	100												
Net Profit Before Taxes	156	3,366	8,022	8,151	7,759	2058%	138%	2%	-5%	3,270	958	1,692	1,823	1,549	3,087		
Assumed Tax Rate	12%	19%	10%	13%	13%												
Assumed Tax	-19	-630	-804	-1,060	-1,009	3216%	28%	32%	-5%								
Net Earnings	137	2,736	7,218	7,091	6,750	1897%	164%	-2%	-5%								
Corporate Banking																	
Net Interest Income	6,943	11,866	22,714	37,446	41,413	71%	91%	65%	11%	5,034	6,397	7,618	8,602	10,262	10,964		
NII / Total Assets	1.9%	1.9%	2.4%	2.8%	2.7%												
Net Commission Income	979	2,343	2,547	3,294	3,459	139%	9%	29%	5%	1,034	695	551	534	569	1,640		
Net Financial Income	-46	247	62	-2,315	-2,315	-637%	-75%	-3834%	0%	36	26	18	22	-1,331	-1,024		
Operating Income	7,876	14,456	25,323	38,425	42,557	84%	75%	52%	11%	6,102	7,119	8,187	9,158	9,500	11,580		
Operating Expenses	2,078	4,155	6,003	10,086	10,691	100%	44%	68%	6%	1,032	2,166	2,397	2,400	2,660	2,629		
GOP	5,798	10,301	19,320	28,339	31,866	78%	88%	47%	12%	5,070	4,953	5,790	6,758	6,840	8,951		
Impairment	1,385	3,268	3,642	3,766	6,135	136%	11%	3%	63%	836	1,493	987	811	991	977		
in bps	38	51	39	28	40												
PBT	4,413	7,032	15,678	24,573	25,731	59%	123%	57%	5%	4,234	3,460	4,803	5,948	5,848	7,974		
Assumed Tax Rate	12%	19%	10%	13%	13%												
Assumed Tax	-546	-1,317	-1,571	-3,194	-3,345	141%	19%	103%	5%								
Net Earnings	3,867	5,715	14,107	21,379	22,386	48%	147%	52%	5%								
Investment banking																	
Net Interest Income	-187	-1,063	1,280	-6,273	-2,781	468%	-220%	-590%	-56%	-625	-1,102	-1,401	-556	-1,955	-2,361		
-0.16%	-0.37%	0.23%	-0.85%	-0.30%													
Net Commission Income	3,663	8,785	19,294	28,335	29,752	140%	120%	47%	5%	3,981	5,294	7,800	7,094	7,707	5,734		
Net Financial Income	10,043	20,789	19,235	18,276	18,276	107%	-7%	-5%	0%	2,586	7,188	8,777	5,880	3,157	462		
Operating Income	13,519	28,511	39,809	40,338	45,246	111%	40%	1%	12%	5,943	11,379	15,176	12,419	8,908	3,835		
Operating Expenses	2,246	5,906	19,101	27,662	30,428	163%	223%	45%	10%	4,728	5,628	5,834	6,292	7,286	8,250		
GOP	11,273	22,605	20,708	12,676	14,818	101%	-8%	-39%	17%	1,215	5,751	9,342	6,127	1,622	-4,415		
Impairment	4	3,033	1,307	762	1,854	75725%	-57%	-42%	143%	216	3	63	-251	-344	1,294		
in bps	0	106	23	10	20												
PBT	11,269	19,572	19,401	11,914	12,964	74%	-1%	-39%	9%	999	5,747	9,278	6,379	1,966	-5,709		
Assumed Tax Rate	12%	19%	10%	13%	13%												
Assumed Tax	-1,395	-3,665	-1,944	-1,549	-1,685	163%	-47%	-20%	9%								
Net Earnings	9,874	15,907	17,457	10,365	11,279	61%	10%	-41%	9%								
AM & PB																	
Net Interest Income	1,141	1,727	2,351	4,519	4,563	51%	36%	92%	1%	734	170	734	797	1,429	1,559		
1.1%	0.8%	0.8%	1.1%	0.9%													
Net Commission Income	1,228	2,466	3,665	4,776	4,298	101%	49%	30%	-10%	830	1,384	816	1,261	1,188	1,511		
Net Financial Income	85	154	303	117	117	81%	97%	-61%	0%	58	48	28	62	114	-87		
Operating Income	2,454	4,348	6,320	9,412	8,979	77%	45%	49%	-5%	1,623	1,602	1,578	2,120	2,732	2,982		
Operating Expenses	1,653	2,208	3,239	6,032	6,032	34%	47%	86%	0%	871	947	1,009	1,538	1,283	2,202		
GOP	801	2,140	3,081	3,380	2,947	167%	44%	10%	-13%	752	655	569	582	1,449	780		
Impairment	235	902	5	11	54	284%	-99%	120%	388%	35	-126	-2	52	-43	4		
in bps	-23	-42	0	0	1												
PBT	566	1,237	3,086	3,369	2,893	119%	149%	9%	-14%	716	792	571	531	1,490	777		
Assumed Tax Rate	12%	19%	10%	13%	13%												
Assumed Tax	-70	-232	-309	-438	-376	231%	34%	42%	-14%								
Net Earnings	496	1,005	2,777	2,931	2,517	103%	176%	6%	-14%								

Source: UBS estimates

Peer comparison

Chart 32: Icelandic banks P&L comparison

Revenues	2002	2003	2004	2005	2006	2007	2008E	2009E	Y-o-Y Growth						
									2003	2004	2005	2006	2007	2008E	2009E
Glitnir	14,074	19,061	28,525	36,411	72,601	85,095	82,011	87,131	35%	50%	28%	99%	17%	-4%	6%
Kaupthing	21,412	31,780	49,946	102,198	167,216	165,818	181,078	193,711	48%	57%	105%	64%	-1%	9%	7%
Landsbanki	13,916	18,982	33,467	60,979	89,426	110,026	117,713	126,695	36%	76%	82%	47%	23%	7%	8%
Expenses	2002	2003	2004	2005	2006	2007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	-7,723	-9,769	-14,357	-15,731	-27,301	-48,143	-47,059	-48,895	26%	47%	10%	74%	76%	-2%	4%
Kaupthing	-12,455	-18,493	-23,625	-34,729	-60,006	-78,731	-84,067	-87,933	48%	28%	47%	73%	31%	7%	5%
Landsbanki	-8,505	-10,815	-14,460	-20,967	-38,588	-57,515	-61,164	-65,845	27%	34%	45%	84%	49%	6%	8%
Operating Profit	2002	2003	2004	2005	2006	2007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	21,797	9,292	14,168	20,680	45,300	36,952	34,951.9	38,236.1	-57%	52%	46%	119%	-18%	-5%	9%
Kaupthing	8,957	13,287	26,321	67,469	107,210	87,087	97,011	105,777	48%	98%	156%	59%	-19%	11%	9%
Landsbanki	5,411	8,167	19,007	40,012	50,838	52,511	56,549	60,850	51%	133%	111%	27%	3%	8%	8%
PBT	2002	2003	2004	2005	2006	2007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	19,613	6,428	14,093	23,060	46,255	33,905	30,287	29,994	-67%	119%	64%	101%	-27%	-11%	-1%
Kaupthing	6,163	9,393	22,496	63,080	101,083	80,907	79,628	80,388	52%	139%	180%	60%	-20%	-2%	1%
Landsbanki	2,459	3,511	14,522	30,782	44,694	45,555	45,728	44,488	43%	314%	112%	45%	2%	0%	-3%
Provisions	2002	2003	2004	2005	2006	2007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	-2,184	-2,864	-3,137	-2,205	-4,759	-5,516	-7,257.8	-11,094	31%	10%	-30%	116%	16%	32%	53%
Kaupthing	-2,794	-3,894	-3,825	-4,389	-6,127	-6,180	-17,383	-25,390	39%	-2%	15%	40%	1%	181%	46%
Landsbanki	2,863	4,656	4,485	9,230	6,144	6,956	10,822	16,362	63%	-4%	106%	-33%	13%	56%	51%
Net Attributable profit	2002	2003	2004	2005	2006	2007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	3,407	5,835	11,958	18,886	37,360	26,681	24,070	23,420	71%	105%	58%	98%	-29%	-10%	-3%
Kaupthing	5,363	7,520	17,707	50,056	85,302	70,020	62,414	62,893	40%	135%	183%	70%	-18%	-11%	1%
Landsbanki	2,028	2,956	12,574	24,740	38,906	38,800	38,576	37,436	46%	325%	97%	57%	0%	-1%	-3%

Chart 33: Icelandic banks balance sheet comparison

Total Assets	2002	2003	2004	2005	2006	2007	2008E	2009E	Y-o-Y Growth						
									2003	2004	2005	2006	2007	2008E	2009E
Glitnir	294,479	391,645	550,472	1,217,647	2,246,340	2,948,910	3,105,880	3,322,442	33%	41%	121%	84%	31%	5%	7%
Kaupthing	1,554,453	2,540,811	4,055,396	5,347,345	5,794,326	6,347,394	7,076,762	-	63%	60%	32%	8%	10%	11%	-100%
Landsbanki	277,824	448,239	737,141	1,405,460	2,172,924	3,057,546	3,297,731	3,617,467	61%	64%	91%	55%	41%	8%	10%
Total Customer Loans	2,002	2,003	2,004	2,005	2,006	2,007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	276,578	349,759	524,020	1,174,428	1,596,184	1,974,907	2,073,652	2,218,808	26%	50%	124%	36%	24%	5%	7%
Kaupthing	269,333	350,995	980,107	1,543,700	2,528,609	3,304,408	3,535,717	3,853,931	30%	179%	58%	64%	31%	7%	9%
Landsbanki	214,787	326,400	542,215	984,593	1,438,395	2,022,738	2,164,330	2,337,476	52%	66%	82%	46%	41%	7%	8%
Deposits	2,002	2,003	2,004	2,005	2,006	2,007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	85,827	107,672	155,602	304,136	438,272	725,349	783,377	900,883	25%	45%	95%	44%	66%	8%	15%
Kaupthing	164,570	182,497	202,193	486,176	750,658	1,381,457	1,726,821	2,072,186	11%	11%	140%	54%	84%	25%	20%
Landsbanki	108,306	152,320	215,730	334,163	682,846	1,421,410	1,535,123	1,765,391	41%	42%	55%	104%	108%	8%	15%
Total Equity	2,002	2,003	2,004	2,005	2,006	2,007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	20,964	29,423	48,474	84,537	146,119	169,201	187,253	204,818	40%	65%	74%	73%	16%	11%	9%
Kaupthing	33,379	45,928	149,370	194,183	323,510	345,607	395,538	445,853	38%	225%	30%	67%	7%	14%	13%
Landsbanki	16,309	22,382	37,705	110,059	144,282	180,008	212,797	244,618	37%	68%	192%	31%	25%	18%	15%
RWA	2,002	2,003	2,004	2,005	2,006	2,007	2008E	2009E	2003	2004	2005	2006	2007	2008E	2009E
Glitnir		287,424	448,819	946,428	1,564,300	2,017,470	1,932,898	2,067,672		56%	111%	65%	29%	-4%	7%
Kaupthing		414,355	1,189,171	1,945,271	3,067,640	4,113,432	3,775,835	4,250,266		187%	64%	58%	34%	-8%	13%
Landsbanki	223,630	350,308	576,498	1,065,074	1,623,143	1,623,143	1,623,143	1,623,143	57%	65%	85%	52%	0%	0%	0%
ROE	2,002	2,003	2,004	2,005	2,006	2,007	2008E	2009E							
Glitnir	16%	20%	25%	22%	26%	16%	13%	11%							
Kaupthing	16%	16%	12%	26%	26%	20%	16%	14%							
Landsbanki	12%	13%	33%	22%	27%	22%	18%	15%							

Source: Company data, UBS estimates

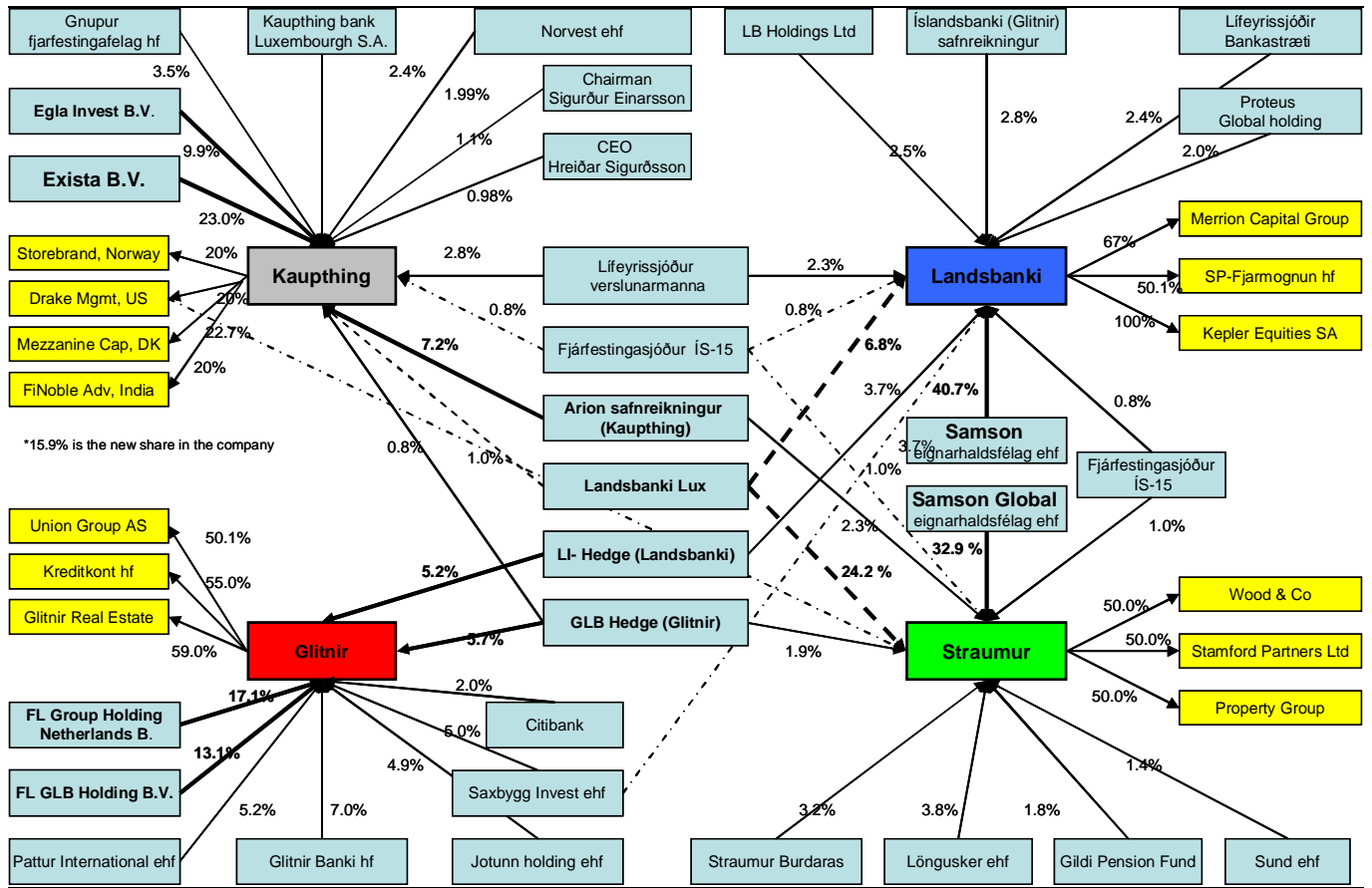
Table 9: Dupont analysis of the Icelandic banks

Revenues/RWA	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	6.6%	6.4%	3.8%	4.6%	4.2%	4.2%	4.2%
Kaupthing	7.7%	4.2%	5.3%	5.5%	4.0%	4.8%	4.6%
Landsbanki	5.4%	5.8%	5.7%	5.5%	6.8%	7.3%	7.8%
Expenses/RWA	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	-3.4%	-3.2%	-1.7%	-1.7%	-2.4%	-2.4%	-2.4%
Kaupthing	-4.5%	-2.0%	-1.8%	-2.0%	-1.9%	-2.2%	-2.1%
Landsbanki	-3.1%	-2.5%	-2.0%	-2.4%	-3.5%	-3.8%	-4.1%
Operating profit/RWA	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	3.2%	3.2%	2.2%	2.9%	1.8%	1.8%	1.8%
Kaupthing	3.2%	2.2%	3.5%	3.5%	2.1%	2.6%	2.5%
Landsbanki	2.3%	3.3%	3.8%	3.1%	3.2%	3.5%	3.7%
Provisions/total assets	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	1.0%	0.8%	0.4%	0.4%	0.2%	0.2%	0.4%
Kaupthing	0.3%	0.2%	0.1%	0.1%	0.1%	0.3%	0.4%
Landsbanki	1.7%	1.0%	1.3%	0.4%	0.3%	0.4%	0.5%
PBT/RWA	2003	2004	2005	2006	2007	2008E	2009E
Glitnir	2.2%	3.1%	2.4%	3.0%	1.7%	1.6%	1.5%
Kaupthing	2.3%	1.9%	3.2%	3.3%	2.0%	2.1%	1.9%
Landsbanki	1.0%	2.5%	2.9%	2.8%	2.8%	2.8%	2.7%

Source: UBS estimates

Tight net of local Icelandic shareholdings

Chart 34: Tight net of local Icelandic shareholdings



Source: UBS estimates, company reports

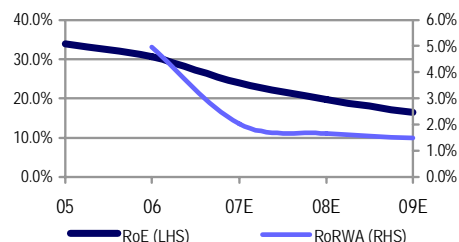
Landsbanki

Per share (Isk)	12/05	12/06	12/07E	12/08E	12/09E
EPS (stated)	2.7	3.7	3.6	3.5	3.4
EPS (UBS adjusted)	2.7	3.7	3.6	3.5	3.4
GOPS	4.2	4.5	4.6	4.8	5.2
DPS	0.3	0.3	0.5	0.5	0.5
BVPS (stated)	11.6	12.9	15.8	18.0	20.7
BVPS (adjusted)	11.6	12.9	15.8	18.0	20.7
Profit & Loss (Iskm)					
Net interest income	22,996	41,491	54,052	60,601	65,449
Other income	<u>37,983</u>	<u>47,934</u>	<u>55,974</u>	<u>57,112</u>	<u>61,246</u>
Total revenues	60,979	89,425	110,026	117,713	126,695
Expenses	(20,966)	(38,588)	(57,515)	(61,164)	(65,845)
Operating profit	40,013	50,837	52,511	56,549	60,850
Provisions and other items	(9,230)	(6,144)	(6,956)	(10,822)	(16,362)
Profit before tax	30,783	44,693	45,555	45,728	44,488
Pre-exceptional net income	24,740	38,906	38,800	38,576	37,436
Capital dynamics (Iskm)					
Risk-weighted assets	0	1,623,143	2,317,362	2,502,751	2,753,026
Tier one capital	126,634	197,468	233,594	271,742	309,457
Total capital	139,708	226,071	270,680	312,639	354,547
Tier one ratio		12.2%	10.1%	10.9%	11.2%
Total capital ratio		13.9%	11.7%	12.5%	12.9%
Net profit after tax	25,019	38,905	38,800	38,576	37,436
Tier 1 requirement	8.0%	8.0%	8.0%	8.0%	8.0%
Less: Working capital requirement	129,851	55,538	14,831	20,022	26,429
Less: Dividends	<u>3,216</u>	<u>3,306</u>	<u>5,820</u>	<u>5,786</u>	<u>5,615</u>
Surplus capital generated	(108,049)	(19,939)	18,149	12,767	5,392
Surplus capital generation ratio	-241.1%	-15.7%	9.2%	5.5%	2.0%
Balance sheet (Iskm)					
Assets	1,405,460	2,172,924	3,057,546	3,305,886	3,709,699
Customer loans	984,593	1,438,395	2,022,738	2,164,330	918,419
Customer deposits	334,163	682,846	1,421,410	1,535,123	1,765,391
Funds under management	345,000	424,000	1,000,000	1,100,000	1,210,000
Loans : assets	70.1%	66.2%	66.2%	65.5%	24.8%
Deposits : assets	23.8%	31.4%	46.5%	46.4%	47.6%
Loans : deposits	294.6%	210.6%	142.3%	141.0%	52.0%
Shareholders funds : assets	8.08%	6.88%	6.02%	6.57%	6.72%
Asset quality (Iskm)					
Non-performing assets			6,068	10,822	11,687
Total risk reserves	9,230	6,144	6,956	10,822	16,362
NPLs : loans			0.30%	0.50%	1.27%
NPL coverage			115%	100%	140%
Provision charge : average loans	1.21%	0.51%	0.00%	0.52%	1.06%
Net NPLs : shareholders' funds			-0.5%	0.0%	-1.9%
Profitability					
Net interest margin (avg assets)	2.15%	2.32%	2.07%	1.90%	1.87%
Provisions : operating profit	23.1%	12.1%	13.2%	19.1%	26.9%
RoE	33.9%	30.6%	23.9%	19.6%	16.4%
RoAdjE	33.5%	0.3%	0.2%	0.2%	0.2%
RoRWA		4.96%	2.03%	1.65%	1.47%
RoA	1.76%	1.79%	1.27%	1.17%	1.01%
Productivity					
Cost : income ratio	34.4%	43.2%	52.3%	52.0%	52.0%
Costs : average assets	2.0%	2.2%	2.2%	1.9%	1.9%
Compensation expense ratio	24.1%	32.5%	41.8%	41.4%	41.5%
Momentum					
Revenue growth	+82.2%	+46.6%	+23.0%	+7.0%	+7.6%
Operating profit growth	+110.5%	+27.1%	+3.3%	+7.7%	+7.6%
Net profit growth	+96.8%	+57.3%	-0.3%	-0.6%	-3.0%
Dividend growth	+67.8%	-12.7%	+72.4%	-3.7%	-3.0%
Value*					
UBS bank valuation					
Leveraged P/E					
Risk tendency P/E					
Merger P/E					
Market capitalisation (Iskm)	174,239	273,053	407,120	326,828	326,828
Conventional valuation					
Market cap./Revenues	5.2x	3.6x	2.9x	2.7x	2.5x
Market cap./Operating profit	8.0x	6.3x	6.1x	5.7x	5.3x
P/E (stated)	10.4x	7.8x	7.9x	8.1x	8.3x
P/E (UBS adjusted)	10.4x	7.8x	7.9x	8.1x	8.3x
Dividend yield (net)	1.2%	1.0%	1.8%	1.7%	1.7%
P/BV (stated)	2.5x	2.2x	1.8x	1.6x	1.4x
P/BV (adjusted)	2.5x	2.2x	1.8x	1.6x	1.4x

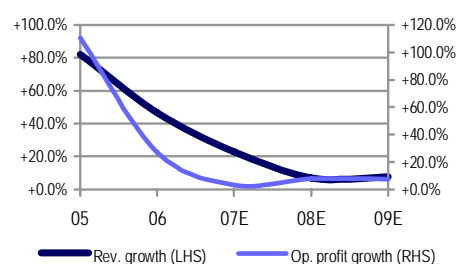
Source: UBS estimates, * Historical, current, & future valuations are based on a share price of Isk28.6 as at close on 19 Feb 2008

Landsbanki is one of the top 3 Icelandic banks. Landsbanki has a strong footprint in its Icelandic home market, grown rapidly over the past 5 years and expanded into 10 European countries with a focus on corporate banking and capital market operations. The next challenge will be the consolidation and integration of acquisitions made.

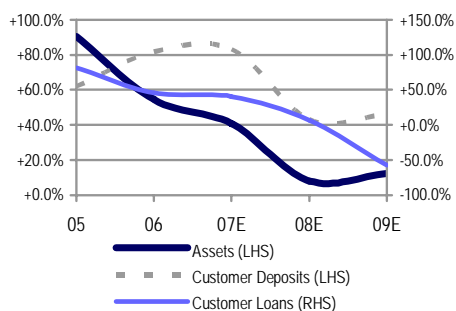
Profitability (RoE & RoRWA)



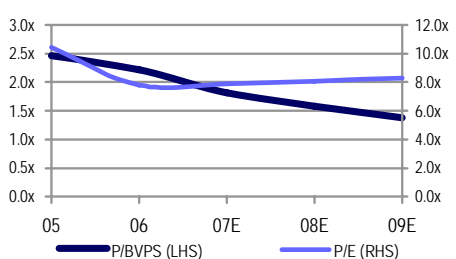
Momentum (Revenue & Operating profit growth)



Balance Sheet Growth



Value (P/Adj. BVPS & P/Adj. EPS)



■ **Landsbanki**

Landsbanki is one of the top 3 Icelandic banks. Landsbanki has a strong footprint in its Icelandic home market, grown rapidly over the past 5 years and expanded into 10 European countries with a focus on corporate banking and capital market operations. The next challenge will be the consolidation and integration of acquisitions made.

■ **Statement of Risk**

Bank earnings are affected by movements in interest rates, the level of economic growth and activity levels in the capital markets, and can be negatively impacted by a slowing of the economy and reduced levels of, and activity in, the capital markets. These companies are also subject to regulatory, legislative, and judicial risk, particularly relating to potential changes in accounting practices, liability arising from perceived conflicts of interest, or damaged corporate clients. These companies are dependent on market and transaction volumes and are subject to technology and operational risk, both of which can impact financial results. Additionally, changes in market structure can adversely impact their ability to compete.

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UBS 12-Month Rating	Rating Category	Coverage ¹	IB Services ²
Buy	Buy	55%	39%
Neutral	Hold/Neutral	36%	36%
Sell	Sell	8%	20%
UBS Short-Term Rating	Rating Category	Coverage ³	IB Services ⁴
Buy	Buy	less than 1%	25%
Sell	Sell	less than 1%	50%

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

3:Percentage of companies under coverage globally within the Short-Term rating category.

4:Percentage of companies within the Short-Term rating category for which investment banking (IB) services were provided within the past 12 months.

Source: UBS. Rating allocations are as of 31 December 2007.

UBS Investment Research: Global Equity Rating Definitions

UBS 12-Month Rating	Definition
Buy	FSR is > 6% above the MRA.
Neutral	FSR is between -6% and 6% of the MRA.
Sell	FSR is > 6% below the MRA.
UBS Short-Term Rating	Definition
Buy	Buy: Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.
Sell	Sell: Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.

KEY DEFINITIONS

Forecast Stock Return (FSR) is defined as expected percentage price appreciation plus gross dividend yield over the next 12 months.

Market Return Assumption (MRA) is defined as the one-year local market interest rate plus 5% (a proxy for, and not a forecast of, the equity risk premium).

Under Review (UR) Stocks may be flagged as UR by the analyst, indicating that the stock's price target and/or rating are subject to possible change in the near term, usually in response to an event that may affect the investment case or valuation.

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Company Disclosures

Company Name	Reuters	12-mo rating	Short-term rating	Price	Price date
Glitnir ^{2, 4, 5, 22}	GLB.IC	Sell	N/A	Isk18.40000	18 Feb 2008
Kaupthing Bank ^{2, 4, 22}	KAUP.IC	Sell	N/A	Isk755.00000	18 Feb 2008
Landsbanki	LAIS.IC	Not Rated	N/A	Isk29.20000	18 Feb 2008

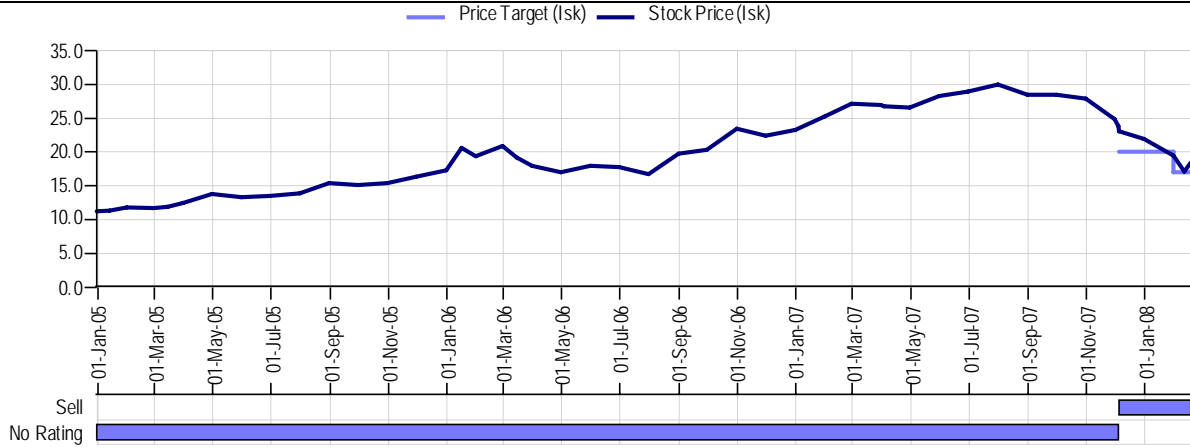
Source: UBS. All prices as of local market close.

Ratings in this table are the most current published ratings prior to this report. They may be more recent than the stock pricing date

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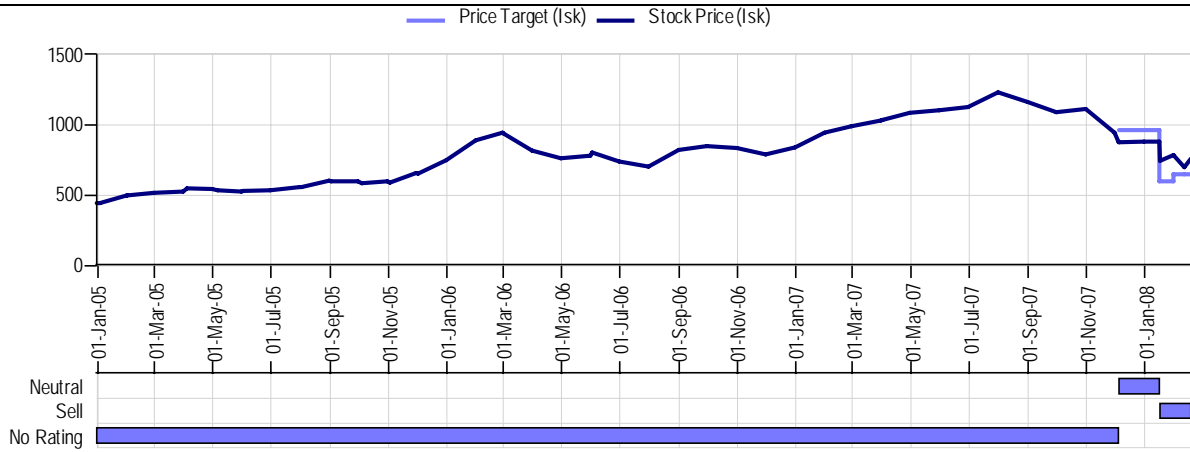
Unless otherwise indicated, please refer to the Valuation and Risk sections within the body of this report.

Glitnir (Isk)



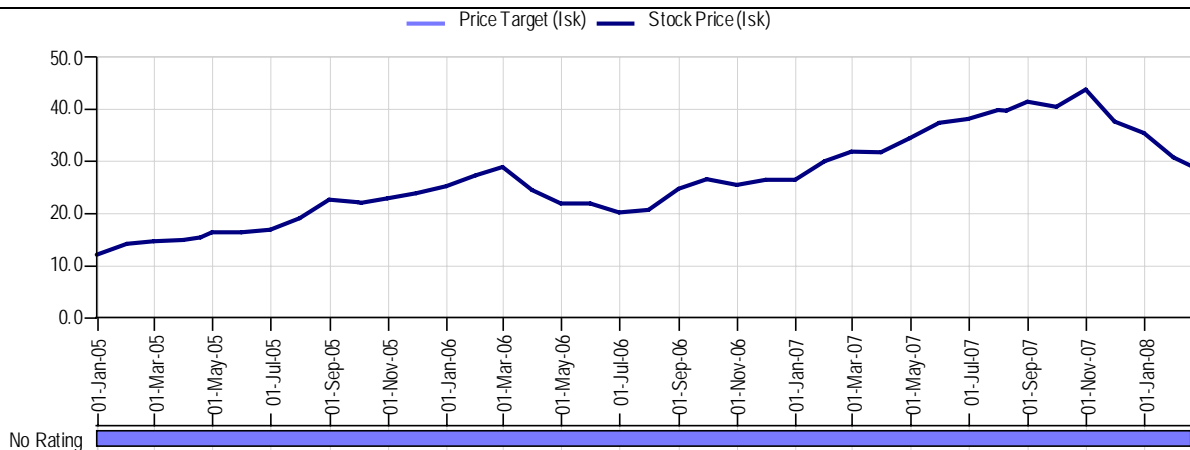
Source: UBS; as of 18 Feb 2008

Kaupthing Bank (Isk)



Source: UBS; as of 18 Feb 2008

Landsbanki (Isk)



Source: UBS; as of 18 Feb 2008

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