

Executive Summary

NAMA “discount” widely misunderstood: We estimate that a 23% discount in the gross lending book destined for NAMA equates to a 42% peak to trough fall in property prices. This purchase price is close to the property market lows seen in the worst banking crisis in Finland in the 1990s, and much lower than in the Swedish banking crisis. The threat to the taxpayer of NAMA overpaying for assets is overlooking the reduction in valuation already built into the cost of acquisition and the potential future levy on the banks if a profitable recovery is not achieved.

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Full nationalisation is the most risky option: The size of the Irish banking sector loan book to GDP is far greater than in previous well referenced banking crises (Finland, Sweden, Japan). Therefore the potential cost of a nationalisation of the Irish banks is far greater to Ireland’s debt raising ability than in previous cases. Rather than the pension, life and investment community, which act as equity/debt holders of the two main Irish banks, being seen as avoiding “moral hazard” in a non-nationalisation scenario, they are acting as a buffer against the recognition on the national balance sheet of these further banking liabilities. There is a significant threat to the State’s funding power and cost with a total nationalisation scenario.

Institutional Equities

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There is already a €825 million benefit to taxpayers from recovery in the market value of Allied Irish Bank and Bank of Ireland: Holding options worth a 25% stake in both AIB and Bank of Ireland, the taxpayer has benefited by €825 million as a result of the shareholding. This is apart from the benefit of the annual 8% yield from the €7 billion injection into the two main banks, which adds a further €560 million to the return per annum.

The Irish economy is suffering from a starvation of liquidity: According to the Bank of International Settlements, international cross border lending is collapsing. Ireland represents the biggest private credit exposure in the Euro-zone for the UK major banks according to the Bank of England. Foreign owned banks in Ireland, which contribute 1/3 of the total Irish lending book, are operating at loan/deposit levels far in excess of optimum levels. There will be an inevitable pull down of lending in the Irish economy from foreign participants as a group as they seek to redress this imbalance. The Irish economy is urgently in need of the liquidity event which the National Assets Management Agency (NAMA) creates by pushing €60—€65 billion into the Irish banking channel.

A “cleansed” Allied Irish Bank and Bank of Ireland post NAMA reduces future tax payer liabilities: Apart from the recent approach by a potential overseas buyer, the Irish banks could be in a much stronger position to raise independently sourced capital after NAMA. With the objective of reducing taxpayer liability to the capital requirements of the banks, the NAMA plan significantly reduces the potential capital burden of Allied Irish Bank and Bank of Ireland on the Irish taxpayer. However, both banks need to have strong residual profitability to raise that capital.

NAMA can reduce potential capital demands on the taxpayer: By removing €85-€90 billion of a lending book from the Irish bank balance sheet, with the coinciding reduction in risk weighted assets (RWA), potentially up to €6-€7 billion in capital demands for the Irish guaranteed banking sector is averted, reducing the burden on the taxpayer for that amount. This is a key under recognised feature of the NAMA plan.

Why the Irish economy needs NAMA to happen

Liquidity crunch necessitates the “NAMA liquidity event”

The 11 institutions studied, providing the vast bulk of lending in Ireland, face a significant imbalance in loan /deposit backing of the existing Irish lending book. This in itself has and will create a significant liquidity shortage in the Irish market. Aside from the capital constraints faced across the Irish lending book, the average loan/deposit level is at 2.56x for the 11 institutions in Ireland. Effectively, the total loan book held by banks operating in Ireland, which currently stands at €534 billion, will need to shrink to €190 billion over the next number of years. This is split between €119 billion for the guaranteed banks and €71 billion for the non guaranteed banks. The long term equilibrium for loan/deposit ratio of 1.25x in the Irish market which requires either a massive increase in the deposit flow or a massive shrinkage of the domestic Irish loan book.

Liquidity Effect: Apart from the basic “bad bank” role, NAMA creates a liquidity event which the market requires to stabilise against the outflow of liquidity which will be needed to redress the loan to deposit ratio. This impact on injecting liquidity into the Irish banks, at a time when the foreign owned banks are facing pressure to shrink their Irish lending book, is essential for restoration of an orderly banking market.

Capital Effect: One of the most positive impacts of the movement of the €85-€90 billion in the lending book from the Irish bank balance sheet to NAMA is the impact on capital requirements among the guaranteed institutions.

NAMA Potential Capital Impact	Gross		Net of RWA	RWA	RWA	Core Equity Tier 1		
	Lending	Impaired		Weighting	Adjusted	7%	8%	9%
Loans Transferred	84.6	17.0	67.6	1.1	80.3	5.6	6.4	7.2

Assume NAMA takes €85 billion in assets from the balance sheet of the Irish banks. Either capital rests against this book for regulatory purposes, or a shortfall must be funded by the bank. On a stand alone basis, taking an equity tier 1 requirement of 9% for this type of lending book, approximately €7.2 billion of capital would be required in reserves. By moving it to NAMA, either existing capital can be moved to back the remaining lending book or a capital shortfall created by this exposure is extinguished.

This is a substantial offsetting benefit for the taxpayers from the creation of NAMA, in reducing the potential recapitalisation liability.

In notional terms, AIB benefits by €2 billion under this assumption and Bank of Ireland benefits by €1.5 billion, if forced to meet a capital requirement against a stand alone book.

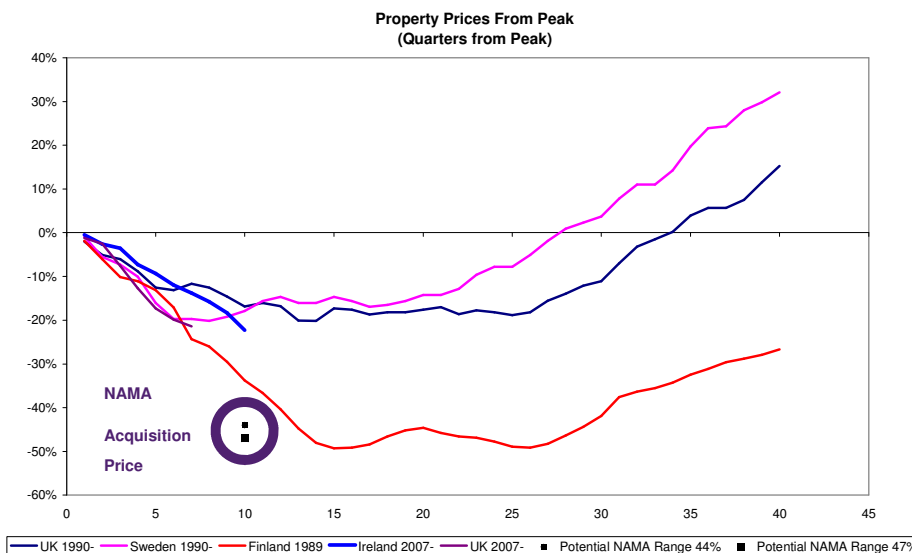
Secondly, the notional capital requirements of the Irish banks reduces in two ways 1) because of a reduction in the loan/deposit level to 1.25x across the guaranteed banks from 1.5x currently, the reduced reliance on the wholesale market decreases liquidity uncertainty and therefore overall risk in the banks 2) the “cleaner” Irish banks have simply less risk than before and much less risk than UK peers.

Concern on overpayment overdone:

Using our simulation of NAMA acquiring €85 billion in the gross lending book, and using an estimated loan to value of 75%, the agency will be acquiring assets at a 42% discount to the peak price of the assets in the loan book. We estimate that the Irish guaranteed banks have made, at a minimum, provisions of c.€6 billion against the loan books that are eligible for NAMA.

According to NAMA, 33% of the loans are on investment properties, and 50% of the loans are cashflow generative. In our simulation of NAMA, one third of the assets are non Irish with one third also in the investment property category. In effect the largest part of any write down will come on the development land exposure which for the three largest institutions comes in at c.€27 billion.

Assuming that on average, NAMA pays a 42% peak to trough price for the asset acquired, using the worst property market comparison, that of Finland in 1990, the acquisition price will be surpassed within 4/5 years, with a substantial uplift in later years.



However, this is certainly a much worse scenario than seen in Sweden or the UK during the same time period, when the property declines were half the level seen in Finland. Both the UK and Swedish property market saw a more sustained recovery from a higher starting point.

In the current market the Bank of England states “in the United Kingdom, property prices had fallen further than in the early 1990s recession, with residential and commercial property prices down 20% and 41% respectively from their 2007 peaks”. This as a framework for assessing the damage to property values implies that if NAMA is acquiring assets at c42% from top end valuation, then it is in line with the falls already seen. Meanwhile, the valuation advisor to NAMA John Mulcahy, stated that property prices had fallen 50% from their peak and that prices had reached the bottom of the cycle. Mr Mulcahy said that the long term value of the loans would be set according to long term economic value reflected in the seven year cycles seen in the market since 1970.

NAMA may be acquiring the worst case scenario of asset prices in an illiquid market, with valuations reflecting a liquidity crisis rather than fundamental value. If liquidity is the driving factor behind the collapse, then the liquidity imbalance in the Irish banking system is the single most important factor in dictating future direction of prices.

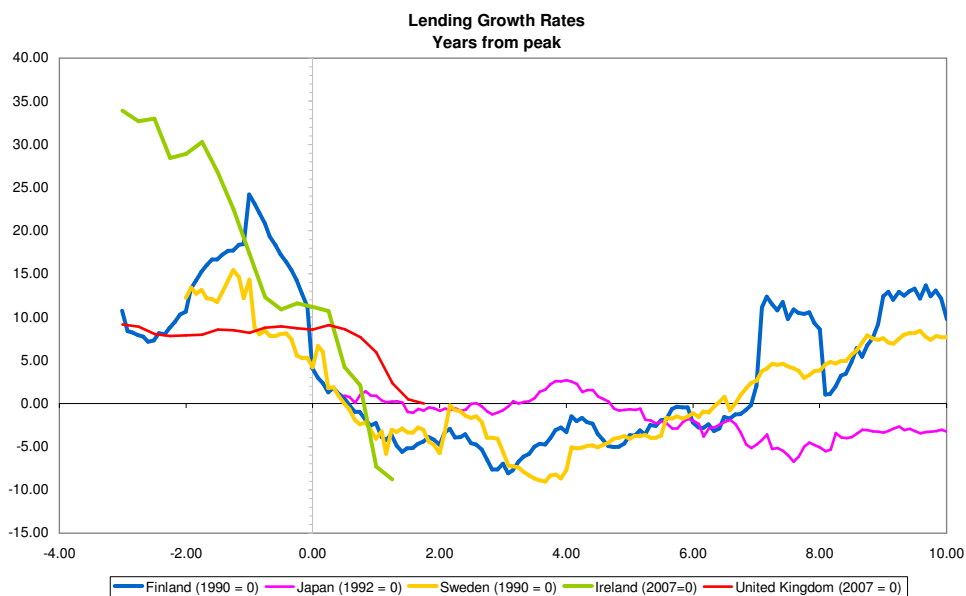
What is driving the Irish lending collapse?

Lending is now falling in Ireland at a faster pace than that seen in Finland and Sweden in the early 1990s, reflecting the frozen nature of the banking sector in the current crisis. This is manifesting itself in a sharp deterioration in asset values. Official property prices appear to be continually underestimating the scale of the fall in land and property prices in Ireland given the comments from the market.

From peak to trough, the level of outstanding loans in Finland fell 25% in seven years after reaching its peak in 1990. In Sweden during the same period until 1996, the national lending private sector book contracted by 25% also. Using what happened in Finland as an example, which suffered both a severe contraction in GDP (15% peak to trough) and a significant jump in unemployment to a peak of 22%, the pull down of credit is worth a comparison with Ireland. In Finland, property prices fell 50% peak to trough during that level of lending contraction.

Using a 25% shrinkage, the Irish lending book, among the 11 institutions, will have to contract by €90 billion over the course of the next number of years to match that of the Finnish and Swedish example. However, Ireland is currently seeing an accelerated lending decline, indicating that there is a greater than expected impact on the credit supply side, rather than recessionary credit demand patterns. This is a danger to GDP expectations and potentially asset values.

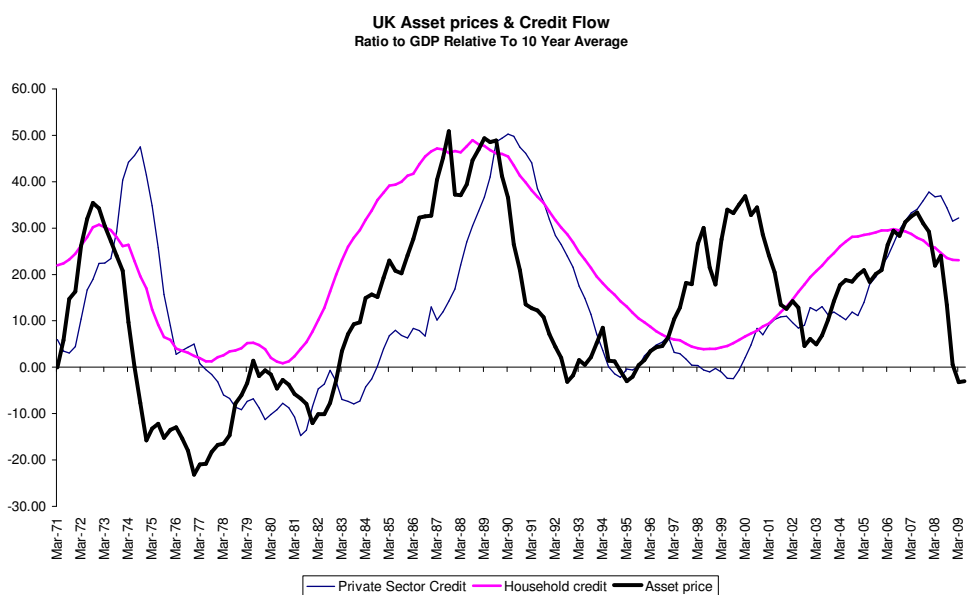
The market share of the Irish owned banks in new lending in recent months is extremely high, lead by AIB and Bank of Ireland. This is likely to continue as foreign owned participants, and Irish participants with severe capital constraints, withdraw supply from the market.



The political pressure on the UK banks to lend domestically continues to increase. The two UK banks with large operations in Ireland, Lloyds and RBS, are both dealing with significant Government ownership (43% and 73% respectively), and are likely to be under pressure to lend into the UK as a priority.

For banks to lend, liquidity must be available. For sustainable liquidity beyond the supply of ECB funding, deposit levels owned by Irish banks must increase over a long term basis, or there must be a positive liquidity event (potentially NAMA).

The UK example of the impact of private sector and household credit on asset prices can be seen below:



The cause and effect of the ratio of private sector credit to GDP is all the more important for Ireland given the extremely strong credit growth seen in the economy over the past 10 years. However, asset prices do appear to lead supply of credit. Rebounding asset values certainly encourage lending expansion, whether pulled by demand or pushed by supply.

According to the Bank of International Settlements, the fall in cross-border lending has been much sharper than that in domestic lending consistent with a 'home bias' in bank lending. In its recent Global Financial Stability report the Bank of England states the slowdown in cross border lending "could, in part, be the unintended consequence of banks satisfying criteria for receiving government support". "Some banks appear to be moving towards a model of funding domestic credit through locally sourced deposits..... A number of international banks have also noted that capital constraints mean they have increasingly focused on their 'core' business. Cross-border activities that were not seen as central to their business models have been scaled back." UK-resident banks faced large outflows of foreign deposits in Q4 2008 , including almost US\$100 billion to Russia. In total, around 35% of the stock of lending to domestic non-financial companies is accounted for by foreign-owned banks resident in the UK. Growth in lending from foreign-owned banks has fallen more quickly than credit from UK-owned banks in the past few quarters. That suggests that UK non-financial companies could be at risk from a further withdrawal of cross-border activity.

Irish Banking Market – Deep structural change inevitable

In analysing the 11 institutions which publish lending data for Ireland, the total amount outstanding comes to €365 billion, c2.2x GDP. The figures are based on those reported by the financial institutions and estimates based on disclosed and undisclosed data. The market data excludes credit unions and smaller lending book exposures of non disclosed market participants which contribute c.€20 billion in lending. We have made approximates where market data was not available and broad assumptions based on information disclosed.

The banks falling under the guaranteed Irish institutions make up c.66% of the total book. Of the total Irish lending exposure, c.33% of the total book is with non guaranteed institutions.

Irish Lending Book (€bn)	Total Group	Total Irish	Irish Mortgage	Irish Property/Dev	Non Property Lending
AIB	134	78	27	30.3	21.2
Bank of Ireland	133	64	28	15.3	20.7
Anglo Irish Bank	72	43	0	30.3	13.0
INBS	11	5	2	2.7	
EBS	17	17	15	2.3	
Irish Life & Permanent	40	33	30		2.4
UlsterBank/ RBS		57	23	17.0	16.4
BOSI/Lloyds/HBOS		33	10	13.5	9.9
KBC Bank Ireland(IIB)		19	14	1.8	3.1
NIB/Danske		11	4	3.3	3.4
ACC/Rabobank		6	0	3.8	1.8
		365	153	120	92
% of total Irish lending			42%	33%	25%

44% of all lending by banks in Ireland has been in the mortgage sector. Mortgages are the biggest single segment of the Irish lending book, as estimated in 11 institutions, representing a total value of €153 billion.

Property investment/land/development lending comes in at c.33% of the total Irish lending shown by institutions operating in Ireland. It is estimated that this book size reached €120 billion in the latest figures released among the 11 institutions covered. In effect 75% of the Irish lending book of the 11 institutions covered is property related lending.

The non-property lending makes up 25% of the total lending book in Ireland, on the most recent figures. This is the area of most economic sensitivity in terms of personal, SME and large corporate exposure, and is sized at around €92 billion on recent figures. It is the supply of credit in this area that is most important for working capital in the economy.

Of lenders in the Irish market only, AIB is the largest lender with a 21.4% share of the total lending book, followed by Bank of Ireland at 17.5%. The next largest is Ulster Bank with an approximate loan book share of 15.5%.

Irish Lending Book (€bn)	Total Irish Lending	
AIB	78	21.4%
Bank of Ireland	64	17.5%
Anglo Irish Bank	43	11.9%
INBS	5	1.3%
EBS	17	4.7%
Irish Life & Permanent	33	9.0%
UlsterBank/First Active/ RBS	57	15.5%
BOSI/Lloyds/HBOS	33	9.2%
KBC Bank Ireland(IIB)	19	5.1%
NIB/Danske	11	2.9%
ACC/Rabobank	6	1.5%
	365	

% of total Irish lending

Bloxham Estimates/Company reports/BIS

Irish Lending Book - Mortgage Market

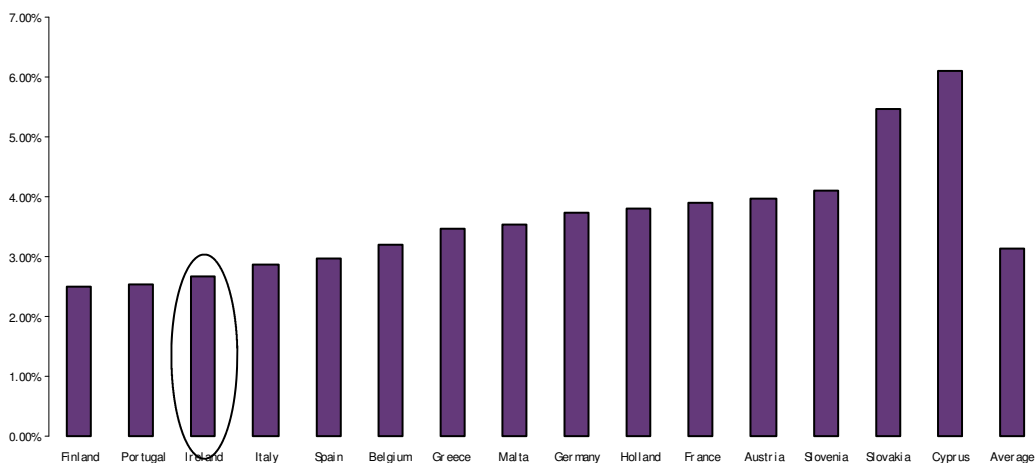
Irish Lending Book	Mortgages	Mkt Share
AIB	26.5	17%
Bank of Ireland	28	18%
Anglo Irish Bank		
INBS	2.3	2%
EBS	15	10%
Irish Life & Permanent	30.4	20%
UlsterBank/RBS	23.34	15%
BOSI/Lloyds/HBOS	10	7%
KBC Bank Ireland(IIB)	13.7	9%
NIB/Danske	3.9	3%
ACC/Rabobank		0%
Total	152.8	
Guaranteed Banks	101.9	67%
Non guaranteed banks	50.9	33%

Irish Life & Permanent lead the total outstanding mortgage amount with a 20% market share, followed closely by AIB and Bank of Ireland at 17% and 18% respectively. The largest non guaranteed bank market share is Ulster Bank/First Active, which shows a €23 billion mortgage book in Ireland.

The guaranteed banking portion of total lending stands at 66%, with approximately €102 billion in outstanding mortgages. The non-guaranteed banks collectively have a €50 billion mortgage exposure in Ireland, representing 33% of the total market.

Average mortgage rates in Ireland are now among the lowest in Europe. This is of particular concern for the profitability of the sector given the high loan/deposit ratio evident across the Irish banking sector. It appears inevitable that margins will have to be increased in the sector, to balance against the cost of funding.

Average Mortgage Rates- June 2009



Irish Lending Book - Investment & Development Property

We have used the available market information to form a broad estimate of the Property Investment & Development (PID) exposures of the 11 institutions operating in the Irish market, and the overseas exposures of the Irish banks. The breakdown is approximate based on disclosed information, and estimates of undisclosed exposures.

Property: Investment, Land & Development	Total Ireland	Total UK	ROW	Total World	
AIB	30.3	8.8	9.2	48.3	Jun-09
Bank of Ireland	15.3	16.9	1.8	34.0	Mar-09
Anglo Irish Bank	30.3	17.1	9	56.4	Mar-09
INBS	2.7	4.3	1.1	8.1	Dec-09
EBS	2.3			2.3	Dec-09
Irish Life & Permanent				-	Dec-09
UlsterBank/RBS	17.0			17.0	Jun-09
BOSI/Lloyds/HBOS	13.5			13.5	Jun-09
KBC Bank Ireland(IIB)	1.8			1.8	Dec-09
NIB/Danske	3.3			3.3	Jun-09
ACC/Rabobank	3.8			3.8	
All Banks	120	47	21	188	
Guaranteed Banks	80.9	47.1	21.1	149.1	

The guaranteed banks hold 67% of a total book which totals €188 billion in PID exposure, made up of €120 billion in lending into Ireland. The non-Irish owned banks have c.€40 billion in PID exposure into Ireland. This represents a substantial set of assets yet to be included under NAMA consideration.

Assuming that €85 billion is destined for NAMA, the remaining total exposure to PID is €98 billion for the 11 institutions. For the guaranteed banks, we estimate that €64 billion in PID exposure will remain outside NAMA. This represents a significant portion of the property.

Irish Lending Book-Non Property Lending

Irish Lending Book (€'bn)	Non Property Lending	Approximate Share
AIB	21.2	23%
Bank of Ireland	20.7	23%
Anglo Irish Bank	13.0	14%
INBS		0%
EBS		0%
Irish Life & Permanent	2.4	3%
UlsterBank/RBS	16.4	18%
BOSI/Lloyds/HBOS	9.9	11%
KBC Bank Ireland(IIB)	3.1	3%
NIB/Danske	3.4	4%
ACC/Rabobank	1.8	2%
	92	100%
% of total Irish lending	25%	

Bloxham Estimates/Company reports/BIS

The €92 billion non-property related book relates to personal lending, SME and corporate lending and represent the most economically sensitive area, particularly in terms of working capital.

Of a total non-property lending book in Ireland, AIB and Bank of Ireland represent approximately 45% of the market. The next largest supplier of credit has been Ulster Bank/RBS with an 18% market share. Bank of Scotland Ireland has also made substantial progress in recent years and holds a 11% share of the non property book. In total the non-guaranteed institutions represent a substantial 38% of the market. Combined with Anglo Irish Bank, which is nationalised, this total reaches 52%.

Observations on the Market :

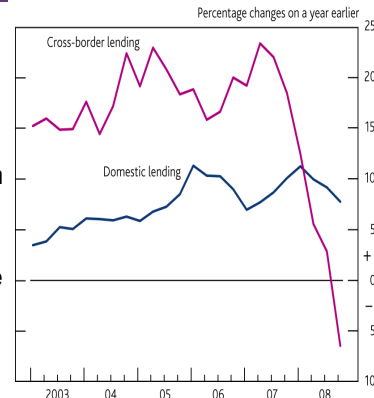
- **Property exposure is vastly over represented in the Irish lending book:** With up on 75% of the total Irish lending book, there will be an inevitable wind down of this over exposure in the medium term.
- **Very strong non-domestic influence in the Irish lending market:** Effectively, over 1/3 of all loans in Ireland outstanding are from banks which are not domestically owned. Assuming that the “nationalisation” of banking practice accelerates, the likely flow of future lending in Ireland will have to be driven by domestic capital, domestic deposits and domestic liquidity origination for the most part.
- **Cross border lending flow of key importance:** The UK is facing similar cross border liquidity pressures as indicated in the recent Bank of England Financial Stability report. Already the foreign percentage of lending flow in the UK has fallen to negative levels. According to the BIS, foreign lending into the UK has now fallen to the lowest levels since 2003. It can be assumed that foreign lending in Ireland is reaching extreme levels given the market share of AIB, Bank of Ireland and EBS in the mortgage market.
- **The Personal/SME/Corporate Market needs competition:** Any reduction in supply of lending, outside AIB and Bank of Ireland, will have an impact on market competitiveness. This is especially true if either Anglo Irish Bank leaves the market or the foreign owned banks operate at lower levels of market participation. Therefore, a potential “third force” in banking may be required to include provision of services in the Personal/SME/Corporate lending area.
- **National Recovery Bank... but for filling where competition is weak:** Should the market be unable or unwilling to supply credit to the Personal or SME sectors then consideration must be made of the role that a National Recovery Bank may have in the future development of the economy. This is particularly the case if the corporate/SME lenders are not fulfilling economic objectives. However, a national recovery bank would not resolve the liquidity problems or facilitate the recovery of the existing Irish banks, two critical facets of any sustainable recovery of the banking sector and the economy.
- **Outside NAMA:** A substantial portion of the Irish Property Investment & Development loan book sits outside the NAMA remit. How NAMA interacts with other players in the market will be of critical importance to the development of the market over the next five to ten years.
- **Mortgage Market:** Rates are at the low end of European averages and will most likely need to move ahead to compensate for higher funding costs across the sector.

Cross Border Lending: From opportunity to threat

Relationship with the UK banks – The impact on lending

The biggest inter-country relationship which the banking sector in Ireland has is with the UK. UK banking exposure to Ireland is the highest in the Euro-zone, standing at €121 billion according to the BIS and Bank of England. This implies that the progress of the Irish economy represents a critical exposure for the UK banking sector.

The net exposure of the two largest UK banks operating in the Irish market is approximately €90 billion or c.25% of the total Irish lending book. According to the BIS, the ultimate risk exposure to Ireland is actually €30 billion higher than this figure, representing Irish counterparties to the other UK banks.



UK Banks - Irish Exposure Euro'bn	Total	Mortgages	Property Inv&Dev	Other Lending
RBS	56.7	23.3	17.0	16.4
Lloyds	33.4	10	13.5	9.9
Total	90	33	30	26
Total Irish Market	365	152.8	120	92
% of Irish Market	24.7%	21.8%	25.3%	28.6%
Ultimate Risk Basis To Ireland	121			
Shortfall	31			

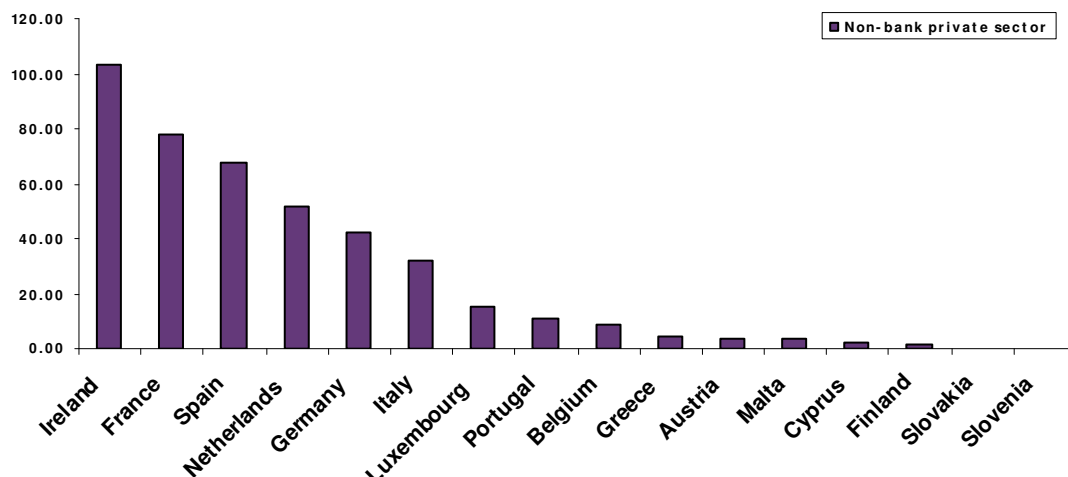
Ireland is the highest single country exposure in Europe for the UK banks. This is a stark reminder of the dependency on UK Government Policy that the Irish banking sector has on future liquidity flows in the Irish market.

The problem for Ireland is that the share of lending from UK owned banks is 25% (22% in mortgages), a substantial portion of the lending book. Therefore, UK Government policy toward the treatment of the overseas operations of the UK banking sector, particularly that of the RBS and Lloyds is of critical relevance to the future direction of the Irish banking sector.

It appears inevitable that given the high direct exposure, on a relative and absolute basis to Ireland, that the UK will seek to reduce its long term banking exposure to the country.

Adding in the remainder of the foreign owned banks, the non-domestically originated loan book amounts to 35% of the total domestic lending book. This is a very significant portion of the existing lending supply.

UK Bank Exposure To Eurozone (£'billions)



Irish banking exposure to the UK:

On the other side of the relationship, the Irish banks' UK exposure is €113 billion or €126 billion on an ultimate risk basis. Again this represents a critical overseas exposure for the Irish banks, representing €43 billion in mortgages, €47 billion in PID exposure and €23 billion on non property lending.

Irish Banks - UK Exposure Euro'bn	Total	Mortgages	Property Inv&Dev	Other
AIB	21.8	3.8	8.8	9.2
BOI	60.14	31	16.9	12.24
IPM	8	8		
Anglo Irish	18.7		17.1	1.6
INBS	4.3		4.3	
Total	112.9	42.8	47.1	23.1
Ultimate Risk Basis To UK	125.7	176.0	126	
Shortfall	12.8			

Bloxham Estimates/Company reports/BIS

The reciprocal exposure between the UK and Ireland is close to neutral on an ultimate risk basis.

Will Rabobank show the way?

The recent comment from senior management in Rabobank is of particular relevance when reviewing the future of the Irish banking sector and the potential credit sources.

Rabobank's CFO stated that he believes that ACC has no future in Ireland as a result of an uneven playing pitch. Based on the economic outlook and the bad debt experience, Rabobank appear to have decided to exit the market. Rabobank/ACC represent just 1.5% of the total lending book in Ireland. However, the departure of any foreign owned bank in Ireland is a cause for concern, especially in light of the high levels of Irish lending supply which the non-Irish owned banks have been responsible for over the past 10 years.

Speculation earlier in the summer about Bank of Scotland Ireland raises the possibility of a key market participant leaving the Irish market.

Changing role for AIB and Bank of Ireland

The role of AIB, Bank of Ireland and the smaller Irish banks will most certainly be greater in the Irish market over the next number of years. This comes at a time when EU Competition worries are forcing a review of the operational strength of Lloyds Banking Group and RBS within the UK.

The Irish lending market inevitably faces a conflict, with the absolute necessity that AIB and Bank of Ireland, and the smaller tier Irish banks increase market share in critical markets to meet economic demand, while EU competition mandates there can be no benefit gained from Government support. It is therefore imperative that AIB and Bank of Ireland move from Government influence as soon as practical for a lending demand to be fully met within the boundaries of EU competition law.

Ireland - The liquidity trap/ The necessity of NAMA's impact

We have reconstructed the loan/deposit ratio of the institutions lending in Ireland, based on company reports and Bloxham estimates.

Liquidity Crunch & NAMA			
	Total Loans	Deposit	Loan/Deposit
AIB	134	83.0	1.61
Bank of Ireland	133	86.0	1.55
Anglo Irish Bank	72	30.4	2.38
INBS	11	7.5	1.40
EBS	17	10.4	1.64
Irish Life & Permanent	40	12.9	3.10
UlsterBank/First Active/ RBS	57	20.0	2.83
BOSI/Lloyds/HBOS	33	6.6	5.06
KBC Bank Ireland(IIB)	19	11.2	1.66
NIB/Danske	11	4.0	2.65
ACC/Rabobank	6	1.3	4.31
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Total Lending	532	273	1.95
Target level	342		1.25
Reduction required	190		
<i>% Of total loan book</i>	36%		
Guaranteed Banks	407	230	1.77
Target level	288		1.25
Reduction	119		
<i>% Of Guaranteed loan book</i>	29%		
Non Irish Banks	125	43	2.90
> target level	54		1.25
Reduction	71		
<i>% of Foreign Owned Irish Loan Book</i>	57%		

In terms of net exposure to the wholesale market, the 11 lenders in Ireland are carrying an average loan to deposit ratio of 1.9x. This is well in excess of the equilibrium accepted long term norm of a 1.25x deposits. The long term equilibrium level of 1.25x needs to be reached as soon as possible given the high price of wholesale monies which threatens the profitability of the sector. This is particularly true in the mortgage market in Ireland, where mortgage rates have remained at the low end of European averages over the past six months.

Without significant new sources of deposits into Ireland, shrinkage of €190 billion in the lending book will be needed over the next number of years to move toward international norms, and reduce the reliance on the volatile wholesale market. This shrinkage would need to be accelerated if Ireland were to lose deposits to abroad on fears for the safety of the guaranteed scheme. Therefore, a recurrence of the deposit flights, post the nationalisation of Anglo Irish Bank in February, would create further liquidity stress in the system.

The guaranteed Irish institutions have a combined loan/deposit ratio of 1.77x, which implies that €0.43 in every €1 of the Irish lending book, is funded from non-deposit sources. The foreign owned Irish lenders have a loan to deposit ratio of 2.9x, vastly inferior to the market equilibrium level, implying over €0.65 of the total funding is derived from the wholesale markets. This is a vast imbalance compared to long term bank balance sheet norms.

Given the high cost of wholesale money in the inter-bank market, the likelihood is that apart from any reaction driven by rising bad debts and declining economic growth, foreign owned banks in Ireland will have to redress the loan to deposit ratio by reducing lending supply/shrinking current lending books. This comes at a time when domestic banks have neither the capital certainty or the liquidity to fill the gap exposed in the countries lending profile.

Aside from Government influence/policy toward lending in other countries, the share of the lending market must fall at the non-Irish owned banks, from an unsustainable 2.9x loan to deposit ratio to c.1.25x in the long term. A movement such as this would require a shrinkage in the lending book of € 71 billion, which equates to 19% of total lending to Ireland currently among the 11 institutions studied. A reduction of this size in the lending supply would in itself create a highly significant shrinkage in availability of lending in Ireland, exasperating liquidity problems in the local asset market.

Liquidity Crunch & NAMA	NAMA Acquired Lending Book	Post NAMA Total Loans	Existing Deposits	New Loan/Deposit
AIB	25	109	83	1.3
Bank of Ireland	18	115	86	1.3
Anglo Irish Bank	33	39	30	1.3
INBS	7	4	8	0.5
EBS	1	16	10	1.5
Irish Life & Permanent		40	13	3.1
		323	230	1.4

For the Irish guaranteed institutions, the current loan to deposit level of 1.77x would require a shrinkage of €120 billion. Again this is a substantial liquidity drain, and represents a very significant threat to Irish credit supply levels.

By using NAMA to take €90 billion in lending off the top line of the Irish Guaranteed lending book, the loan to deposit ratio falls from 1.9x ratio to 1.37x. This would come at a time when foreign banks will most likely be shrinking Irish exposure due to their liquidity constraints.

The biggest benefit of the liquidity injection from NAMA will be to AIB, Bank of Ireland and Anglo Irish Bank, who in combined terms would move to a sustainable Loan/Deposit ratio of 1.3x. The potential impact of NAMA on liquidity is discussed later.

The tightening of the passport rules for banks setting up operations in the UK has been recently reported on. Irish Life & Permanent are believed to have shelved plans to set up a deposit gathering bank due to increased requirements from UK regulators. The Treasury has already paid out c.£35 billion in deposits on two Icelandic banks which operated in the UK before failing. It now wants a full subsidiary set up before allowing banks from overseas to take deposits. It is clear that the risk of allowing the passport rules on EU banking to operate with impunity exposes the domestic taxpayer to an overseas banking failure. The UK taxpayer is already assuming a significant level of risk from the asset insurance program, and the Treasury is unlikely to want to extend that risk to foreign operated banks.

Irish Economic & Banking Crisis Compared

Comparison of Crisis Entry Statistics							
	Japan 1990	Sweden 1989	Norway 1990	Finland 1990	Average 1990s	UK 2007	Ireland 2007
Household Indebtedness	129.7	124.8	148.6	88	122.8	168.5	212
House Price Build Up (5Yrs)	47.8%	72.4%	84.9%	84.3%	72.4%	88.3%	60.0%
Year end Bank Assets To GDP	162.8	111.7	96	134.4	126.2	444	316

Peak To Trough							
	Japan 1991	Sweden 1989	Norway 1987	Finland 1989	Average 1990s	UK 2007	Ireland 2007
House Prices	36	19	30	41	31.5	21	20
Equity Prices	75	48	52	68	60.8	48	81

1. The table shows the 5 years pre the peak in the market
2. Household indebtedness as measured by household liabilities as a % of disposable income

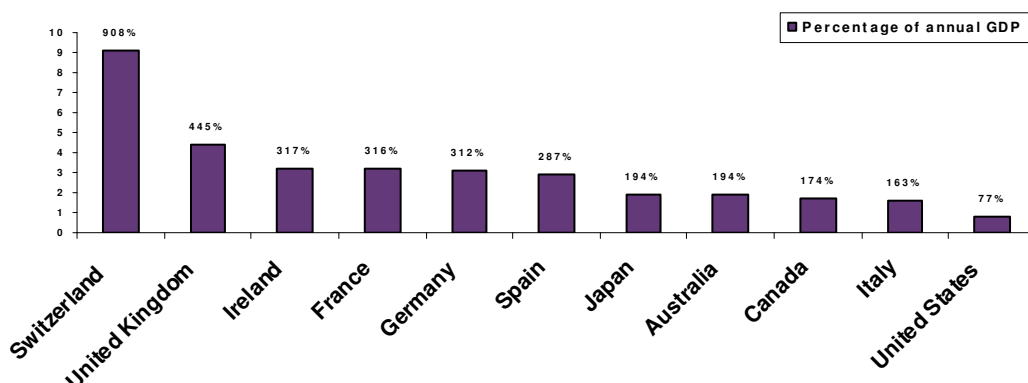
Ireland is more exposed to the banking sector than in previous crisis, under two critical measures:

- Irish household indebtedness as measured by household liabilities to disposable income, is running at 212% and significantly ahead of Finland and Sweden in the early 1990s examples. This is partly due to the strong propensity for home ownership in Ireland, which runs well ahead of European norms. However, it is also driven by the very high level of Property Investment & Development exposure.
- Ireland bank assets to GDP is running at 316%, compared with just 112% in Sweden and 96% in Finland in 1990. This is behind the level currently seen in the UK and well behind Switzerland. However, Ireland is inline with France and Germany. As a financial markets hub, the high level of bank assets to GDP is not as surprising as the original observation would suggest.

In comparison of equity market performance, on the assumption that March 2009 represented the lows of the stock market, Ireland's fall of 81% is the most severe of any of the comparatives. This is partly due to the heavy exposure to banking shares at the peak to the market but also the high percentage of construction related companies on the exchange at the time.

In Ireland, the increase was at a lower level at 60%. (BOE 'The aftermath of financial crises', American Economic Review, Vol. 99 No. 2, pages 466–72). The study analysed a large sample of systemic financial crises to find that, on average, house prices fall 35.5% over 6 years, while equity prices fall 55.9% over 3.4 years.

Consolidated Banking Sector Assets To GDP



Key observations on the Finland banking crisis 1990-1994

By far the worst economic disaster happened in Finland:

- The property market fell 41% peak to trough and the local stock market fell 70%. The stock market bottomed by the end of 1992, having peaked in late 1989. The stock market bottom pre-empted the economic bottom by one year. The Irish stock market hit a peak to trough fall of 81% in March 2009. *The property market is already down by at least 20%, although the anecdotal evidence suggests a fall much greater than that. Will the stock market pre-empt the Irish economic recovery?*
- The collapse of the Soviet Union put the Finnish economy in turmoil. 20% of Finnish exports were to the Soviet Union, which went to zero during the crisis. *Irish exports continue to be extremely resilient.*
- Unemployment rose from 3% to 18% in 1990-1994. Levels of employed people in the economy fell from 2.7 million in 1990 to 1.9 million by Q 1 1994. *Already Irish unemployment is forecast to reach 15% in 2010.*
- 225,000 people were employed in construction in 1990. This fell to just 82,000 by 1994, providing the bulk of the rise in unemployment during the crisis.
- Public debt increased from 12% to 60% of GDP in 1990-1995. *Already Irish public debt to GDP is over 60% in 2009.*
- Cumulative credit losses of Finnish banks amounted to 15% of GDP. Equating a similar figure to Ireland would see losses reach € 22 billion. *The IMF forecasts losses would reach €35 billion.*
- Finnish currency suffered from speculative attacks against the fixed exchange rate. The Central Bank kept interest rates on average at 13% between 1989-1992 in order to protect the currency and take steam out of an overheated property market. To avoid a devaluation of the currency, the policy priority became internal devaluation from depressing demand and cutting wages. However, the Bank of Finland abandoned the policy of fixed exchange rates in September 1992 during a currency crisis after a massive reserve loss. Once allowed to float the currency fell 40%. The ECB rate has already hit 1%, while membership of the Euro implies a fixed exchange mechanism.
- Due to an accounting loop hole, the Finnish banks built up significant revaluation reserves. These reserves made up 80%-90% of the capital base in Finland in 1990. *While the Irish banks are not faced with the same accounting error, the procyclical nature of BASEL has impacted on capital buffers against the sharp decline in property values.*
- By 1993 the trend of negative GDP had started to break in Finland. By 1994 in Sweden and 1996 in Finland, bank profits increased significantly to levels seen before the crisis.

Ireland and the bond market

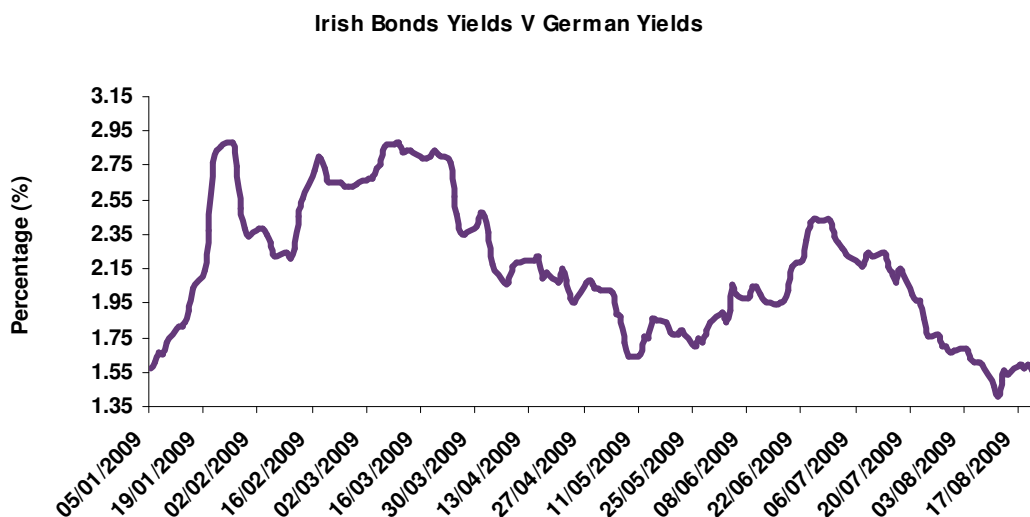
The National Treasury Management Agency (NTMA) has now raised all but €1bn of this year's €25bn bond sale target - €20bn of new funding to meet the country's projected 2009 budget deficit and €5bn to refinance maturing debt. Demand at the August monthly auction (€1bn) was very strong, just as it was in July, with a key factor being that Ireland is paying more in interest to investors than any other Eurozone country to achieve its funding. The one positive is that the premium (or interest-rate differential) Ireland is paying over benchmark German bonds has narrowed in recent months.

The yield spread of 10-year Irish debt over equivalent German paper has dropped to c. 1.60 % at present from just under 3% back in March, as fears of an Icelandic-style bust receded. It is clear that overseas investors now believe that Ireland is dealing with its economic/financial problems, and as long as that remains the case then the NTMA should not have too much difficulty in raising its required funding. Indeed, with the European Central Bank in effect saying that no Eurozone member would be allowed default on its debt, and that a mechanism would be set up to help individual member states that may run into difficulty, demand for Irish bonds has been solid in recent months. The bottom line is that Ireland is in a lot more comfortable position than many other Eurozone members, with current cash balances of around €25bn, not to mention the €19bn or so in the National Pension Reserve Fund (NPRF).

Therefore, the uncertainty on Ireland's short term debt outlook is clearly linked to two factors in the political mix in the next month-

- 1) Approval of NAMA
- 2) The Lisbon Treaty vote.

Irish Bonds Yields V German Yields



We believe the cost of debt improvement is due to perception of the Irish fiscal state, including the aggressive policy taken but also the setting up of NAMA.

What is the cost of full nationalisation ?

National debt (€ bn)							
	2008	2009	2010	2011	2012	2013	Total
National debt post Nama (€ bn)	-	121185	189983	196344	206407	210956	210956
Interest cost (EUR bn)	1641	3956	5613	6700	7578	8100	8100
Implied Rate (%)		3.3%	3.0%	3.4%	3.7%	3.8%	3.8%

Sensitivity analysis							
Interest cost (€ bn)							
+100bps		5168	7513	8663	9642	10210	36028
+200bps		6380	9413	10627	11706	12319	44065
+300bps		7592	11312	12590	13770	14429	52102

Additional Cost Over Base							
+100bps		1212	1900	1963	2064	2110	8037
+200bps		2424	3800	3927	4128	4219	16074
+300bps		3636	5699	5890	6192	6329	24111

Removing the buffer of private ownership from the banking system, the anticipated impact on the cost of Irish sovereign debt could significantly outweigh any upside created for the tax payer in floating the banks at a later stage. We believe that investors in sovereign debt believe that the Irish bank solution is relieving pressure on domestic funding power. If the cost of Irish debt were to increase significantly, after the Anglo Irish Bank nationalisation, then the argument that full nationalisation would increase the taxpayers' take of the potential sale value of the banks decreases in relevance. By wiping out bondholders and shareholders, the default premium which future investors in Irish assets will require could vastly increase in the long run cost of capital to the economy.

By cutting off the potential for equity insurance in the banking sector, by full nationalization, the short run cost to the taxpayers of supporting the banks is likely to increase significantly. The cost of money for the Irish Government has improved significantly since NAMA was announced as investors understood the positive impact that NAMA would have on the risk of the guarantee scheme being called. (*Bloxham Banking Survey July 2009*). Equity valuations in the Irish banks have rebounded since March. Therefore the scope for a fund raising increased for the Irish banks and with the rebuild in the listed equity foot print, a positive feedback cycle has been created.

Estimating the cost of full nationalisation is highly subjective. However, given the current value of the Government warrants, the notional capital saving made from NAMA implementation, and the cut off of a potential source of funds for the Irish Banks, we can make a deduction on the true cost of bringing the bank debt fully onto the Irish Sovereign balance sheet. Assuming a 100bps move in Irish debt costs, the full nationalisation solution to the crisis would cost the taxpayer upwards of €21 billion, aside from the loss of liquidity on the economy.

Cost of Full Nationalisation Strategy	€'bn
Loss of Warrant Value In AIB/BKIR	1.0
Loss of future potential upside in warrant stake	?
Loss of "Capital Benefit" of NAMA	7.0
Loss of Liquidity Impact of NAMA's €60/€65 billion	?
Loss of Potential Private Funding For AIB/Bank of Ireland (@50%)	1.5
Nationalisation Cost to Sovereign Bonds (150bps) over 4yrs	12.0
Gross Notional Cost of Full Nationalisation	21.5
Less future equity benefit from relisting AIB/Bank of Ireland	?
Net Notional Cost of Full Nationalisation	21.5

The NAMA simulation

Using a top down and bottom up approach to the gross lending book guidelines which NAMA outlined as the potential make up of the acquired assets, and guidance from Bank of Ireland and AIB in recent presentations, we have created a “simulated” version of NAMA’s assets. The numbers for other institutions which are included are estimates based on loan book disclosure.

Simulated NAMA Assets			
NAMA	Total Investment	Total Development	Total
AIB	8.0	17.0	25.0
Bank of Ireland	7.0	11.0	18.0
Anglo Irish Bank	14.0	19.4	33.4
INBS		7.0	7.0
EBS	0.8	0.4	1.2
	29.7	54.8	85

Split 35% 65%

Gross Discount	Total Investment	Total Development	Total
AIB	0.7	5.0	5.7
Bank of Ireland	0.7	2.4	3.0
Anglo Irish Bank	1.6	6.8	8.4
INBS	0.0	2.0	2.0
EBS	0.1	0.3	0.3
Gross Discount	3.0	16.4	19.4

Purchase Price	Total Investment	Total Development	Total
AIB Bank	7.3	12.0	19.3
Bank of Ireland	6.3	8.6	15.0
Anglo Irish Bank	12.3	12.6	24.9
INBS	0.0	5.0	5.0
EBS	0.7	0.2	0.9

Total Cost 26.7 38.4 65.1

Gross Lending Book 84.6

Mark Down Discount 19.4 23%

Property Value at Peak (75% LTV) 112.7

Peak to trough move 47.6

Discount from Peak Price 42%

After bad debt allowance of €6 billion, we see the total discount as c€20 billion on a €85 billion lending book.

Understanding the discount

At the moment we estimate that the Irish guaranteed banks have made, at a minimum, provisions of c.€6 billion against the loan books that are eligible to NAMA.

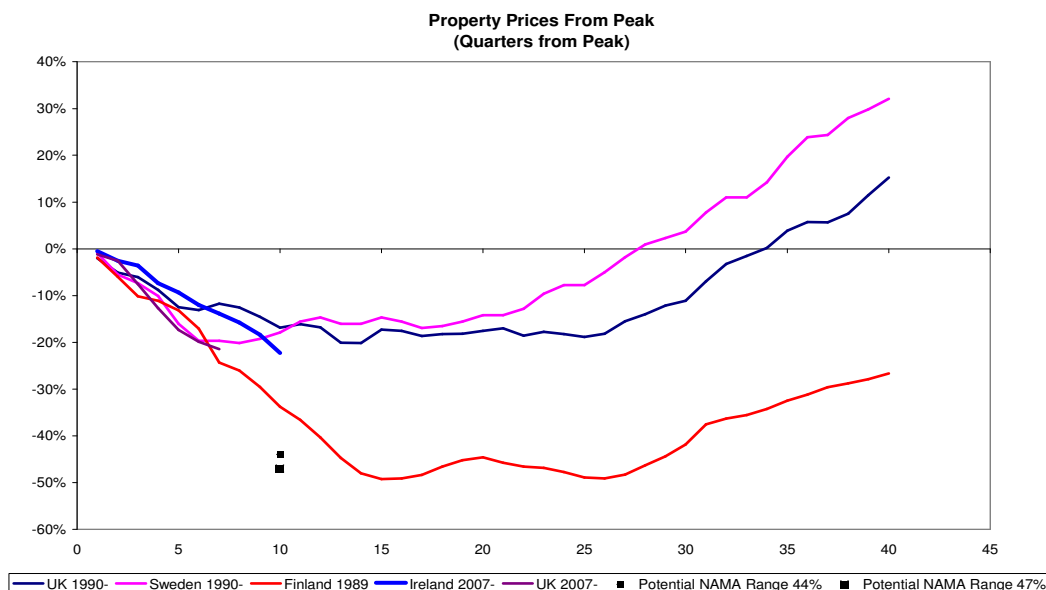
Using a simulation of NAMA acquiring €85 billion in the lending book, and using a loan to value of 75%, the agency will be acquiring assets at a 42% discount to the peak price of the assets in the loan book.

€'bn	Scenario 1	Scenario 2	Scenario 3
Gross Lending Book (e)	85	85	85
Write offs (e)	6	6	6
Net Lending Book (e)	79	79	79
Loan To Value % (2007)	0.7	0.75	0.8
Peak Asset Value	121	113	106
NAMA Payment	65.1	65.1	65.1
Peak to Trough Price Discount	46%	42%	39%
Additional Write Offs	13.4	13.4	13.4
Total Haircut/Discount	23%	23%	23%

According to NAMA, 33% of the loans are on investment properties, and 50% of the loans are cashflow generative. In effect the largest part of any write down will come on the development land exposure which for the three largest institutions comes in at c.€27 billion.

Assuming that on average, NAMA pays a 42% peak to trough price for the assets acquired, using the worst property market comparison, that of Finland in 1990, the acquisition price will be surpassed within 4/5 years, with a substantial uplift in later years.

Landbank Exposure	€'bn
AIB	11.3
Bank of Ireland	5.3
Anglo Irish Bank	10.4
Total	27.0



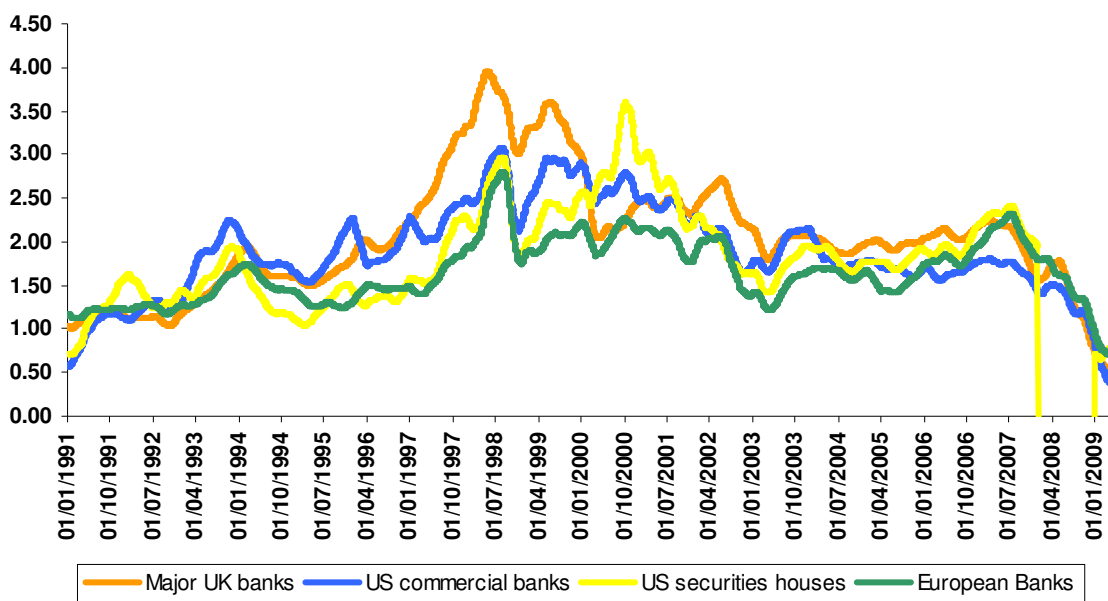
Long term bank valuations: What is the upside?

Key valuation points:

- The average long term price to book in the UK banking sector is 2x. The low during the past twenty years was 0.51x Price/Book reached in early April 2009. The high reached 3.95x in May 1995.
- There is a high correlation between the price to book between the UK, and European banks of 80% over the twenty years.
- From 1991 to 1994, post the last major banking crisis average price/book ran at 1.23x.
- AIB's 2009 forecast Price To Book is just 0.33x, while Bank of Ireland is trading on a forecast 0.7x Price/Book..

1991-2009	Major UK banks	US commercial banks	US securities houses	European Banks	Overall
Average	2.04	1.88	1.83	1.65	1.85
Low	0.50	0.37	0.65	0.70	0.56
High	3.95	3.08	3.60	2.80	3.36
Average 1991-1993	1.24	1.38	1.39	1.29	1.32
2009-	0.57	0.50	0.79	0.78	0.66

Long term price/book of the international banking sector



Allied Irish Banks – potential impact of NAMA

We are assuming that €25 billion moves to NAMA made up of €17 billion in development lending and €8 billion in property investment lending. In our simulation, we are expecting NAMA to pay €19.3 billion for the assets, leaving a €5.7 billion gross discount of 23%. Recognised provisions against this portfolio are c.€2.4 billion (out of €2.9 billion provisions made). The additional write down post NAMA is therefore €3.23 billion while the expected loss is booked at c.€600 million on the portfolio, giving a net capital effect of €2.63 billion. We are splitting the impact of the write off 2/3 to 1/3 between 2009 and 2010.

AIB Simulated NAMA Asset Transfer			
	Total Investment	Total Development	Total
Assets	8.00	17.00	25.00
Minus Gross Discount (23%)	0.67	4.98	5.65
Purchase Price	7.33	12.02	19.35
Existing Provisions	0.10	2.33	2.43
Additional Write Down Post Provision			3.23
Expected Loss			0.60
Net Cap Effect			2.63
Net Post Provision Discount			12.9%
Net Cap Effect Discount			10.5%

Profit Impact: On the €25 billion asset move, we are assuming a net interest margin of 2%. The gross operating impact of the reduction in the lending book is € 750 million in a full year. We are assuming that 2/3rds of the assets pass through in 2010. The payment from the bond partially offsets this, which we are assuming at €290 million on the €19 billion bond. The net impact in 2009 is minimal, but in 2010 it shaves €460 million off our 2010 forecast. The post NAMA pre-provision profit settles at €1.4 billion. The profit impact assumed that

1. no cost cutting comes through
2. that margins remain subdued
3. lending volumes to not accelerate

These assumptions have upside

Risk Weighted Asset Impact: The impact on risk weighted assets (RWA) is substantial, reducing the figure by €21 billion. This adds 0.6% to the Core Equity Tier 1 Ratio in 2010.

Impact of NAMA:

4% Core Tier 1 Target: We estimate that to maintain a 4% Core equity tier 1 ratio, AIB will have to raise €1 billion by 2011 if NAMA was not to happen, but the shortfall with NAMA drops to €670 million. AIB has targeted €400 million for funding purposes as part of its €1.5 billion announcement earlier in the year.

5% Core Tier 1 Target: Setting the target at 5% at the bottom of the cycle, post NAMA, AIB would have a funding requirement of €1.7 billion to meet that capital target. Without NAMA we estimate the shortfall would be closer to €1.8 billion.

Assessing the impact of a rights Issue:

Allied Irish Banks					
	Price	Shrs (m)	Mkt Cap(€m)		
	2.56	893	2286.08		

PRE NAMA					POST NAMA				
Profit & Loss	2008	2009 (F)	2010(F)	2011(F)	Profit & Loss	2008	2009 (F)	2010(F)	2011(F)
Net Income	3867	3303	3026	2935	Net Income	3867	3303	2566	2475
Non Interest Income	1200	1521	901	856	Non Interest Income	1200	1521	901	856
Total	5067	4824	3927	3791	Total	5067	4824	3466	3331
Costs	-2357	-2121	-2015	-1914	Costs	-2357	-2121	-2015	-1914
Operating Profit	2710	2703	1912	1877	Operating Profit	2710	2703	1451	1416
Impairments	-1822	-4671	-3495	-2221	Impairments	-1822	-6871	-1995	-1421
Exceptionals & Assoc	10	111	111	111	Exceptionals & Assoc	10	111	111	111
Profit Before Tax	898	-1857	-1472	-233	Profit Before Tax	898	-4057	-433	106
Tax	-130	400	100	100	Tax	-130	500	100	100
Profit After Tax	768	-1457	-1372	-133	Profit After Tax	768	-3557	-333	206
Guarantee Cost/Minorities	-38	-400	-420	-420	Guarantee Cost/Minorities	-38	-400	-420	-420
Attributable Profit	730	-1857	-1792	-553	Attributable Profit	730	-3957	-753	-214
Shares + Options	888	895	900	900	Shares + Options	888	895	900	900
Diluted Av No of Shares	887	893	899	899	Diluted Av No of Shares	887	893	899	899
Diluted EPS	0.83	-2.08	-1.99	-0.61	Diluted EPS	0.83	-4.43	-0.84	-0.24
DPS	30.60				DPS	30.60			

AIB Capital Position					AIB Capital Position				
	2008	2009 (F)	2010(F)	2011(F)		2008	2009 (F)	2010(F)	2011(F)
Original Core Equity	7700	6243	4450	3797	Original Core Equity	7700	4343	3690	3376
Government Preference	3500	3500	3500	3500	Government Preference	3500	3500	3500	3500
Minority	2120	2120	2120	2120	Minority	2120	2120	2120	2120
Total Tier 1	13320	8363	6570	5917	Total Tier 1	13320	8263	6470	5917
Risk Weighted Assets	133895	129882	125986	122206	Risk Weighted Assets	133895	108882	104986	101206
Core Equity Tier 1 Ratio	5.75%	4.81%	3.53%	3.11%	Core Equity Tier 1 Ratio	5.8%	4.0%	3.5%	3.3%
Shareholders Equity	8,441	6,467	4,974	4,021	Shareholders Equity	8,441	5,343	4,190	3,476
Tangible NAV	8.60	7.24	5.20	4.47	Tangible NAV	8.60	5.97	4.65	3.86
Price/Book	0.30	0.35	0.49	0.57	Price/Book	0.33	0.41	0.58	0.66
Funding Gap	4% - 2,344 -	1,047	589	1,091	Funding Gap	4%	13	509	672
	5% - 1,005	252	1,849	2,313		5%	1,102	1,559	1,684
	6% - 334	1,550	3,109	3,535		6%	2,190	2,609	2,696
Cumulative Loan Loss	- 1,822 -	6,493 -	9,988 -	12,209	Cumulative Loan Loss	- 1,822 -	8,693 -	10,688 -	12,109

Scenario 1: €1 billion rights issue

Assuming that AIB raises €1 billion in 2009 post NAMA, it can reach a 5.5% core tier 1, excluding the €400 million from other targets. The positive feedback created by the share price appreciation is significant. In the event that the Government would be the only investor in a "cleaned" banking entity, its stake (pre warrants) would be 43%. At a €2 share price, the Government stake would fall to 37%.

Allied Irish Bank						
		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
Core equity pre pref of €3.5 bn		7.6	7.6	7.6	7.6	7.6
Buy back (f) benefit						
Core Equity After Buyback		7.6	7.6	7.6	7.6	7.6
*€25 bn X Haircut	Haircut	2.6	2.6	2.6	2.6	2.6
	Haircut %	11%	11%	11%	11%	11%
Post NAMA Core Tier 1	(€'bn)	5.0	5.0	5.0	5.0	5.0
RWA now	(€'bn)	130	130	130	130	130
NAMA	(€'bn)	21	21	21	21	21
Post NAMA RWA	(€'bn)	109	109	109	109	109
Equity Tier 1 (exc €3.5 bn pref)		5.8%	5.8%	5.8%	5.8%	5.8%
		Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA
		4.6%	4.6%	4.6%	4.6%	4.6%
Target	Core Equity Tier 1	5.5%	5.5%	5.5%	5.5%	5.5%
Funding Requirement	(€'bn)	1.0	1.0	1.0	1.0	1.0
At rights share price of	(€)	0.50	1.00	1.50	2.00	2.50
		3.00				
Number of new shares needed	('bn)	2.04	1.02	0.68	0.51	0.41
Add existing number on issue	('bn)	0.89	0.89	0.89	0.89	0.89
Total new shares on issue	('bn)	2.93	1.91	1.57	1.40	1.29
Government Stake (assuming the only investor)		70%	54%	43%	37%	32%
					28%	
Tangible Equity		7.0	7.0	7.0	7.0	7.0
Tangible NAV per share		2.39	3.67	4.47	5.01	5.41
					5.71	

Allied Irish Bank		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
Core equity pre pref of €3.5 bn		7.6	7.6	7.6	7.6	7.6	7.6
Buy back (f) benefit							
Core Equity After Buyback		7.6	7.6	7.6	7.6	7.6	7.6
*€25 bn X Haircut		2.6	2.6	2.6	2.6	2.6	2.6
Haircut							
Haircut %		11%	11%	11%	11%	11%	11%
Post NAMA Core Tier 1		5.0	5.0	5.0	5.0	5.0	5.0
		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
RWA now		130	130	130	130	130	130
NAMA		21	21	21	21	21	21
Post NAMA RWA		109	109	109	109	109	109
Equity Tier 1 (exc €3.5 bn pref)		Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA
		5.8%	5.8%	5.8%	5.8%	5.8%	5.8%
		Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA
		4.6%	4.6%	4.6%	4.6%	4.6%	4.6%
Target		Core Equity Tier 1	Core Equity Tier 1	Core Equity Tier 1	Core Equity Tier 1	Core Equity Tier 1	Core Equity Tier 1
Funding Requirement		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
		1.5	1.5	1.5	1.5	1.5	1.5
At rights share price of		(€)	(€)	(€)	(€)	(€)	(€)
		0.50	1.00	1.50	2.00	2.50	3.00
Number of new shares needed		('bn)	('bn)	('bn)	('bn)	('bn)	('bn)
Add existing number on issue		2.91	1.46	0.97	0.73	0.58	0.49
Total new shares on issue		0.89	0.89	0.89	0.89	0.89	0.89
		3.80	2.34	1.86	1.61	1.47	1.37
Government Stake (assuming the only investor)		77%	62%	52%	45%	40%	35%
Tangible Equity		7.4	7.4	7.4	7.4	7.4	7.4
Tangible NAV per share		1.96	3.17	4.00	4.60	5.06	5.42

Scenario 2: €1.5 billion rights issue

Assuming that AIB raises €1.5 billion in 2009 post NAMA, it can reach a 5.9% core tier 1 ratio, excluding the €400 million from other targets. The positive feedback created by the share price appreciation is significant. In the unlikely event that the Government would be the only investor in a "cleaned" banking entity, its stake (pre warrants) would be 52% at a price of €1.50. At a €2 share price, the Government stake would fall to 45%.

Scenario 3: Extreme case scenario

In the most stressed environment created by NAMA, AIB, if it had to recognize the full amount of the addition NAMA induced hit in 2009, the overall gross discount would need to run at over 30%. This would imply an immediate funding need in 2009 at the core equity tier 1 level. From peak valuations, NAMA would be purchasing assets at 47% down from peak price. However, even at this level, AIB would be assuming all the write offs in 2009 although in reality much of the write downs would be spread into 2010.

Other funding options

Aside from the €400 million which AIB is targeting to raise as part of its €1.5 billion target, AIB still has options on the potential for an asset sale of M&T which potentially releases €500 million in capital for the bank. This would add c.0.48% on core tier post NAMA in 2010. Including the €400 million, the impact in total of the €900 million in new capital would be to add 82 bps to core equity tier 1.

Bank of Ireland – the Impact of NAMA

We are assuming that €18 billion moves to NAMA made up of €11 billion in development lending and €7 billion in property investment lending. In our simulation, we are expecting NAMA to pay €15 billion for the assets, leaving a €3 billion gross discount of 17%. Recognised provisions against this portfolio are estimated at €1 billion. The additional write down post NAMA is therefore €2 billion. The expected loss is booked at c.€100 million (although this is a very rough estimate) on the portfolio giving a net capital effect of just under €2 billion. We are splitting the impact of the write off 2/3 to 1/3 between 2010 and 2011.

The level of gross write off on Bank of Ireland's portfolio is lower than in AIB's case due to the lower percentage of development land held in the portfolio.

BOI Simulated NAMA Asset Transfer			
	Total Investment	Total Development	Total
Assets	7.00	11.00	18.00
Minus Gross Discount (16.8%)	0.70	2.40	3.00
Purchase Price	6.30	8.60	15.00
Existing Provisions	0.10	0.90	0.90
Additional Write Down Post Provision			2.08
Expected Loss			0.10
Net Cap Effect			1.98
Net Post Provision Discount			12.0%
Net Cap Effect Discount			11.0%

Profit Impact: On the €18 billion asset move, we are assuming a margin of 3%. This equates to an operating impact of €540 million in a full year. We are assuming that 2/3rds of the assets pass through in 2010. The payment from the bond partially offsets this, which we are assuming at €225 million on the €15 billion bond. The net impact is €315 million in a full year. Pre-provision operating profit comes in at €930 billion by 2011.

1. no cost cutting comes through
2. that margins remain subdued
3. lending volumes to not accelerate

These assumptions have upside

Risk weighted asset impact: The impact on risk weighted assets (RWA) is substantial, reducing RWA by €16 billion. This adds 0.7% to core equity tier 1 ratio in 2011 in a full year. We assume that all of the RWA transfers at the end of 2010.

Impact of NAMA:

4% Core Tier 1 Target: With or without NAMA, Bank of Ireland can maintain ratios above the 4% level, with RWA falling by €17 billion, the shortfall is €200-€400 million.

5% Core Tier 1 Target: Setting the target at 5% at the bottom of the cycle, without the impact of NAMA, Bank of Ireland would have a funding requirement of €1.3 billion to meet capital demands by end 2011. With NAMA, this funding requirement would reduce by €200million.

Bank of Ireland

Price	Shrs ('m)	Mkt Cap(€m)
2.34	1002	2344.68

PRE NAMA
POST NAMA

Profit & Loss	2008	2009	2010 (F)	2011 (F)	Profit & Loss	2008	2009	2010 (F)	2011 (F)
Net Income	3263	3670	3000	2954	Net Income	3263	3670	2843	2639
Non Interest Income	857	239	300	100	Non Interest Income	857	239	300	100
Total	4120	3909	3300	3054	Total	4120	3909	3143	2739
Costs	-2140	-2022	-1902	-1807	Costs	-2140	-2022	-1902	-1807
Operating Profit	1980	1887	1398	1248	Operating Profit	1980	1887	1241	933
Impairments	-223	-1520	-3326	-2709	Impairments	-223	-1520	-4626	-2209
Exceptionals & Assoc	129	-400	1,000	52	Exceptionals & Assoc	129	-400	900	52
Profit Before Tax	1886	-33	-927	-1409	Profit Before Tax	1886	-33	-2485	-1224
Tax	-223	-45	200	200	Tax	-223	-45	400	150
Profit After Tax	1663	-78	-727	-1209	Profit After Tax	1663	-78	-2085	-1074
Minorities/Pref	-19	-20	-300	-300	Minorities	-19	-20	-300	-300
Attributable Profit	1644	-98	-1027	-1509	Attributable Profit	1644	-98	-2385	-1374
Shares + Options	994	990	1018	1006	Shares + Options	994	990	1018	1006
Period End No Shares	980	1002	1000	1000	Period End No Shares	980	1002	1000	1000
Diluted EPS	1.49	0.30	-1.61	-1.22	Diluted EPS	1.49	0.30	-2.34	-1.37
DPS	0.63				DPS	0.63			

Bank of Ireland	Capital Position	2008	2009	2010 (F)	2011 (F)	Bank of Ireland	Capital Position	2008	2009	2010 (F)	2011 (F)
Core Equity		6800	6300	5152	3621	Core Equity		6800	6300	4094	3020
Government Preference			3500	3500	3500	Government Preference			3500	3500	3500
Risk Weighted Assets		116961	105791	101560	99529	Risk Weighted Assets		116961	105791	84560	82529
Equity Tier 1 Ratio		5.8%	9.3%	5.1%	3.6%	Equity Tier 1 Ratio		5.8%	9.3%	4.8%	3.7%
Shareholders Equity		5,621	3,400	3,452	1,921	Shareholders Equity		5,621	3,400	2,394	1,420
Tangible NAV		5.74	3.39	3.45	1.92	Tangible NAV		5.74	3.39	2.35	1.41
Price/Book		0.41	0.69	0.68	1.22	Price/Book		0.41	0.69	0.99	1.66
Funding Gap		4% - 2,122	- 2,068	- 1,089	361	Funding Gap		4% - 2,122	- 2,068	- 712	281
		5% - 952	- 1,010	- 74	1,356			5% - 952	- 1,010	134	1,106
		6% 218	47	942	2,351			6% 218	47	979	1,932

Assessing The Impact of A Rights Issue:

Scenario 1: €1 billion rights issue

Assuming that Bank of Ireland raises €1 billion in 2009/2010 post NAMA, it can reach a 6.6% core tier 1 ratio. The positive feedback created by the share price appreciation is significant, vastly reducing the dilution at higher placing prices. In the event that the Government would be the only investor in a "cleaned" banking entity, its stake (pre warrants) would be 38%. At a €2 share price, the Government stake would fall to 32%.

Bank of Ireland

	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
Core Equity After Buyback	6.9	6.9	6.9	6.9	6.9	6.9
*€18 bn X Haircut	2.0	2.0	2.0	2.0	2.0	2.0
Haircut	11%	11%	11%	11%	11%	11%
Haircut %						
Post NAMA Core Equity Tier 1	4.9	4.9	4.9	4.9	4.9	4.9
	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
RWA now	105	105	105	105	105	105
Take out assets of	16	16	16	16	16	16
	89	89	89	89	89	89
Equity Tier 1 (exc €3.5 bn pref)	6.6%	6.6%	6.6%	6.6%	6.6%	6.6%
	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA
	6.6%	6.6%	6.6%	6.6%	6.6%	6.6%
	Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA
	5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Target	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%
Funding Requirement	1.5	1.5	1.5	1.5	1.5	1.5
	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
At share price of	0.50	1.00	1.50	2.00	2.50	3.00
	(€)	(€)	(€)	(€)	(€)	(€)
Number of new shares needed	2.98	1.49	0.99	0.74	0.60	0.50
Add existing	1.02	1.02	1.02	1.02	1.02	1.02
Total new shares on issue	4.00	2.51	2.01	1.76	1.62	1.52
Government Stake (assuming the only investor)	74.5%	59.3%	49.3%	42.2%	36.8%	32.7%
Tangible Equity	5.4	5.4	5.4	5.4	5.4	5.4
Tangible NAV per share	1.35	2.16	2.69	3.07	3.35	3.57

Bank of Ireland		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
Core Equity After Buyback		6.9	6.9	6.9	6.9	6.9	6.9
*€18 bn X Haircut	Haircut	2.0	2.0	2.0	2.0	2.0	2.0
	Haircut %	11%	11%	11%	11%	11%	11%
Post NAMA Core Equity Tier 1	(€'bn)	4.9	4.9	4.9	4.9	4.9	4.9
		(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)	(€'bn)
RWA now		105	105	105	105	105	105
Take out assets of		16	16	16	16	16	16
		89	89	89	89	89	89
Equity Tier 1 (exc €3.5 bn pref)		Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA	Pre NAMA
		6.6%	6.6%	6.6%	6.6%	6.6%	6.6%
		Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA	Post NAMA
		5.5%	5.5%	5.5%	5.5%	5.5%	5.5%
Target	Core Equity Tier 1	7.2%	7.2%	7.2%	7.2%	7.2%	7.2%
Funding Requirement	(€'bn)	1.5	1.5	1.5	1.5	1.5	1.5
At share price of	(€)	0.50	1.00	1.50	2.00	2.50	3.00
Number of new shares needed	('bn)	2.98	1.49	0.99	0.74	0.60	0.50
Add existing	('bn)	1.02	1.02	1.02	1.02	1.02	1.02
Total new shares on issue	('bn)	4.00	2.51	2.01	1.76	1.62	1.52
Government Stake (assuming the only investor)		74.5%	59.3%	49.3%	42.2%	36.8%	32.7%
Tangible Equity		5.4	5.4	5.4	5.4	5.4	5.4
Tangible NAV per share		1.35	2.16	2.69	3.07	3.35	3.57

Scenario 2: €1.5 billion rights issue

Assuming that Bank of Ireland raises €1.5 billion in 200/2010 post NAMA, it can reach a 7.2% core tier 1 ratio. The positive feedback created by the share price appreciation is significant, vastly reducing the dilution at higher placing prices. In the highly unlikely event that the Government would be the only investor in a "cleaned" banking entity, its stake (pre warrants) would be 49%. At a €2 share price, the Government stake would fall to 42%.

Scenario 3: Extreme case scenario

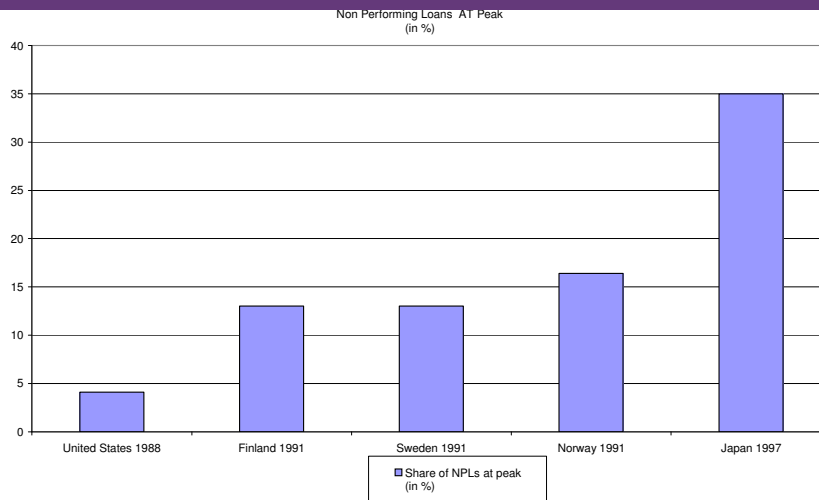
In the most stressed environment created by NAMA, Bank of Ireland, if it had to recognise the full amount of the additional NAMA induced hit in 2009, the overall gross discount would need to run at over 30% before needing funding short term. From peak valuations, NAMA would be purchasing assets at 47% down from peak prices.

Main implications of NAMA for the Irish Banks

AIB and Bank of Ireland will need further funding but NAMA needs to happen to facilitate direct interest for future rights issues. However, NAMA's impact on the banks brings positives and negatives:

- Risk Weighted Assets reduce on the Irish Banking balance sheet. This reduces the future potential capital demand from the sector, and therefore the taxpayer. This has positive implications on capital demand for both AIB and Bank of Ireland.
- The loan to deposit ratio is reduced to 1.4x at the guaranteed banks from 1.7x. This helps redress a crucial imbalance in wholesale market exposure.
- The liquidity effect of €60/€65 billion will have a significantly positive impact on structure of the Irish banking market. This is particularly important when assessing the potential impact of a sharp withdrawal of liquidity/lending flow from non guaranteed institutions. As noted by the Bank of International Settlements, the lending flow of foreign lenders is collapsing on an international cross border basis. Flushing the Irish banks with liquidity, including AIB and Bank of Ireland, will help ease this impact on the economy.
- Loss of income to the Irish banks is severe from the movement in the lending book, despite an income of c1.5% in potential bond payments. We estimate a net annual negative impact of €775 million from AIB and Bank of Ireland. Coupled with the preference share costs and the guarantee costs, and the 25% warrant in each bank, the taxpayer is gaining more protection. Further out the levy potentially leaves the state with even more notional protection.
- The reduction in profits leaves a gross cost/income imbalance in the Irish banking system. How the banks address this imbalance without wide scale job cuts will be of critical importance. Effectively, the banks must be in a position to increase income quickly to redress this imbalance.
- Finally, the size of the discount is critical in assessment and the future funding potential of the Irish banks. Too much and the capital requirements will be penal, cutting off the potential for future private sector funding. Therefore, the increase in the equity footprint of AIB and Bank of Ireland needs to be maintained.

Crisis Compared: IMF Extract



Country	Systemic Banking Crisis (starting date)	Share of NPLs at peak (in %)	Fiscal Cost (gross, as % of GDP)	Output loss (IMF) (as % of GDP)	Minimum real GDP growth rate (in %)	Comments
Finland	1991	13	12.8	59.1	-6.2	The three Nordic countries went through a financial liberalization process that led to a lending boom. However, they also suffered the adverse consequences of higher German interest rates. In the case of Finland, the problems were exacerbated by the collapse of exports to the Soviet Union. The first bank in trouble was Skopbank, which was taken over by the Central Bank in September 1991. Savings banks badly affected; government took control of three banks that together accounted for 31% of system deposits.
Japan	1997	35	14	17.6	-2	Banks suffered from sharp decline in stock market and real estate prices. In 1995 the official estimate of nonperforming loans was 40 trillion yen (\$469 billion, or 10% of GDP). An unofficial estimate put nonperforming loans at \$1 trillion, equivalent to 25% of GDP. Banks made provisions for some bad loans. At the end of 1998 banking system nonperforming loans were estimated at 88 trillion yen (\$725 billion, or 18% of GDP). In 1999 Hokkaido Takushoku bank was closed, the Long Term Credit Bank was nationalized, Yatsuda Trust was merged with Fuji Bank, and Mitsui Trust was merged with Chuo Trust. In 2002 nonperforming loans were 35% of total loans; with a total of 7 banks nationalized, 61 financial institutions closed and 28 institutions merged. In 1996 rescue costs were estimated at more than \$100 billion. In 1998 the government announced the Obuchi Plan, which provided 60 trillion yen (\$500 billion, or 12% of GDP) in public funds for loan losses, bank recapitalizations, and depositor protection.
Sweden	1991	13	3.6	30.6	-1.2	Nordbanken and Gota Bank, accounting for 22% of banking system assets, were insolvent. Sparbanken Foresta, accounting for 24% of banking system assets, intervened. Overall, 5 of the 6 largest banks, with more than 70% of banking system assets, experienced difficulties.
United Kingdom	2007					On September 14, 2007, Northern Rock, a mid-sized UK mortgage lender, received a liquidity support facility from the Bank of England, following funding problems related to global turmoil in credit markets caused by the US subprime mortgage financial crisis. Starting on September 14, 2007, Northern Rock experienced a bank run, until a government blanket guarantee—covering only Northern Rock—was issued on September 17, 2007. On February 22, 2008, the bank was nationalized, following two unsuccessful bids to take it over. On April 21, 2008, the Bank of England announced it would accept a broad range of mortgage backed securities and swap those for government paper for a period of 1 year to aid banks in liquidity problems. The scheme enabled banks to temporarily swap high quality but illiquid mortgage backed assets and other securities with Treasury bills for a period of one year.
United States	2007					During 2007, the US subprime mortgage market melted down. The crisis manifested itself first through liquidity issues in the banking system owing to a sharp decline in demand for asset-backed securities. Hard-to-value structured products had to be severely marked down due to newly implemented fair value accounting. Credit losses and asset writedowns got worse with accelerating mortgage foreclosures. On August 16, 2007, Countrywide Financial ran into liquidity problems, triggering a deposit run on the bank. The Federal Reserve Bank lowered the discount rate by 0.5% and accepted \$17.2 billion in repurchase agreements for mortgage backed securities to aid in liquidity. Bear Stearns, a major investment bank, was purchased by JP Morgan Chase with federal guarantees on its liabilities in March 2008. By June 2008, subprime-related losses or writedowns by global financial institutions stood at around \$400 billion. The Fed introduced the Term Securities Lending facility to swap mortgage backed securities for Treasury notes. On September 7, 2008, mortgage giants Fannie Mae and Freddie Mac were placed under conservatorship.

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